ADB

Policy Paper

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# Proposal for ADB’s New Products and Modalities



Asian Development Bank

## ABBREVIATIONS

| | | |
|---|---|---|
| ADB | – | Asian Development Bank |
| ADF | – | Asian Development Fund |
| CEP | – | credit enhancement product |
| DMC | – | developing member country |
| IBRD | – | International Bank for Reconstruction and Development |
| MDB | – | multilateral development bank |
| MFF | – | multitranche financing facility |
| OCR | – | ordinary capital resources |
| PBA | – | performance-based allocation |
| PBL | – | policy-based loan |
| PBG | – | policy-based guarantee |
| PCG | – | partial credit guarantee |
| PDA | – | project design advance |
| PDF | – | project design facility |
| PRF | – | project readiness financing |
| PRG | – | partial risk guarantee |
| PPP | – | public–private partnership |
| SEFF | – | small expenditure financing facility |
| TA | – | technical assistance |
| TAS | – | transaction advisory services |

## NOTE

In this report, "$" refers to United States dollars.

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**CONTENTS**

# EXECUTIVE SUMMARY

Development finance in Asia and the Pacific is changing rapidly. While preparing Strategy 2030, the Asian Development Bank (ADB) reviewed its products and modalities. Although ADB provides a wide range of both, there are still some gaps and most operations use standard project loans. Since ADB's borrowers are becoming increasingly sophisticated and diversified, ADB needs to refine and differentiate its products to better meet their needs and achieve higher development impact.

ADB conducted extensive consultations in its developing member countries (DMCs). Based on DMC needs, gaps in the products offered, and the expected impacts on key development agenda, this paper focuses on products and modalities in the following areas:

(i) making ADB more agile and responsive,
(ii) strengthening ADB's catalytic roles, and
(iii) expanding ADB's support for public–private partnership (PPP) projects.

**Making ADB more agile and responsive.** ADB's business process is primarily designed for project loans to finance large investments. With its current suite of products, it is difficult for ADB to quickly provide financing even for small or relatively low-risk activities, such as consulting services. Consulting services to support project preparation are critical to enhance project readiness and ensure expeditious project implementation. This paper proposes to refine existing products and modalities and introduce a new product that will help ADB respond quickly to DMCs' financing needs and deliver development results.

**Strengthening ADB's catalytic roles.** Given the large financing needs and the development of financial markets in the region, ADB's role as a catalyzer of development finance is becoming increasingly important. Credit enhancement products—such as B loans, guarantees, and risk transfer arrangements—catalyze private financing even in challenging markets by mitigating risks for private financiers. This paper proposes to expand product availability and strengthen incentives to use credit enhancement products. By improving product availability, ADB will be able to capture more business opportunities. Enhanced incentives will help ADB expand credit enhancement operations to catalyze more private financing for development purposes.

**Expanding ADB's support for public–private partnership projects.** Supporting PPP projects is another important measure for catalyzing private financing for development. Although ADB supports PPP projects in various ways, its existing products are not well suited to support PPP projects for which governments make payments to concessionaires according to their performance over a long contract. This paper proposes to introduce a financing facility to support PPP projects. Through this facility, ADB can help governments expand PPP projects, especially in challenging sectors and markets.

ADB will continue reviewing and refining its product offerings regularly because the needs and operating environments of DMCs keep evolving.

# I. INTRODUCTION

1. The Asian Development Bank (ADB) is preparing Strategy 2030, its new long-term corporate strategy, to outline its vision for responding to the region's development challenges. To ensure Strategy 2030 is effectively implemented, ADB launched a review of its products and modalities and formed an ADB-wide task force to identify priority areas for improvement. ADB conducted consultations in 10 developing member countries (DMCs) to better understand their needs, discuss possible improvements to existing products, and assess their demand for new products.[1]

2. The review found that although ADB has a broad product offering, critical gaps remain. ADB's operations are still concentrated on standard investment loans, but DMCs have become increasingly sophisticated and diversified regarding access to capital and institutional capacity. ADB must offer more refined and differentiated products to better respond to DMC's diverse needs and to achieve greater development impact.

3. This paper targets priority areas where ADB should improve its product range based on DMCs' critical needs, gaps in the current product offering, and the expected impacts on key development agenda. It does not cover some products and modalities that have been or will be examined separately.[2] ADB will keep reviewing and refining its products as clients' needs and operating environments evolve.

# II. BACKGROUND

## A. Development Context

4. **Financing for development projects.** Major development challenges remaining in Asia and the Pacific include deficient infrastructure, climate change adaptation and mitigation, and rapid urbanization—all of which require substantial financial resources. DMCs can accelerate investment by developing a pipeline of projects that are ready for financing. High project readiness is also essential for smooth project implementation and the realization of the project's development impact.[3] ADB's role as a provider of project development support, rather than just financing, will become increasingly important. During the consultations, many DMCs stressed the need for faster project preparation and implementation. ADB needs to refine its products and modalities to become more agile to respond to these needs.

5. **Mobilizing private financing.** The latest draft of Strategy 2030 emphasizes mobilizing private financing for development.[4] ADB's overall lending capacity remains small relative to the region's large financing needs. However, there is a large amount of private capital that could be used for investment. As DMCs improve their creditworthiness and develop financial markets, they are gaining more access to private capital. It is critical and an opportune time for ADB to leverage more effectively its capital and catalyze private financing for development.

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1 The 10 DMCs are Bangladesh, Cambodia, Fiji, Georgia, India, Indonesia, Myanmar, Pakistan, Philippines, and Viet Nam.

2 This paper does not cover (i) policy-based lending, results-based lending, or multitranche financing facilities, which have been evaluated or reviewed separately; (ii) local currency operations, which was reviewed in 2014; and (iii) contingent financing to address disasters triggered by natural hazards, which use policy-based loans with precautionary financing options.

3 For example, ADB. 2018. *2018 Annual Evaluation Review.* Manila; and ADB. 2018. *2017 Annual Portfolio Performance Report*. Manila.

4 ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific (Consultation Draft).* Manila.

6. **Diverse needs of developing member countries.** Although DMCs are generally improving their institutional capacity and access to financing sources, the degree of improvement varies greatly among them. For example, DMCs comprise countries above and below investment grade, as well as countries with no international rating. Accordingly, they have very different needs for ADB's credit enhancement products (CEPs). Their budget systems and administrative capacities are also diverse, resulting in different needs for ADB's financial products and modalities. ADB needs to expand its product offering to better respond to the diverse needs of DMCs according to their specific context.

## B. ADB's Current Products and Modalities

7. **ADB's product offering.** ADB's financial products include loans, grants, guarantees, and equity extended to both public and private clients (Table 1). Loans and grants are used the most, accounting for 96% of total approvals of sovereign and nonsovereign operations during 2015–2017 (Figure 1). Among loans and grants, project lending is the most common product (71% of total approvals), with sovereign operations also using policy-based lending (19% of total approvals) and results-based lending (7% of total approvals).[5] Partial risk guarantees (PRGs)[6] and partial credit guarantees (PCGs) are important CEPs to catalyze private financing, but their use has been limited (2% of total approvals).[7] These financial products are used in various modalities or under financing facilities, such as additional financing, multitranche financing facilities (MFFs), and project design facility (PDF).

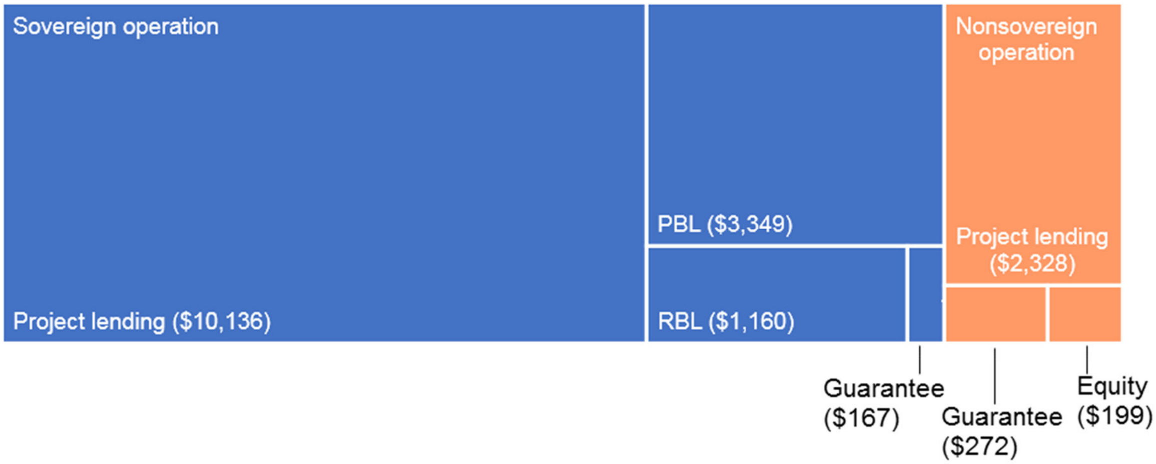
**Table 1: ADB's Main Financial Products and Modalities**

| Products | Sovereign Operation | Nonsovereign Operation |
|---|---|---|
| Loans and grants | (i) Project lending (e.g., project loan, financial intermediary loan, sector loan, and TA loan)<br>(ii) Policy-based lending<br>(iii) Results-based lending | (i) Project lending (e.g., project loan and financial intermediary loan) |
| Guarantees | (i) Partial risk guarantee<br>(ii) Partial credit guarantee | (i) Partial risk guarantee<br>(ii) Partial credit guarantee |
| Equity | | (i) Equity investment |
| Modalities and financing facilities | (i) Additional financing<br>(ii) Multitranche financing facility<br>(iii) Project design facility | (i) Additional financing |

ADB = Asian Development Bank, TA = technical assistance.
Source: Asian Development Bank.

[5] Resource allocation for results-based loan programs are limited to 5% of total ordinary capital resources and the Asian Development Fund resource allocation for the first 3 years of policy effectiveness (6 June 2013 to 5 June 2016), rather than 3 calendar years. ADB. 2013. *Piloting Results-Based Lending for Programs*. Manila.
[6] ADB offers guarantees, not insurance products.
[7] CEPs also include lender-of-record structures, such as B loans and risk transfer arrangements, such as reinsurance. These products are counted as cofinance, rather than approval on ADB's own account, because they do not use ADB's financial resources.

**Figure 1: Average Approval of ADB Financing by Product, 2015–2017**
($ million)




ADB = Asian Development Bank, PBL = policy-based loan, RBL = results-based loan.
Source: Asian Development Bank.

8. **Comparison with other multilateral development banks.** Table 2 compares the available products and modalities of other multilateral development banks (MDBs). Although ADB's product offering broadly matches its peers, there are still some differences.[8] Some MDBs offer products that ADB does not (e.g., policy-based guarantees), and ADB offers some products that many of its peers do not (e.g., MFFs). MDBs use similar modalities and facilities, but their applicability and features differ.[9] Unlike the various arms of the World Bank Group, ADB, as a single organization, can provide most products to both public and private entities.

**Table 2: Multilateral Development Bank Products and Modalities**

| | | World Bank Group | | | | |
|---|---|---|---|---|---|---|
| | ADB | IBRD/IDA | IFC | MIGA | IADB/IIC | AfDB |
| Loan and grant | | | | | | |
| Project lending | X | X | X | | X | X |
| Policy-based lending | X | X | | | X | X |
| Results-based lending | X | X | | | X | X |
| Guarantee | | | | | | |
| Partial risk guarantee | X | X | | X | X | X |
| Partial credit guarantee | X | X | X | X | X | X |
| Policy-based guarantee | | X | | | X | X |
| Equity | X | | X | | X | X |
| Modality and financing facility | | | | | | |
| Additional financing | X | X | | | X | X |
| Multitranche financing facility | X | X | | | | |
| Project design facility | X | X | | | X | X |

ADB = Asian Development Bank, AfDB = African Development Bank, IADB = Inter-American Development Bank, IBRD = International Bank for Reconstruction and Development, IDA = International Development Association, IFC = International Finance Corporation, IIC = Inter-American Credit Corporation, MIGA = Multilateral Investment Guarantee Agency.
Note: The table summarizes the products available at multilateral development banks. While it compares equivalent products and modalities, the name, applicability, and features of some products may not be the same as ADB's products.

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8 The products and modalities are compared in greater detail in Appendix 6, Table A6.1 and Table A6.2.
9 For example, the African Development Bank provides additional financing but only for cost overruns, not for scaling-up of projects.

Sources: ADB; AfDB; IADB; World Bank Group; and C. Humphrey and A. Prizzon. 2014. *Guarantees for Development: A Review of Multilateral Development Bank Operations*. London: Overseas Development Institute.

## C. Gaps in the Product Offering and ADB's Past Reforms

9. ADB's product offering is extensive but has some gaps that make it difficult to fully address DMCs' diverse needs and deliver development impact. This paper focuses on the following three critical areas: (i) ADB's agility and responsiveness, (ii) ADB's role in catalyzing private finance, and (iii) ADB's support for public–private partnership (PPP) projects.

10. **Agility and responsiveness.** To accelerate infrastructure investment, many DMCs stressed the need for faster project preparation and implementation (Box 1). Effective project preparation and enhanced project readiness are critical to ensure the expeditious realization of a project's development impact. ADB has implemented business process reforms to accelerate general loan processing; it approved the most recent efficiency reform in 2015.[10] The introduction of the PDF in 2011[11] and the reform of grant-funded technical assistance (TA) in 2016 also aimed to streamline business processes and enhance project readiness. Although project loans for large capital investment require extensive due diligence, business processes for small or low-risk activities could still be further streamlined—such as consulting services to prepare investment projects.

**Box 1: Feedback Obtained during Developing Member Country Consultations**

The Asian Development Bank (ADB) conducted consultations in developing member countries. The following comments were received during the consultations:

(i) "ADB's operations are concentrated in standard investment loans. Given the evolving landscape of development finance, ADB should boldly pursue innovation to offer new financing products and modalities."
(ii) "Facing large investment needs, we appreciate instruments to build a pipeline of high-quality projects and enhance their readiness for implementation."
(iii) "ADB has much room to improve its speed of operations. ADB's business processes are designed for large capital investment, and ADB cannot quickly respond to our financing needs even for small expenditures."
(iv) "Mobilizing private financing is becoming increasingly important. Our access to private capital is improving, but credit enhancement is still needed in certain areas."
(v) "Public–private partnership (PPP) projects are important to catalyze private capital for development. ADB is actively supporting PPP projects, but its products do not fit to support certain types of PPP projects."

**Consultations in Developing Member Countries**

| Developing Member Country | Date | Developing Member Country | Date |
|---|---|---|---|
| Viet Nam | December 2016 | Fiji | August 2017 |
| Georgia | January 2017 | Myanmar | August 2017 |
| Pakistan | January 2017 | India | September 2017 |
| Indonesia | February 2017 | Cambodia | September 2017 |
| Bangladesh | August 2017 | Philippines | December 2017 |

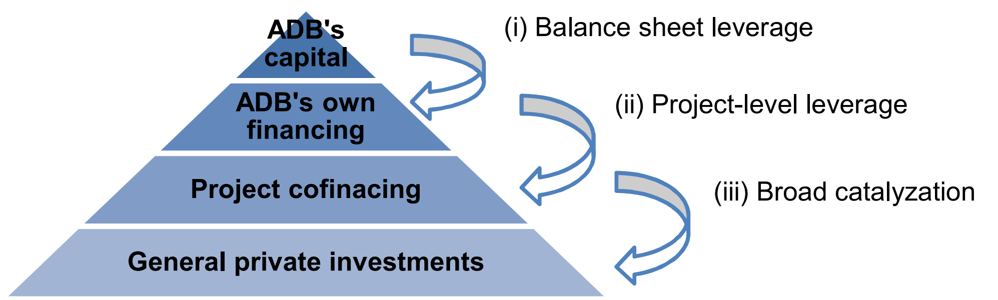
Source: Asian Development Bank.

[10] ADB. 2015. *Enhancing Operational Efficiency of the Asian Development Bank*. Manila.
[11] ADB. 2011. *Establishing the Project Design Facility*. Manila.

11. Commercial banks provide lines of credit, often in parallel with loans for capital investment, to respond quickly to clients' needs for small expenditures as they arise. ADB does not have an equivalent financial product since its existing products and their associated business processes are primarily geared toward financing large investment projects. To improve agility to respond to DMCs' financing needs, this paper proposes to enhance existing products and modalities (paras. 24–29, 37–40) and introduce a new product (paras. 30–36).

12. **Catalyzing private financing for development.** Given the region's large financing needs, it is critical for ADB to leverage its capital to mobilize greater private financing. ADB catalyzes private financing through the following three channels (Figure 2): (i) it borrows from markets for new commitments by leveraging its capital (balance sheet leverage); (ii) it mobilizes private funds from co-lenders to cofinance projects (project-level leverage); and (iii) it helps DMCs develop bankable projects by offering transaction advisory services (TAS) and improving the business environment through policy reforms, which subsequently catalyzes private investment (broad catalyzation).

**Figure 2: Leveraging Effects of ADB's Operations**




ADB = Asian Development Bank.
Source: Asian Development Bank.

13. ADB expanded its capital base by combining Asian Development Fund (ADF) lending operations with the ordinary capital resources (OCR) balance sheet. ADB also actively employs risk transfer arrangements, such as reinsurance, to increase the leverage of capital for new commitments. For project-level leverage, ADB sets targets for and encourages cofinancing from public and private sources. ADB also introduced several measures to streamline cofinancing operations in 2015 (footnote 10). While some DMCs have better access to private financing, many clients still need MDB guarantees and other CEPs, especially for challenging projects.[12] The wider use of CEPs could further expand private cofinancing, even in challenging markets. Although guarantees and other CEP products are increasingly used in the last 5 years, they are still limited in ADB's overall portfolio. An Independent Evaluation Department report in 2017 recommended that ADB should strengthen its deployment of CEPs.[13]

14. ADB provides various guarantee products, but there are still gaps in the product offering. For example, ADB does not provide policy-based guarantees (para. 8) or any type of sovereign guarantees to group A countries (i.e., countries that only have access to the ADF and concessional OCR) except in special cases.[14] This paper proposes to expand product availability to fill these gaps (paras. 43–50) and to strengthen the incentives for using CEPs (paras. 53–56).

[12] In this paper, clients include DMCs, private sector borrowers, and private sector lenders that use ADB's CEPs.
[13] Independent Evaluation Department. 2017. *Boosting ADB's Mobilization Capacity: The Role of Credit Enhancement Products*. Manila: ADB. A review of credit enhancement operation is in Appendix 4.
[14] ADB. 2018. Classification and Graduation of Developing Member Countries. *Operations Manual*. OM A1. Manila.

15. **Expanding public–private partnership projects in developing member countries.** Supporting PPP projects is an important way to catalyze private financing for development projects. ADB established a dedicated office for PPP in 2014 and formally launched TAS to support PPP projects. ADB has been supporting DMCs' PPP initiatives through policy advisory, capacity building, project development, and financing. Although PPP is increasingly used in the energy sector in some DMCs, its use is still limited in other sectors because private sponsors and financiers perceive it to have higher risks. Although certain contractual arrangements can mitigate the risks (e.g., the government takes demand risks and makes payments to concessionaires according to their performance), ADB's existing financial products are not well suited to support these PPP projects. To fill the gap, this paper proposes to introduce a new financing facility (paras. 57–66).

## III. PROPOSALS

16. **Summary of proposals.** Table 3 summarizes the key issues and proposals. The proposals focus on products and modalities in three areas: (i) making ADB more agile and responsive, (ii) strengthening ADB's catalytic roles, and (iii) expanding ADB's support for PPP projects. Most of the proposals are for ADB's sovereign operations but some also cover nonsovereign operations (i.e., additional B loan and incentives to use CEPs).

17. Board approval will be required for some proposals, and Management will implement others. Subject to Board approval, Management will implement the proposals to ensure the smooth introduction of the products and modalities (paras. 67–73). Appendixes 1–5 describe assessments of past operations and provide further details about the proposals.

**Table 3: Summary of Issues and Proposals**

| Issue | Proposal |
|---|---|
| **A. Making ADB more agile and responsive** | |
| **A.1. Project readiness financing.** Processing TA loans involves excessive procedures and documentation. The PDF has a streamlined business process but has some restrictions. | Establish project readiness financing by refining TA loans with PDF's streamlined features[a] |
| **A.2. Small expenditure financing facility.** ADB cannot quickly process a loan and provide financing even for small, low-risk activities. | Introduce the small expenditure financing facility, which will finance small activities quickly and responsively[a] |
| **A.3. Streamlined business process for additional financing.** Processing additional financing takes almost as much time as processing a new loan. | Simplify documentation requirements for certain types of additional financing |
| **B. Strengthening ADB's catalytic roles** | |
| **B.1. Policy-based guarantee.** ADB's guarantees support only project-specific borrowing. | Introduce the policy-based guarantee, which will support governments' general borrowing anchored with policy conditions[a] |

| Issue | Proposal |
|---|---|
| **B.2. Guarantees in group A countries.** ADB cannot offer sovereign guarantees for group A countries except in special cases. | Expand the use of regular OCR in group A countries to support sovereign guarantee operations[a] |
| **B.3. Additional B loan.** ADB cannot provide additional B loans quickly when opportunities are identified after the original project approval. | Streamline the business process for the speedy provision of additional B loans[a] |
| **B.4. Incentive to use credit enhancement products.** ADB and clients do not have strong incentives to use CEPs in lieu of direct loans. | (i) Review the capital requirement of partial risk guarantees<br>(ii) Review the performance metric with more emphasis on private cofinancing<br>(iii) More flexibly allocate regular OCR for sovereign guarantee operations |
| **C. Expanding ADB's support for PPP projects** | |
| **PPP standby financing facility**. ADB's existing products are not fit to support PPP projects for which the government makes payments according to a concessionaire's performance over a long contract period. | (i) Introduce the PPP standby financing facility, which will support governments' financial obligations over a long concession period[a]<br>(ii) More flexibly allocate regular OCR for sovereign financing of PPP projects |

ADB = Asian Development Bank, CEP = credit enhancement product, OCR = ordinary capital resources, PDF = project design facility, PPP = public–private partnership, TA = technical assistance.
[a] Requires Board approval.
Source: Asian Development Bank.

18. **Types of proposals.** To fully meet DMC needs and achieve higher development impact, it is necessary to close the gap in ADB's product line and effectively apply ADB's existing products. Therefore, the proposals comprise (i) the introduction of new products, (ii) the enhancement of existing products, and (iii) the introduction of incentive measures (Table 4).

**Table 4: Types of Proposals**

| Area | New Product Introduced | Existing Product Enhanced | Incentive Measure Introduced |
|---|---|---|---|
| A. Making ADB more agile and responsive | Small expenditure financing facility | (i) Project readiness financing<br>(ii) Streamlined business process for additional financing | |
| B. Strengthening ADB's catalytic roles | Policy-based guarantee | (i) Guarantee in group A countries<br>(ii) Additional B loan | Incentives to use CEPs |
| C. Expanding support for PPP projects | PPP standby financing facility | | |

ADB = Asian Development Bank, CEP = credit enhancement product, PPP = public–private partnership.
Source: Asian Development Bank.

19. **Differentiated approach to diverse needs.** ADB's DMCs are becoming more diverse regarding access to finance, fiscal space, and administrative capacity. While some of ADB's proposed and existing products may support similar expenditure types, the most effective product and modality for DMC needs may be different even for the same type of expenditure. For example,

DMCs with weak institutional capacity prefer simple products, even if more flexible but complex products would offer greater efficiency gains (para. 36). The proposals in this paper will make available a wide range of products and enable ADB to offer differentiated products according to the specific contexts of DMCs. The latest draft of Strategy 2030 proposes a differentiated approach to diversified DMC needs as one of the general principles of ADB operations.

20. **Financial implications.** The proposed products and modalities, except the small expenditure financing facility (SEFF), will follow ADB's standard financing terms in accordance with the financing source (i.e., from regular OCR, concessional OCR, and the ADF). Although the financing terms of the SEFF are not exactly the same as the standard terms, its income is equivalent to the standard products. Therefore, introducing new products and modalities will not directly affect ADB's incomes assuming the same level of total commitment. However, the expected improvements in loan disbursements could gradually have a positive impact on ADB's income and use of capital. Project readiness financing and the SEFF enhance project readiness, which could improve the disbursements of ensuing project loans.

21. The wide use of CEPs would help enhance ADB's leverage and could reduce ADB's use of its own capital resources. For example, risk transfers will enhance the balance sheet leverage, and B loans will increase project-level leverage (paras. 12–13). Because a guarantee and an equivalent loan require the same amount of ADB capital under the current framework, the expanded use of guarantees will not directly change the leverage of ADB's balance sheet and the utilization of capital. The proposed expansion of guarantee operations in group A countries, however, would increase ADB's capital requirement because of the higher risk of these countries, but the impact would be limited because of the small expected volume of the operation (para. 50). However, if the capital requirement is lowered for PRGs because of the proposed study (para. 55), it will increase the leverage of ADB's balance sheet and reduce the utilization of ADB's capital for the same level of the PRG commitment.

## A. Making ADB More Agile and Responsive

22. There are opportunities for ADB to be more agile and responsive in meeting DMC needs and delivering development results. With the available product range and current business process, ADB cannot quickly approve a loan and provide financing even for small or relatively low-risk activities. By focusing on these activities and introducing a risk-based approach with proper oversight, the business process of these areas can be streamlined while containing potential risks. This paper proposes to refine the existing TA loan and PDF (paras. 24–29) and additional financing (paras. 37–40) and introduce a small expenditure financing facility (paras. 30–36). These products and modalities will be used for sovereign operations.

23. In addition to the speedy delivery of financing, introducing these products will increase the development impact by (i) improving project readiness to minimize start-up delays and cost overruns, resulting in the more timely delivery of project benefits; (ii) making the most of successful projects by scaling them up in a more efficient manner; and (iii) providing small and quick financing to support the innovation and sustainability of ADB projects.

### 1. Project Readiness Financing

24. **Issues.** ADB's Midterm Review of Strategy 2020 identified improved project readiness as a key measure for reducing project implementation delays.[15] Low project readiness often results

[15] ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific.* Manila.

in extensions of project closing dates and cost overruns during implementation. Among the existing products, ADB uses the TA loan and the PDF to support high project readiness. TA loans and PDFs provide financing for project preparation activities, such as detailed engineering design and the preparation of safeguards and bidding documents, before financing for the ensuing investment project has been approved.

25. The current business process and documentation requirements for preparing a TA loan, which consists mostly of consulting services, are lengthy and overly cumbersome because they are nearly the same as for preparing a project loan for capital investment despite TA loans generally being much smaller in value and less risky. Such procedures increase the time required to provide project design support to ensure high project readiness. However, TA loans offer flexibility regarding scope and financing arrangements, which DMCs appreciate. For example, a TA loan has been used to support the preparation of several projects, which helped reduce transaction costs compared with preparing one TA loan for each ensuing project.

26. ADB introduced the PDF on a pilot basis in 2011 to address the lengthy business process required for TA loans (footnote 11). Individual project design advances (PDAs) under the PDF follow a much more streamlined business process than TA loans. However, PDAs are generally limited to $10 million or 4% of the value of the ensuing loan, whichever amount is larger.[16] PDAs are provided for a single ensuing loan. The Board has delegated authority to the relevant vice-presidents to approve PDAs within a total commitment envelope of $150 million.[17]

27. **Proposal.** This paper proposes to refine the TA loan by incorporating streamlined features of the PDF and to rename it project readiness financing (PRF). This will obviate the need to mainstream the PDF.[18] While ADB's policy and instructional documents for project loans govern TA loans,[19] separate instructional documents will govern PRF to streamline the business process. PRF will finance project preparation and design activities for investments that are expected to be financed under an ensuing ADB project(s).[20] Renaming the product would also remove any confusion between a TA loan and grant-funded transaction TA. The following are key features of the proposed refinements.

(i) **Eligible expenditures.** The following are eligible for PRF support:
   (a) consulting services for project preparation, such as detailed engineering design, feasibility study, and capacity building for future projects,[21] and limited project start-up activities;[22] and
   (b) pilot testing of project designs including the costs of equipment and works.

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[16] Management may approve PDAs that exceed this ceiling, provided that the Board has given a prior no objection.
[17] A detailed discussion on project readiness financing is in Appendix 1.
[18] The pilot period of the PDF was extended until 31 December 2018. Transitional arrangements will be established for PDA and TA loan proposals that are already in the processing stage and such proposals may be approved as PDAs or TA loans (if it is not practical to convert to PRFs) up to 31 December 2018. The PDF policy continues to apply to PDAs that were already approved, while ADB's sovereign lending policy applies to ongoing TA loans.
[19] ADB. 1977. *Technical Assistance Operations*. Manila; and ADB. 2014. Lending Policies for Sovereign and Sovereign-Guaranteed Borrowers. *Operations Manual*. OM D1/BP. Manila.
[20] The following types of project will continue to be processed in accordance with ADB's sovereign lending policy, as project loans: (i) stand-alone projects that do not involve any physical investments for capacity building and related activities, and which are not related to preparing an ensuing ADB-financed loan; and (ii) project preparation and design support for investments that are not expected to be financed by ADB.
[21] While PRF cannot finance project implementation activities, it may finance activities to support strengthening project implementation of future ensuing projects, covering procurement, safeguards, financial management, institutional strengthening and gender mainstreaming, in DMCs where capacity is weak.
[22] This will be limited to small-value contracts for consulting services and goods, such as equipment and furniture to establish a project management office.

(ii) **Scope.** PRF can support single or multiple ensuing projects.[23]

(iii) **Financing terms.** The financing terms of PRF are the same as those for a TA loan, including the standard interest rate, no commitment charge, and a repayment period of 15 years for regular OCR loans. The standard terms apply for concessional OCR loans and ADF.

(iv) **Refinancing.** PRF can be refinanced under an ensuing loan to the same borrower or using surplus loan proceeds under an ongoing loan to the same borrower.[24]

(v) **Approval authority.** The approval authority of PRFs will be differentiated by size. The Board will approve large-scale PRFs with a value exceeding $15 million. The Board will authorize the President to (a) approve small-scale PRFs with a value not exceeding $15 million and (b) further delegate such approval authority to the relevant vice-presidents. Total annual commitments by the President for small-scale PRFs will not exceed $100 million.[25]

(vi) **Board reporting.** To ensure proper oversight, Management will circulate to the Board a summary of the small-scale PRFs it has approved and provide the Board an annual summary of operational statistics of small-scale PRFs for information. The summary may be consolidated with other operation statistics (para. 35, and para. 52).

(vii) **Simplified documentation.** The format of project processing documents for PRFs will be based on the simplified documentation used to present PDA proposals.

28. The eligible expenditures and financing terms of PRFs will generally follow those of TA loans. However, a PRF can be refinanced by an ensuing loan and by surplus loan proceeds under an ongoing loan to the same borrower through a change in scope of the ongoing loan. A PRF can support multiple ensuing projects so its average size is expected to be larger than a PDA, which only supports single project. Because of this, this paper proposes a $15 million ceiling for Management's approval for PRF.

29. Based on the proposals in paras. 27–28, the time required from PRF concept clearance to approval is expected to drop from 8 months for TA loans to 4–6 months, depending on the size and scope. PRF is not the only modality that supports project preparation and enhances readiness. Paragraph 49 describes the current and proposed products that support project preparation.

### 2. Small Expenditure Financing Facility

30. **Issues.** ADB cannot quickly prepare a loan and provide financing even for small or relatively low-risk activities. Commercial banks provide a line of credit, often in parallel with a loan for capital investment, to quickly respond to clients' small financial needs. ADB does not have an equivalent financial product, and the existing products and their business processes are primarily designed for large investment projects.[26] ADB projects often support small equipment, works, and services as part of major capital investments. When these expenditures are required before or

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[23] The practice of supporting the preparation of multiple projects under a single TA loan has emerged, which has proved to be an efficient and effective means of supporting the preparation and detailed design of a whole portfolio of projects.

[24] This requires a change in scope of the ongoing loan.

[25] Because PRFs only finance consulting services and pilot testing, they are unlikely to have a *category A* safeguard classification for environment, resettlement, and indigenous people. Should a PRF have a *category A* classification, it should go to the Board for approval, even if it is a small-scale PRF that does not exceed $15 million.

[26] While financial intermediary loans, policy-based loans, and results-based loans do not finance large investment projects, they are also not designed to support small expenditure to complement investment projects.

after the investment project, they tend to be excluded from the project scope and are not implemented despite their potential importance. Borrowers and ADB do not want to extend the project implementation period for small expenditure items, and it is cumbersome to prepare a separate loan for them.[27]

31. **Proposal.** This paper proposes to introduce a SEFF—a facility that will quickly and responsively finance multiple small activities, such as consulting services, pilot testing, and rehabilitation. Once the Board approves a facility, the borrower can propose eligible activities under the facility and ADB can fund them as and when needed through simplified business processes. The SEFF would help ADB respond quickly to DMCs' small financing needs. To contain potential risks, eligible expenditures are limited to small-scale activities that are likely to be *category B or C* safeguard classification. The key terms and conditions of the SEFF are as follows.

(i) **Eligible expenditures.** Expenditures that are eligible for SEFF support are
   - (a) consulting services to prepare or support the implementation of ADB-financed projects, such as detailed engineering design, feasibility study, safeguard assessment, capacity building, and survey for impact assessment;[28]
   - (b) small equipment, works, and services to support ADB-financed projects, such as pilot testing, rehabilitation, post-disaster early recovery,[29] and operation and maintenance services; and
   - (c) a total estimated contract value not exceeding $15 million per activity.[30]

(ii) **Facility size.** The size will be discussed and agreed with the borrower for each facility, subject to the following general ceilings. A DMC can establish multiple facilities (each to be approved by the Board), and these ceilings apply to the sum of all facilities in the country. For DMCs with access to different financing sources, the size of facility funded with each financing source will be subject to these ceilings.[31]
   - (a) For facilities funded with regular OCR, the facility size should not exceed 20% of the average annual commitments of regular OCR for the country in the past 3 years, or $150 million, whichever value is smaller.
   - (b) For facilities funded with concessional OCR or the ADF, the facility size should not exceed 20% of the average annual PBA of concessional OCR or the ADF for the country, respectively.
   - (c) Notwithstanding items (a) and (b), the facility size can exceed 20% of the annual commitment or PBA but not more than $10 million to ensure a reasonable facility size in small DMCs.

(iii) **Financing terms.** A facility that will be funded by regular OCR will require a 5-year term from commitment of each activity with a bullet repayment,[32] an interest based

[27] A detailed discussion on the small expenditure financing facility is in Appendix 2.
[28] Expenditure may include payments for ADB's reimbursable TA and transaction advisory services.
[29] When emergency rehabilitation is included as an eligible expenditure, discussions during country programming need to ensure consistency with the possible use of a policy-based loan as contingent financing for disasters triggered by natural hazards.
[30] SEFFs only finance consulting services and small works and equipment, and are unlikely to have a *category A* safeguard classification. Should an activity under SEFF have a *category A* classification, Board approval should be sought for a major change in scope of the SEFF and such activity.
[31] For example, if a DMC has access to concessional OCR loans and ADF grants, the facility size funded with concessional OCR loans (or ADF grants) should be limited to 20% of PBA of concessional OCR loans (or ADF grants).
[32] All principals and interest of each activity will be repaid in the 5th year from the commitment of respective activity.

on that for regular OCR loan less 20 basis points for a shorter tenor,[33] no commitment fee, and a front-end fee of 15 basis points on the facility amount. For a facility that will be funded by concessional OCR or the ADF, standard financing terms will apply.

(iv) **Refinancing.** When a SEFF is funded by regular or concessional OCR, it can be refinanced by an ensuing loan or surplus loan proceeds under an ongoing loan to the same borrower.[34]

(v) **Rollover.** The facility has a fixed facility period of 5 years for new commitments. The facility can be rolled over for another 5 years at the end of the facility period, subject to Board approval. The facility size may be amended based on the annual commitment or PBA at the time of rollover.

(vi) **Legal agreements.** Each facility will have a SEFF facility agreement and short form agreements for activities under the facility.

32. All activities to be supported under the SEFF should be associated with or support ADB-financed projects. When an activity supports a planned ADB project, it should be identified in country operations business plans or other documents. Use of the SEFF will be discussed as part of country programming missions to develop a project pipeline, enhance project readiness, and ensure sustainability. Management will assess how potential activities will support associated ADB-financed projects and confirm they are strategically important in line with country partnership strategies. Procurement, consultant selection, and disbursement of proceeds under the SEFF will follow ADB's standard policies and requirements.

33. DMCs and regional departments will assess the facility size based on estimated funding needs. If a typical project requires 4% of project costs for consulting services to prepare a detailed engineering design and bidding documents, and 70% of projects in the country use the SEFF for such purposes, the estimated funding needs over 5 years will be equivalent to 14% of annual commitments (4% x 70% x 5 years). If the borrower also wants to use the SEFF for pilot testing and operation and maintenance services, the facility size may be close to the ceiling of 20% of the annual commitment.

34. When funded with regular or concessional OCR, the SEFF may be a revolving facility. ADB may make new commitments as long as the total net commitments (i.e., total cumulative commitments minus total cumulative repayments) do not exceed the facility size. As the principals are repaid, more funds will become available for new commitments. Although sovereign operations do not use this type of revolving product, nonsovereign operations have used it, such as in the Trade Finance Program.[35]

35. The business process of a SEFF starts with the processing of the facility, including appraisal, Board approval, and a facility agreement with the borrower. The facility agreement specifies the facility's framework. Within the agreed framework, individual activities will be identified and appraised through simplified business processes. ADB and the borrower will confirm the funding of activities through a short form agreement. Management will provide the Board an annual summary of operational statistics of the SEFFs.[36]

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[33] The standard spread is 50 basis points as of March 2018, implying the net contractual spread of 30 basis points. Standard rebate and surcharge will be applicable to the SEFF.

[34] This requires a change in scope of the ongoing loan.

[35] ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Trade Finance Facilitation Program*. Manila.

[36] The annual report may be consolidated with reports of other products.

36. There are various types of products and modalities for project preparatory works (Box 2). A SEFF can finance consulting services to prepare a project, which can also be supported by PRF. Borrowers can choose the best product or modality depending on their capacity and operating environment. Compared with PRF, the SEFF is a more flexible facility that can support a wider range of activities as and when necessary, implying greater efficiency gains for ADB and DMCs. However, using the SEFF requires sufficient administrative capacity and certain flexibility in the budget system. A SEFF will be especially useful and effective in DMCs with a sizable ADB project pipeline and adequate capacity to manage the facility. To accommodate diversified DMC needs and environments, ADB should offer differentiated products and modalities even for the same type of expenditures.

**Box 2: Products and Modalities for Project Preparatory Works**

Developing a project properly and enhancing its readiness for financing are critical initial activities of projects. Existing and proposed products may support the same type of expenditures for these project preparatory works. Developing member countries (DMCs) have diverse capacity and access to capital, and they should be allowed to choose the best products and modalities for their needs and operating environments.

Project preparatory works typically start with a feasibility study, including technical, economic, and safeguard assessments. Feasibility studies are usually supported by transaction technical assistance (TA). Transaction TA is provided on a grant basis and funded by the Technical Assistance Special Fund (TASF) or trust funds, such as the Japan Fund for Poverty Reduction and the Asia Pacific Project Preparation Facility. The Asian Development Bank (ADB) directly administers transaction TA, including the selection and management of consultants. ADB reviewed transaction TA in 2016, and this paper does not propose further changes.

Following a feasibility study, a detailed engineering design (DED) is often required for infrastructure projects. DEDs are mostly financed by a TA loan, a project design facility (PDF), or as part of a project loan. Using part of a project loan to finance a DED slows down the project implementation because only a small portion of an approved loan is withdrawn for consulting services in the initial years. Because the DED is not completed at the time of loan approval, project readiness tends to be low and the cost estimate is less accurate. TA loans and PDFs were introduced to separate financing of DEDs from the ensuing project loan. TA loans, PDFs, and project loans are provided on a loan basis, except DMCs with access to Asian Development Fund (ADF) grants, and funded with regular ordinary capital resources (OCR), concessional OCR, or the ADF. DMCs take the main responsibility of administering consulting services with ADB support (Appendix 1 and Appendix 6, Table A6.7 provide more details).

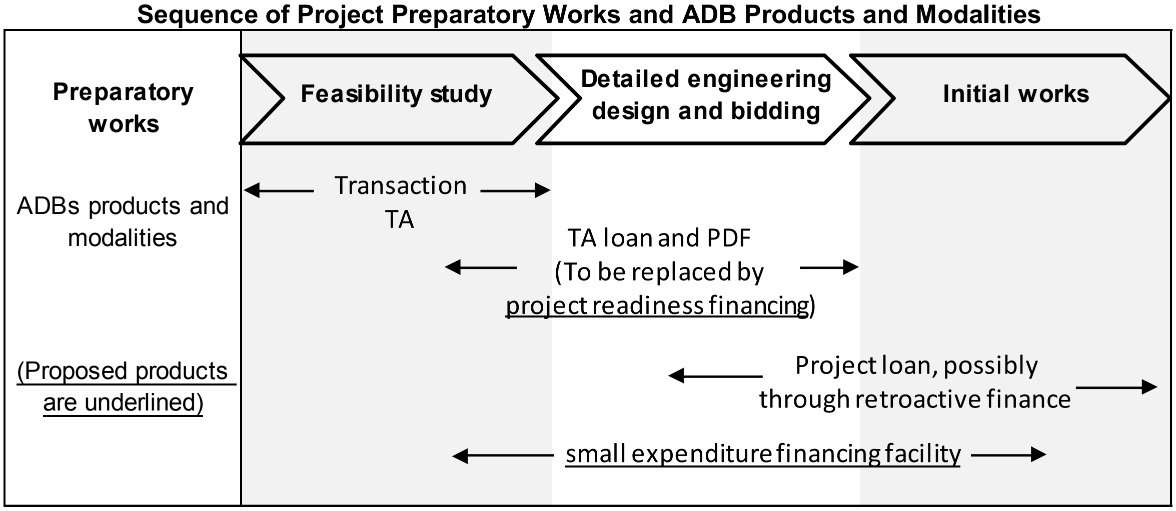
**Funding of Project Preparatory Works**

| | **Transaction technical assistance** | **Technical assistance loan, project design facility, and project loan** |
|---|---|---|
| Main scope of consulting service | Feasibility study | Detailed engineering design |
| Financing term | Grant | Loan[a] |
| Financing source | Technical Assistance Special Fund or trust funds | Regular OCR, concessional OCR, and ADF |
| Administration | ADB | DMC |

ADB = Asian Development Bank, ADF = Asian Development Fund, OCR = ordinary resource capital.
[a] Grant for DMCs with access to ADF grants.
Source: Asian Development Bank.

The main reason for using two types of funding mechanisms (i.e., transaction TA for feasibility study and TA loans, PDFs, and project loans for DEDs) is because DEDs require much larger financial resources than feasibility studies. The available resources for transaction TA are limited because they are funded by the TASF or trust funds from donors on a grant basis. Moreover, transaction TA funded by the TASF cannot support DEDs according to its policy. TA loans, PDFs, and project loans can finance DEDs because of the large size of regular OCR, concessional OCR, and the ADF. However, TA loans and PDFs may support feasibility studies if the DMC agrees. These rules and practices will apply to project readiness financing (PRF), which will replace TA loans and PDFs.

**Sequence of Project Preparatory Works and ADB Products and Modalities**




ADB = Asian Development Bank, PDF = project design facility
Source: Asian Development Bank.

DED is followed by bidding and initial works. The works are financed by a project loan, and retroactive finance may be applied to further expedite the project start-up. Some DMCs are reluctant to use retroactive finance because they do not want to risk that the ensuing loan may not be realized or that ADB may not approve retroactive financing. The proposed small expenditure financing facility (SEFF) can address this issue by providing funding for small initial works.

The SEFF can also support DEDs, which can also be funded by PRF. The SEFF is more flexible because it can provide funding for a wider range of expenditures as and when necessary, which implies greater efficiency gains for ADB and the borrower. However, some governments may prefer PRF because it is simpler and does not require strong administrative capacity. Borrowers can choose the most appropriate product or modality depending on their preference, budgetary system, and administrative capacity.

Introducing PRF and the SEFF will help enhance project readiness by facilitating the preparation of DEDs before approval of the ensuing loan. Consultations with DMCs indicated that some borrowers would remain reluctant to use a loan to fund DEDs separately from the ensuing loan because they cannot eliminate the risk that the ensuing loan may not realize after the DED. PRF and the SEFF will not resolve this concern. Funding DEDs with transaction TA on a grant basis is not feasible because of limited TASF and trust fund resources. ADB will explore alternative financing arrangements. Expanding the use of reimbursable TA is an option, although it requires substantial initial capital to cover DEDs.

Source: Asian Development Bank.

### 3. Streamlined Business Process for Additional Financing

37. **Issues.** Additional financing is used to finance (i) scale-up, including changes in project scope; (ii) cost overruns and financing gaps; and (iii) a combination of these. Despite the simplified business processes that ADB introduced in 2010 for additional financing, it takes almost as much time to process additional financing to scale up a project as it does to prepare a new loan.[37] This is because the business process for additional financing is almost the same as that for a new loan. The lengthy and time-consuming process reduces the incentive to use additional financing to scale up a project rather than processing a new loan.

38. Further streamlining of the business process is possible while containing risks by focusing on the scale-up of well-performing projects. Compared with a new loan, additional financing to scale up a well-performing project involves fewer risks because the original project has a proven record of effective implementation and can build on existing project implementation arrangements.[38]

39. **Proposal.** To improve ADB's responsiveness to DMC needs, this paper proposes to simplify documentation requirements (i.e., a shortened board paper) for additional financing that meets certain conditions.[39]

40. To minimize risks, the simplified documentation can be used only for additional financing that meets certain conditions. If these requirements are not met, standard full documentation will be required. The terms for using the streamlined business process are as follows:

(i) **Eligible expenditures.** The additional financing is used to scale up a project loan, sector loan, or financial intermediary loan.[40]
(ii) **Size.** The proposed additional financing should not exceed 100% of the project base cost or $200 million, whichever value is smaller.
(iii) **Project performance.** The project should be assessed as *performing well* in project implementation performance, implementation progress, and the delivery of expected outputs.

## B. Strengthening ADB's Catalytic Roles

41. Given the large financing needs and the development of financial markets in the region, ADB's role as a catalyzer of development finance is becoming increasingly important. CEPs, such as B loans, guarantees, and risk transfer arrangements, can catalyze private financing by mitigating risks for private financiers.[41] MDBs' CEPs are particularly important when private financiers first enter challenging markets since it is difficult for them to assess and assume market risks. ADB can provide various guarantee products but still lacks the ability to offer certain types of guarantee products (e.g., policy-based guarantee). ADB and its clients do not have strong

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[37] The processing time for additional financing was about 5 months for scaling up well-performing projects, compared with the average time of 7 months required to process a new project, from the fact-finding mission to financing approval.
[38] A detailed discussion on the streamlined business process for additional financing is in Appendix 3.
[39] The Board's approval of projects that use simplified documentation will be reviewed after one year to examine if the process can be further streamlined by shortening the Board circulation period from the current 21 calendar days to 10–14 days.
[40] If the additional financing has a *category A* safeguard classification for environment, resettlement, and indigenous peoples, the simplified documentation would not be applicable.
[41] In this document, guarantees include risk participation.

incentives to use CEPs over loans because of the current practice of pricing, capital requirement, and performance metrics.

42. This paper proposes to expand ADB's product availability for sovereign guarantee operations (paras. 43–50), enhance an existing nonsovereign product (paras. 51–52), and strengthen incentives to use CEPs for sovereign and nonsovereign operations (paras. 53–56). By improving product availability, ADB can capture missed business opportunities. Combined with enhanced incentives to use CEPs, ADB can expand credit enhancement operations to catalyze a greater amount of private financing for development.[42]

### 1. Policy-Based Guarantee

43. **Issues.** The World Bank and other MDBs offer policy-based guarantees (PBGs), which ADB cannot offer under its current policies. The World Bank approved eight PBGs totaling $2 billion during 2011–2016, with the last one to Pakistan (Box 3). While a standard guarantee supports the funding of a specific project, a PBG supports the general government budget. Like a policy-based loan (PBL), a PBG is anchored with policy conditions but provides a guarantee over government borrowing from private financiers in lieu of a direct loan. A PBG is useful for a country without a strong rating that is willing to initiate borrowing from capital markets or commercial lenders. ADB's guarantee helps give the government access to commercial borrowing or improve the terms of such borrowing. The government can also learn the best practice of commercial borrowing and build relations with commercial lenders.

44. The World Bank recently evaluated its experience with PBGs.[43] The evaluation summarizes the lessons as follows.

(i) PBGs can represent an important instrument of development policy financing that can be used effectively to help members overcome difficult financing and reform challenges.
(ii) A robust macroeconomic and fiscal policy framework is essential for sustaining benefits from improved access to private finance for deficit financing.
(iii) The impact of PBGs on borrowers' credit terms varied from one program to another.
(iv) Greater attention to the modality for raising private finance is needed.

[42] A detailed discussion on credit enhancement products is in Appendix 4.
[43] 2016. World Bank. *Findings from Evaluations of Policy-Based-Guarantees.* Washington, DC.

**Box 3: Example of a Policy-Based Guarantee**

The World Bank's International Bank for Reconstruction and Development (IBRD) provided a $420 million policy-based guarantee to Pakistan in 2016. The policy-based guarantee partially covered the government's borrowing from commercial banks totaling $700 million, achieving leverage of 1.7 times.

While Pakistan had successfully accessed the international capital markets, market conditions had become more challenging in raising adequate volumes of sovereign funding at acceptable financial terms. IBRD's policy-based guarantee acted as a catalyst by ensuring Pakistan's access to foreign capital inflows at a sustainable cost.

The policy-based guarantee was anchored with a policy matrix with eleven prior actions. The policy matrix was structured around two pillars—improving the business environment and enhancing fiscal management—and included specific actions for capital market development, improved investment climate, revenue mobilization, and improved debt management.

As market conditions evolved quickly, the flexible structure of a policy-based guarantee helped the government adapt to the market conditions and choose the optimal financing structure and terms. For example, the policy-based guarantee could support commercial financing in the loan and/or bond capital markets, and it could be sliced up and used for accessing the same or different markets at multiple points in time.

World Bank and the Government of Pakistan signed a counter indemnity agreement. If Pakistan failed to make a guaranteed debt service payment, the holders of the financing could call on IBRD's guarantee for repayment. Following such payments, IBRD would decide whether to demand immediate repayment from Pakistan or to extend the terms for repayment over time.

Sources: World Bank. 2016. Islamic Republic of Pakistan, Competitiveness and Growth Development Policy Financing.

45. **Proposals.** This paper proposes to introduce a PBG, which will cover the credit risk of sovereign borrowing for the general budget from commercial lenders. A PBG will in principle follow the current and future PBL policy and requirements.[44] When the PBL policy is amended, it will also incorporate the PBG. ADB's financial support, for example, will be subject to compliance with policy conditions agreed with the government. In formulating the policy conditions, ADB must consider the link between the PBG and the macroeconomic conditions, and the direction of macroeconomic policies must be deemed satisfactory. The importance of macroeconomic and fiscal policy framework is an important lesson of World Bank's evaluation (para. 44). ADB will systematically consult and closely coordinate with the International Monetary Fund, the World Bank, and other agencies.[45] Approvals of PBGs will be part of the Bank-wide ceiling applicable to PBLs.

46. In general, a PBG will be offered in parallel with a PBL to facilitate monitoring of the policy conditions. It will be provided with a sovereign counterindemnity, and the guarantee fee will be equivalent to the sovereign loan spread following the existing policy.[46] The key features are as follows.

[44] ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila.
[45] It is critical to ensure the rigorous application of the PBL policy and close consultation with the International Monetary Fund. A 2016 World Bank report noted that "relatively large loans mobilized through policy-based guarantees might have created incentives for sub-optimal fiscal choices." Independent Evaluation Group. 2016. *Findings from Evaluations of Policy-Based Guarantees.* Washington, DC: World Bank.
[46] ADB. 2006. *Review of ADB's Credit Enhancement Operations*. Manila.

(i) **Eligible expenditures.** As with the PBL, general budget support or balance-of-payment assistance will be eligible.
(ii) **Financing terms.** The guarantee fee will be equivalent to the standard interest spread for policy-based lending.[47]
(iii) **Instrument.** The financial instrument will be a partial credit guarantee with a sovereign counterindemnity.
(iv) **Legal agreements.** ADB will enter into a guarantee agreement for the sovereign borrowings and a counter indemnity agreement with the sovereign government.

47. World Bank's evaluation confirmed that although PBGs improved the credit rating and lowered the borrowing spread, the degree varied from one program to another (para. 44). When a PBG is considered, careful assessment of the possible impact of ADB's PBG should be made through close interaction with market participants. To assess the advantage of a PBG compared with a PBL, the information and analysis should be disclosed and discussed with the government. Another lesson of the World Bank's evaluation is the importance of attention to the funding modality among staff (para. 44). ADB plans to strengthen capacity building and awareness programs among staff (para. 72).

### 2. Guarantees in Group A Countries

48. **Issues.** The ADF and concessional OCR are not intended to support guarantee operations. The regular OCR may be used to support sovereign guarantee operations (i.e., guarantees with sovereign counterindemnity) in group A countries, but only in special cases.[48] This effectively eliminates opportunities for sovereign guarantee operations in group A countries, which have access only to the ADF and concessional OCR (footnote 14). Nonsovereign guarantee operations (i.e., guarantees without sovereign counterindemnity) are possible in group A countries, but opportunities are limited because of the lack of bankable projects or high-risk profiles. Consultations indicated that commercial lenders' demand for ADB's CEPs is strong in group A countries because of their higher risk profile. The development impact of guarantee operations is clear in group A countries because it is challenging to realize private investments in these countries.

49. **Proposals.** The current policy allows the use of regular OCR for sovereign loans and guarantees in group A countries only if the projects generate net foreign exchange over and above the foreign debt service requirements. This paper proposes to allow the use of regular OCR in group A countries for guarantee operations with a sovereign counterindemnity on the condition that the project is not expected to undermine the debt sustainability of the country. In particular, the country should not be classified as being in high risk of debt distress in accordance with the Concessional Assistance Policy,[49] and the proposed project is not expected to change the country's debt distress classification. The debt distress risk classification is based on debt sustainability analyses using the International Monetary Fund–World Bank debt sustainability framework for low-income countries. While the current condition focuses on project-specific foreign currency cash flow, the proposed condition focuses on macroeconomic debt sustainability. The proposal covers PRGs, partial credit guarantees (PCGs), and proposed PBGs. With

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[47] A guarantee fee may be adjusted if the guarantee takes a certain structure that has significant implications on effective risk exposure for ADB (e.g., first loss cover).
[48] ADB. 1998. *A Graduation Policy for the Banks's DMCs*. Manila, and ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank.* Manila.
[49] ADB. 2016. *Concessional Assistance Policy*. Manila. Countries with high risk of debt distress have access only to ADF grants.

guarantees being used more, the implementation arrangements under the existing policy will need to be updated[50] and reflected in the Operations Manual.

50. Because group A countries do not have a regular OCR allocation, the required resource will be allocated on a case-by-case basis (para. 56) by assessing the development impact of the proposed project (e.g., catalyzing private financing in challenging markets), as well as the potential impact on ADB's capital requirement. Such an impact on ADB's capital is expected to be limited because there are limited viable guarantee projects in group A countries that meet the criteria in para. 49. Although the volume of operations would not be large, these guarantee operations in group A countries would deliver important development impact by realizing innovative and pathfinder projects in challenging markets.

### 3. Additional B Loans

51. **Issues.** Syndicating B loans is another way to catalyze private financing.[51] B loans are approved together with A loans (i.e., ADB's own account financing), and a subsequent increase of a B loan requires additional Board approval if the amount is more than 20% of the originally approved B loan amount (footnote 10). This requirement reduces ADB's ability to quickly capture emerging opportunities to mobilize private cofinancing because B loan lenders sometimes decide to join a project only after ADB's project approval. B loans are mostly used for cofinancing nonsovereign operations. For official cofinancing, the Board delegated the approving authority to the President regardless of its size in 2015 (footnote 10).

52. **Proposals.** To facilitate more active and responsive use of B loans, this paper proposes to permit increases in existing B loans up to 100% of the original B loan amount under delegated authority to the President, provided the amount of the additional B loan does not exceed 100% of the original B loan. Increasing the amount of the B loan does not involve significant risks for ADB because B loan lenders bear all the credit risks. To minimize potential reputational risks, the President will not be authorized to approve additional B loans that (i) require an exception to an existing ADB policy or (ii) involve the potential for significant adverse environmental, economic, and/or social impacts, particularly for vulnerable groups that may be unable to absorb such impacts, unless such cofinancing is for a project whose loan has already been approved by ADB's Board and no new significant adverse impacts are envisaged.[52] An additional B loan may result in the partial substitution of an A loan by the incremental B loan, resulting in even greater leverage. Like the reporting of official cofinancing approved by the President, Management will inform the Board annually of operational statistics of additional B loans approved by Management.[53]

### 4. Incentive for Credit Enhancement Operations

53. **Issues.** In addition to filling gaps in product availability, enhancing incentives to use CEPs is important because ADB and its clients do not have strong incentives to use CEPs over loans.

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[50] The updates will reflect the (i) transfer of the CEP function from the Office of Cofinancing to the Private Sector Operations Department and the (ii) replacement of the Pricing and Credit Enhancement Committee with the Management Review Meeting or Staff Review Meting for sovereign CEP proposals.

[51] A B loan refers to financing for which ADB serves as a lender of record and includes complementary financing in local currency with onshore banks. While ADB's current policy and regulations refer to B loans, local banks play an increasingly larger role in infrastructure financing in large markets.

[52] Management may apply a liberal interpretation of these criteria in determining whether to submit a project proposal to the Board for approval if such impacts can be sufficiently mitigated.

[53] The annual report may be consolidated with reports of other products.

First, ADB's policy set guarantee fees at the same level as ADB's loan credit spread.[54] This typically makes all-in costs for the borrower of a guaranteed loan higher than that for a direct ADB loan, especially for sovereign operations.[55] Borrowers prefer direct loans because of the lower price, even when the guarantee may leverage a greater financing amount. Second, ADB sets a target and monitors approvals on its own account and cofinancing, but the emphasis is often placed on ADB's own account approvals. Because most CEPs are counted as commercial cofinancing, a weak incentive for cofinancing implies a weak incentive to use CEPs.[56] Third, because providing a guarantee requires the same amount of capital as an equivalent loan under the current capital framework, using a guarantee does not save lending headroom. This is an important disincentive, especially for sovereign guarantees in countries with tight country programming.

54. **Proposals.** This paper proposes to enhance incentives for ADB to use CEPs in lieu of loans. To incentivize operations departments and staff, ADB will introduce a performance metric for nonsovereign operations. Rather than monitoring ADB's own commitment and cofinancing separately, ADB will monitor the "total investment" or the sum of ADB's own commitment and cofinancing. This performance metric gives equal weight to ADB's own account financing and cofinancing, resulting in an enhanced incentive for cofinancing.

55. ADB will commission a study to evaluate whether the capital requirement can be lowered for PRGs. ADB's guarantee products include PRGs and PCGs. While PCGs cover general credit risks, PRGs only cover specific political risks (e.g., expropriation, currency inconvertibility or nontransferability, political violence, and/or breach of contract). The capital requirement review will focus on PRGs because they cover limited risks and their default event is less likely than the equivalent direct loan. Lowering the capital requirement for PRGs will strengthen the incentive for ADB to use them because PRGs will consume less lending headroom than the equivalent direct loan.

56. ADB will more flexibly allocate regular OCR for sovereign guarantee operations on top of the regular country allocation. The additional allocation will create an incentive to develop projects and help country programming. Unlike standard public sector projects, guarantee projects are often driven by private sponsors and lenders. Because ADB needs to capture business opportunities as they emerge, it is difficult to fully incorporate guarantee projects and assign resources through the regular country programming cycle. ADB will consider the additional allocation not only for groups B and C countries but also for group A countries, subject to certain conditions (para. 49). The additional allocation of regular OCR will be considered for standard guarantees as well as PBGs (paras. 45–46). The allocation of concessional OCR will not be affected by additional allocation of regular OCR and will continue to follow the performance-based allocation.

[54] The pricing of nonsovereign PRGs reflects insurance costs if risk exposure is transferred to an insurance company.
[55] This paper does not propose to alter the general pricing principle that the return on a credit guarantee is consistent with the credit margin on an equivalent loan. Pricing should reflect costs for ADB and should not influence choice of products.
[56] Under ADB's current framework, lender-of-record structures, risk transfer arrangements, and the uncovered portion of a guaranteed loan are counted as commercial cofinancing. Guarantees are counted as ADB's own account commitment.

### C. Expanding Support for Public–Private Partnership Projects

57. **Public–Private Partnership Standby Financing Facility.** Supporting PPP projects is an important measure to catalyze private capital for development.[57] Although ADB supports PPP projects in various ways, financing support for PPP projects from sovereign operations has been limited. This paper proposes to introduce a new financing facility under sovereign operations. By introducing the new facility, ADB can help DMC governments expand PPP projects, especially in challenging sectors and countries.[58]

58. **Issues.** ADB has been supporting DMCs' PPP initiatives based on four pillars: advocacy and capacity development, enabling environment, project development, and project financing.[59] Generally, regional departments support the first two pillars through TA and PBLs, and the Office of Public–Private Partnership supports the third pillar through TAS. Although the Private Sector Operations Department can support the fourth pillar through nonsovereign lending and regional departments can support it through sovereign lending, ADB support has so far been mainly through nonsovereign lending, especially in the energy sector.

59. Because PPP projects in the energy sector in upper middle-income countries are often commercially viable without direct financial support from the government, ADB can support it through nonsovereign lending. However, PPP projects are expanding into non-energy sectors, such as water and transport, in Asia and the Pacific. In these sectors, projects are often not commercially viable without government financial support because of the low level of affordable tariffs (e.g., water and sanitation) and/or high risks (e.g., demand risk in transport projects). Some governments support these projects by providing up-front capital (e.g., viability gap funding), taking more risks (e.g., availability payments unrelated with demand volume), or implementing other forms of cost or risk sharing (e.g., revenue sharing and minimum revenue guarantee). ADB's sovereign lending for government financial support to PPP projects is so far limited. ADB's standard investment loans can fund governments' up-front financial obligations, such as viability gap funding. However, ADB's standard loan is not a good fit for supporting governments' payments that are made over a long period and contingent on the concessionaire's performance (e.g., availability payments).

60. **Proposal.** This paper proposes to introduce the PPP Standby Financing Facility on a pilot basis for 5 years from effectiveness of this policy. Each facility will support government payments to private PPP concessionaires through standby financing. The government can withdraw funds from the facility when needed, such as during a cash shortage because of revenue fluctuation. The facility will help the private concessionaire secure timely payments from the government. The key features of the PPP Standby Financing Facility are as follows.

(i) **Eligible expenditures**. The financial obligations of a government or its agency to a private concessionaire for PPP projects (e.g., availability payment, service payment, annuity payment, and other similar payments) are eligible. A facility can support a single project or a bundle of similar projects in the borrowing country.[60]

[57] "A PPP refers to a contractual arrangement between public (national, state, provincial, or local) and private entities through which the skills, assets, and/or financial resources of each of the public and private sectors are allocated in a complementary manner, thereby sharing the risks and rewards, to seek to provide optimal service delivery and good value to citizens." ADB. 2012. *Public–Private Partnership Operational Plan, 2012–2020—Realizing the Vision for Strategy 2020: The Transformational Role of Public–Private Partnerships in Asian Development Bank Operations*. Manila (p. 2, para. 4).

[58] A detailed discussion on the Public–Private Partnership Standby Financing Facility is in Appendix 5.

[59] ADB. 2012. *Public–Private Partnership Operational Plan, 2012–2020—Realizing the Vision for Strategy 2020: The Transformational Role of Public–Private Partnerships in Asian Development Bank Operations*. Manila.

[60] Support through the PPP standby financing facility will comply with ADB's Safeguard Policy Statement (2009).

(ii) **Financing terms.** A facility can be funded with regular or concessional OCR and will have standard financing terms in accordance with the financing source. For regular OCR, a commitment fee will be charged on the amount of the loan agreement, not on the facility amount.

(iii) **Legal agreements.** Each facility will have a facility agreement not exceeding 15 years and loan agreements to cover government payments for a shorter period (e.g., 1–3 years).

61. The Board will approve each facility (not exceeding 15 years) and authorize the President to approve legal commitments (each typically 1–3 years but not exceeding 15 years) under the approved facility. Because the tenor of private lending for these types of projects is around 15 years, ADB demonstrating its engagement for this period comforts private lenders. When the concession period is longer than 15 years, Board approval will be sought to authorize the President to approve legal commitments (each not exceeding 15 years) for the next 15 years with a report on project implementation. Board approval may also be sought for a further period.

62. ADB and the government will enter into a facility agreement that specifies the scope, size, terms, and other key conditions. Under the facility agreement, ADB will make a series of small loan commitments through loan agreements. ADB will have the legal obligation to provide financing only upon effectiveness of the loan agreement, not the facility agreement. Through this structure, the borrower can avoid allocating large resources and paying commitment charges for a long concession period. Given the diversity of PPP concession contracts and market environment, each facility will be structured flexibly to accommodate the diverse characteristics of the projects.[61] This paper proposes to introduce the facility on a pilot basis for 5 years, during which new facilities may be proposed and approved. Based on lessons learned from the initial cases, the facility design would be reviewed and refined at the end of the pilot period.

63. The economic and financial analysis of the project should include detailed assessments of the PPP concession contracts, including the level and terms of government payments to the concessionaire and the risk allocation between the government and private parties. ADB needs to confirm that the proposed structure is likely to achieve the best value for money, the expected return to the private concessionaire is adequate but not excessive, and risks are allocated properly among the concerned parties. Government payment obligations and the use of ADB's sovereign financing should not grant excessive concessionality to support an unviable project, and ADB's financing should not crowd out potential commercial financing.

64. Regional departments will propose and implement projects, with possible collaboration with the Office of Public–Private Partnership. Given the long gestation period of PPP projects, early involvement in project development is important to ensure compliance with relevant ADB policies and requirements for potential use of ADB financing.[62] Through TAS and TA, the Office of Public–Private Partnership supports the government in the early stage of project development to ensure the concession contract is structured properly.

65. When advisory and financial support are considered for the same project, actual and perceived conflicts of interest must be managed diligently. The prudential and proper management of conflicts is important for avoiding reputational or dispute risks. For example, conflict of interests should be managed by separating the concerned staff with information barriers

[61] For example, a loan agreement may have a longer coverage period (e.g., 5 years) if the private party needs stronger security, but this will incur a larger financing cost to and resource commitment from the government.

[62] The concerned regional department will be responsible for due diligence, including safeguard measures.

and obtaining a consent from clients based on full disclosure. ADB's financing decision must be made entirely independently of TAS mandates, and ADB must not seek a TAS mandate from the government by offering or implying ADB's potential financing.

66. As with guarantee projects, private sponsors drive PPP projects, and it is difficult to fully incorporate such projects and assign resources through the regular country programming cycle. ADB will more flexibly allocate regular OCR for sovereign operations to support PPP on top of regular country allocations.

## IV. MANAGEMENT ACTIONS FOR IMPLEMENTATION

67. Subject to the Board's approval of the proposals in para. 74, Management will take the following actions to ensure the smooth introduction and the effective implementation of the proposed products and modalities.[63] All items in para. 74 will become effective upon approval by the Board of Directors.

68. **Develop and continuously refine manuals.** Management will develop new operations manuals and related instructional documents to implement the new products and modalities and will revise existing documents to refine the current products and modalities, as appropriate. The Strategy, Policy and Review Department; the Office of the General Counsel; and other relevant departments will provide adequate support to operations teams that adopt new products and modalities in the initial years. This support will ensure the smooth introduction and continuous refinement of manuals by reflecting experiences gained from the initial cases. Management continues to streamline business processes, including simplifying documentation for additional financing as described in para. 39.

69. **Ensure proper financial planning.** For the SEFF and the PPP Standby Financing Facility, the amount of the Board approval will be gradually converted into ADB's legal commitments. Even without a full legal commitment, Board approval will imply ADB's engagement with the overall facility. New commitments in each country, including those under the proposed new products and those for stand-alone regular projects, need to be managed in line with the country programming, and total new commitments must be consistent with ADB's overall financial planning. Management will monitor the approved amount and incorporate resulting loan commitments that are likely to be made in the future in its planning process to ensure proper financial management.

70. **Enhance incentives.** Management will enhance incentives to use new products and modalities. As described in para. 56 and para. 66, Management will allocate more flexibly regular OCR for sovereign guarantee projects and PPP projects, on top of the regular country allocation. Since these projects are often driven by private sponsors and lenders, it is not always easy to fully assign resources through the regular country programming cycle.

71. Weak incentives constrain the expansion of credit enhancement operations. To enhance the incentives, Management will introduce "total investment" as a new performance metric for nonsovereign operations and give equal weight to ADB's own financing and cofinancing (para. 54). Management will also commission a study to evaluate whether the capital requirement can be lowered for PRGs (para. 55).

72. **Strengthen capacity and organizational setup.** Management will carry out capacity-building programs to smoothly introduce new products and modalities. Giving more attention to

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[63] A summary of the implementation plan is in Appendix 6, Table A6.4.

the modality for raising private finance is an important lesson of World Bank's evaluation on PBGs (para. 44). Management has already strengthened the organizational setup of relevant units, such as the Guarantees and Syndication Unit in the Private Sector Operations Department, to expand credit enhancement operations, including supporting regional departments in designing and executing projects.[64] Management will enhance awareness and understanding of guarantees and PPP operations, especially among sovereign operations staff.

73. **Conduct outreach and co-working with governments.** Management will launch outreach activities in DMCs to raise awareness of new products and modalities and explore opportunities to apply them. New products and processes may not be immediately accommodated in the budget and administrative processes of the borrowing countries. Where feasible, ADB will work with the concerned authorities to help facilitate the accommodation of the new products and processes. Based on the interaction, Management will keep refining and adjusting operational details to accommodate the specific conditions of DMCs.

## V. RECOMMENDATIONS

74. It is recommended that the Board approve the proposals listed in items (i) to (vi), each of which will be considered to be approved separately:

(i) refine the technical assistance loan modality as project readiness financing (PRF), with annual commitments of small-scale PRF not exceeding $100 million, as described in paras. 27–28;
(ii) introduce the small expenditure financing facility, as described in paras. 31–35;
(iii) introduce the policy-based guarantee, as described in paras. 45–46;
(iv) allow group A countries access to regular ordinary capital resources for guarantee operations,[65] as described in para. 49;
(v) permit increases in existing B loans up to 100% of the original B loan amount under delegated authority to the President,[66] as described in para. 52; and
(vi) introduce the public–private partnership standby financing facility on a pilot basis for 5 years, as described in paras. 60–65.

[64] ADB upgraded the Guarantees and Syndication Unit in April 2018 with a director-level advisor and additional staff.
[65] This will supersede para. 47 of ADB. 1998. *A Graduation Policy for the Banks's DMCs*. Manila, and para. 46 of ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank.* Manila, in connection with such access to regular ordinary capital resources for group A countries.
[66] This will supersede para. 90(x)(b) of ADB. 2015. *Enhancing Operational Efficiency of the Asian Development Bank*. Manila.

# PROJECT READINESS FINANCING

## A. Introduction

1. When an infrastructure project is approved based on preliminary design, significant time is required to complete detailed engineering design, prepare bidding documents, and address environmental and social safeguards issues once a loan becomes effective. Cost estimates are also less accurate when detailed engineering design is undertaken after project approval (Table A1.1). Low project readiness often results in the need for extensions in project closing dates and additional financing when actual costs deviate from estimated costs and can ultimately reduce the development impact of Asian Development Bank (ADB) operations.

**Table A1.1: Design Stage and Cost Accuracy**

| Design Stage | Purpose | Basis | Cost Accuracy[a] |
|---|---|---|---|
| Planning design | Used for scoping purposes and preliminary budget estimates | Based on past cost experience with similar facilities or order of magnitude estimates | ±40% |
| Conceptual design | Used to undertake feasibility studies | Development of reliable project cost estimates consistent with realistic schedules | ±30% |
| Preliminary engineering design | Used for final investment decision and budget authorization | Estimates based on outline specifications | ±20% |
| Detailed engineering design | Used for bidding documents | Estimates based on detailed drawings and specifications, and bills of quantity | ±10% |

[a] The cost accuracy figures are estimates. Cost accuracy by the design stage can vary significantly depending on the nature, size, and complexity of a project.
Source: Asian Development Bank estimates.

2. ADB's Midterm Review of Strategy 2020 identifies improved project readiness as a key measure for reducing project implementation delays.[1] The action plan for the review assesses project readiness using two categories—design readiness and procurement readiness.[2] In 2012, 36% of sovereign infrastructure projects were design-ready, but only 15% were procurement-ready at the time of approval. There has been significant improvement in project readiness for infrastructure projects since 2016. The proportion of loans assessed as procurement-ready rose to 45% in 2017, exceeding ADB's corporate target of 40%.[3] Design-ready projects increased to 82% in 2017, which also exceeded the corporate target of 60%. Despite these achievements, the average length of time in 2016 from project approval to the award of the first construction contract for sovereign operations was 11.7 months, compared with ADB's corporate target of 9 months.

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1 ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific.* Manila.
2 ADB. 2014. *Midterm Review of Strategy 2020 Action Plan*. Manila. Procurement-ready infrastructure projects are defined as those in which bid documents for engaging contractors for a major construction or goods contract were launched before project approval. Design-ready infrastructure operations have completed one of two steps before approval. They have either completed (i) detailed engineering designs suitable for preparing and launching bidding documents for major construction or goods contracts or (ii) preliminary designs and specifications suitable for preparing and launching bidding documents for construction contracts that involve detailed design and/or turnkey or engineering procurement and construction contracts.
3 ADB. 2018. 2017 *Development Effectiveness Review*. Manila.

3. Grant-financed transaction technical assistance (TA), generally administered by ADB, is used to undertake feasibility studies on proposed investments.[4] Transaction TA is financed through ADB Special Funds, particularly grants from the Technical Assistance Special Fund (TASF), and other grant cofinancing sources, such as ADB-administered trust funds. While TASF-financed transaction TA may be used to prepare preliminary engineering designs and cost estimates, existing regulations disallow TASF being used to finance detailed design activities. Cofinancing from sources such as ADB-administered trust funds may be used to finance detailed engineering design if the cofinancing regulations permit. Retroactive financing may also be used when an ADB-financed loan is used to reimburse the borrower for project preparation costs, including detailed engineering design expenditures, incurred by the borrower before the effective date of the related loan agreement.[5] Expenditures financed under retroactive financing are incurred prior to the loan effective date but generally no earlier than 12 months before the signing of the loan agreement.[6] A comparison of ADB's project preparation tools is in Table A1.2.

**Table A1.2: Comparison of Project Preparation Tools**

| Design Stage | Transaction TA | TA Loan | Project Design Facility | Retroactive Financing |
|---|---|---|---|---|
| Feasibility studies | √ | √ | √ | √[b] |
| Preliminary engineering design | √ | √ | √ | √[b] |
| Detailed engineering design | X[a] | √ | √ | √[b] |
| Pre-implementation works | √ | √ | √ | √[b] |

TA = technical assistance.
[a] Transaction TA may finance detailed engineering design only with cofinancing and if permitted by cofinancing regulations.
[b] The Asian Development Bank and the borrower must agree to the retroactive financing arrangements in the loan agreement. The only eligible expenditures covered are those incurred by the borrower generally up to 12 months before the signing of the loan agreement.
Source: Asian Development Bank.

4. ADB offers two financing modalities that are specifically intended to finance detailed engineering design and can also finance broader project preparation activities, including policy advice to support policy-based lending operations, in advance of the ensuing project: TA loans and the pilot project design facility (PDF).[7]

## B. Background

### 1. Project Design Facility

5. ADB introduced the PDF as a pilot in 2011. Under it, project design advances (PDAs) are provided as quick disbursing resources so that detailed engineering design can occur immediately following the completion of project feasibility studies. This allows projects to be immediately implemented upon loan effectiveness.[8] PDAs can also finance broader project and program preparatory work.[9] A PDA is provided only when it is highly likely that ADB will finance an ensuing

[4] ADB may delegate the administration of transaction TA to the executing agency.
[5] ADB's financing amount is up to 20% of the total ADB loan amount, except in the case of emergency lending where the maximum amount is up to 30%.
[6] A period longer than 12 months may be allowed, if justification is provided.
[7] TA loans may also be provided on a grant basis for DMCs that are eligible for ADF grants. Grant cofinancing may also finance TA loans.
[8] ADB. 2011. *Establishing the Project Design Facility*. Manila.
[9] This includes feasibility studies, due diligence, safeguards assessments, advance procurement actions, legal services, capacity building, and transaction advisory services for the preparation of public–private partnership agreements.

loan, although approval of a PDA does not commit ADB to providing financing for the follow-on loan. A PDA is approved once PDA implementation readiness has been demonstrated—when the selection of consultants has been substantially completed and the related contract is ready for signing.

6. The vice-president of the concerned operations group approves PDAs under a commitment authority of $150 million. The PDA implementation period is generally 2 years. ADB designed PDAs to be refinanced under their ensuing loans, with payments of applicable interest or service charges deferred until the PDA is refinanced. If no loan ensues, the PDA is repaid in 10 equal semiannual installments over 5 years. Multiple PDAs may be provided up to the PDA ceiling for an ensuing project.

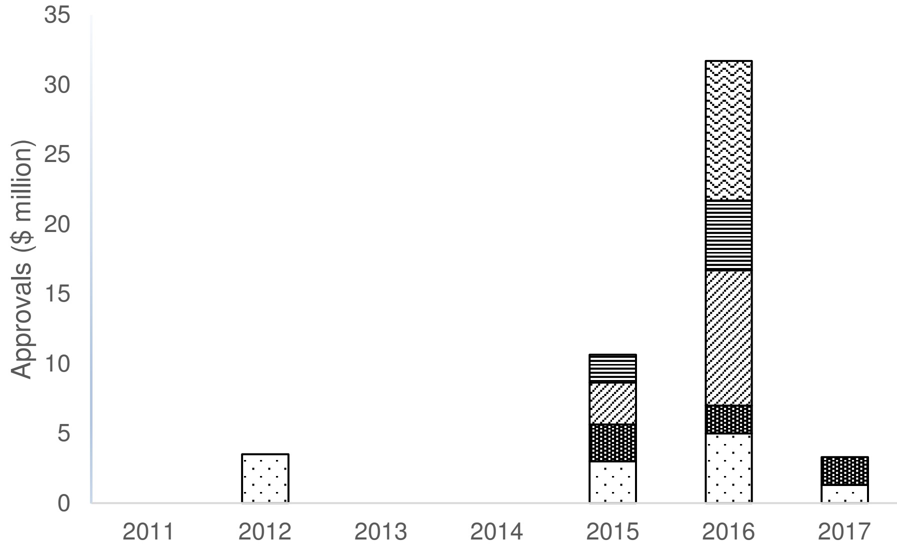
7. In January 2014, the Board approved to extend the pilot to provide additional time to try the modified PDF. ADB introduced the following modifications during the pilot extension period to address the PDF's shortcomings: (i) increased the PDF ceiling from 1% to 4% of the ensuing loan value, or from $5 million to $10 million, based on the larger of these amounts; (ii) launched country-level master agreements to cover multiple PDA approvals; and (iii) waived commitment charges for the initial 2-year implementation period. The modifications also allowed Management to approve PDAs more than the revised ceiling for a single ensuing project as long as there was appropriate justification and a no objection had been obtained from ADB's Board of Directors.

#### a. Number and Size of Approved Project Design Advances

8. As of the end of 2017, ADB had approved 12 PDAs totaling $49.15 million (Figure A1.1). Except for Fiji, all PDF users have been group A and group B countries, which likely reflects borrowers' inability to prepare detailed engineering designs or prefinance such activities before the ensuing loan is approved.[10] All approved PDAs have provided project design support for project loans, not policy-based or results-based loans. All but two approved PDAs (82%) have been less than $5 million. Half of the approved PDAs supported detailed engineering designs for transport projects; 33% supported the designs for water and other urban infrastructure and service projects; and 17% supported the designs for agriculture, natural resources, and rural development projects.

[10] Under ADB's classification system, group A countries are those that have access to concessional assistance only, including concessional ordinary capital resources and resources from the Asian Development Fund. Group B countries have access to both concessional and regular ordinary capital resources.

**Figure A1.1: Number and Size of Project Design Advance Approvals, 2011–2017**




Note: Patterned blocks are used to distinguish the number and size of a project design advance approved in a year, e.g., in 2017, two project design advances were approved ($1.03 million and $2.00 million).
Source: Asian Development Bank.

### b. Time from Loan Approval to First Construction Contract Award

9. Because of the small number of approved PDAs, it is difficult to assess in detail the performance of this modality in supporting higher project readiness. As of December 2017, only seven of the projects that received PDAs had been approved. Of these, the financing agreements are only effective for four projects. Based on this small sample of projects, the PDA instrument appears to have supported a higher level of project readiness. The time frame between loan approval and the awarding of the first major contract for projects supported by PDAs has been equal to or less than the ADB corporate target of 9 months. For the Coastal Towns Environmental Infrastructure Project in Bangladesh, the first civil works contract was awarded 5.5 months after project approval.[11] The contracts for major civil works for the Tuvalu Outer Island Maritime Infrastructure Project were awarded 9 months after project approval.[12] The major contracts worth 48% of the total value of ADB financing for the Peshawar Sustainable Bus Rapid Transit Corridor Project were awarded 4.5 months after project approval. Figure A1.2 illustrates PDA performance in detail.

### c. Allocation of Contingency in Project Cost Estimates

10. ADB expected PDA use to result in more robust cost estimates and obviate the need for large contingencies. Contingencies consist of physical and price allowances. Physical contingencies cover possible increases in the quantity or categories of expenditure and are normally calculated as a percentage of the base cost for each project component. Price contingencies cover price increases over the project implementation period resulting from

[11] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Loan and Grants to the People's Republic of Bangladesh for the Coastal Towns Environmental Infrastructure Project*. Manila.
[12] ADB. 2015. *Project Design Advance: Outer Islands Maritime Infrastructure Project in Tuvalu*. Manila; and ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Grants and Administration of Grant to Tuvalu for the Outer Island Maritime Infrastructure Project*. Manila.

inflation, foreign exchange movements, or expected real price increases. The greater the uncertainty, the higher the allowance for physical contingencies. Cost accuracy improves as a project's design is refined and more information becomes available. Cost accuracy is generally about ±20% when cost estimates are based on preliminary engineering design and about ±10% when based on detailed engineering design. Cost accuracy for a project varies, however, based on the nature and complexity of the project (Table A1.1).

11. For the seven projects that received PDAs and were approved as of December 2017, physical contingencies of 3%–10% were within the expected range when cost estimates are based on detailed engineering design activities. For the Bangladesh Coastal Towns Environmental Infrastructure Project, the Tuvalu Outer Island Maritime Infrastructure Project, and the Jalalpur Irrigation Project, the allotted physical contingencies were 5% or less, indicating that the use of the PDA had significantly reduced the need to budget for larger physical contingencies.[13] The allotted physical contingencies were 8% for the Kyrgyz Republic Central Asia Regional Economic Cooperation Corridors 1 and 3 Connector Road Project and 10% each for the Fiji Urban Water Supply and Wastewater Management Investment Program and the Pakistan Peshawar Sustainable Bus Rapid Transit Corridor Project.[14] The allocation for the Nauru Sustainable and Climate-Resilient Connectivity Project was 10% for both price and physical contingencies, but the breakdown between these two categories was not provided in the project document.[15]

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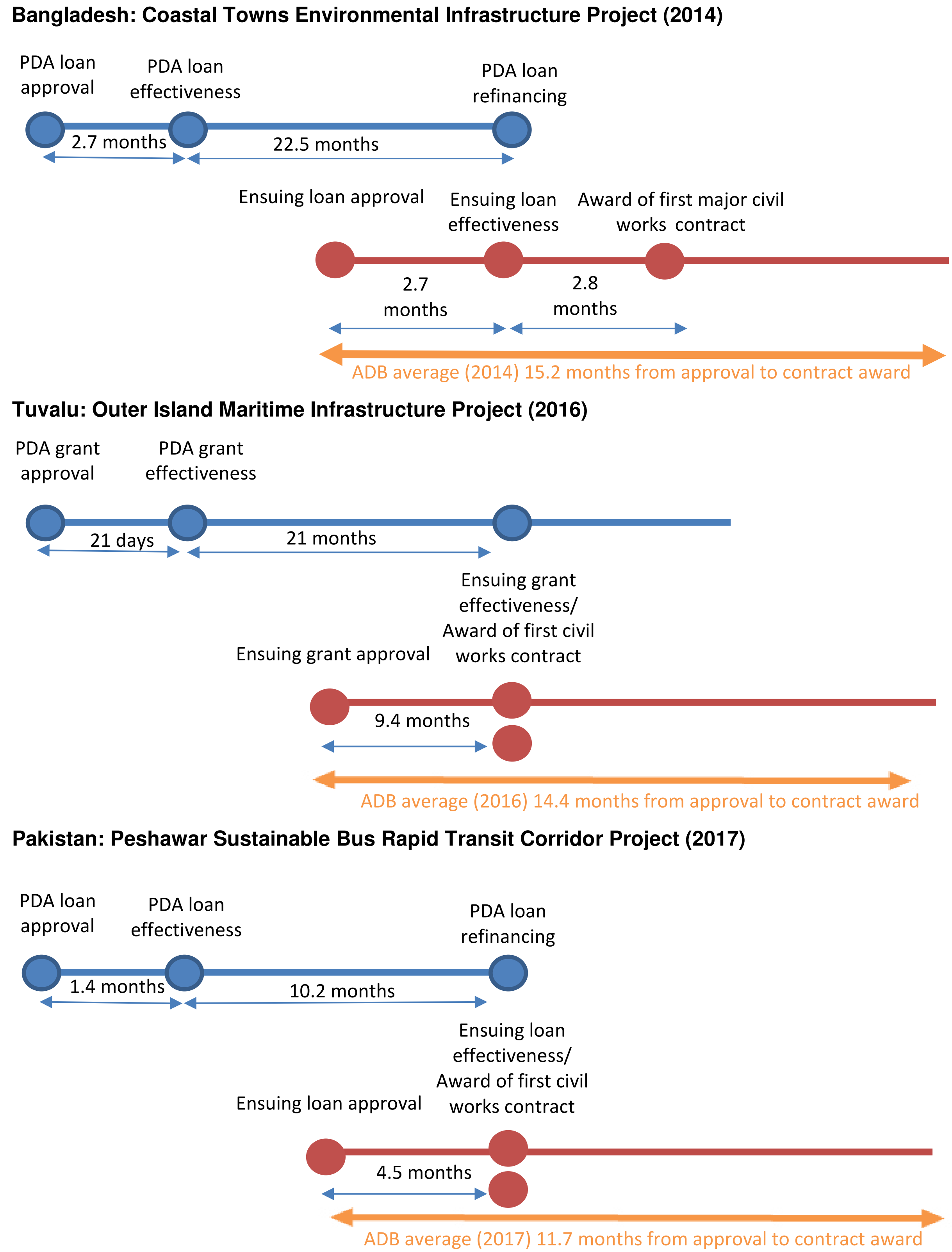
[13] ADB. 2017.*Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Islamic Republic of Pakistan for the Jalalpur Irrigation Project. Manila*;

[14] ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to the Kyrgyz Republic for the Central Asia Regional Economic Cooperation Corridors 1 and 3 Connector Road Project. Manila*; ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Republic of Fiji for the Urban Water Supply and Wastewater Management Investment Program*. Manila; and footnote 12.

[15] ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Grant and Administration of Grants to Nauru for the Sustainable and Climate-Resilient Connectivity Project*. Manila. This project also included an additional cost category called resource buffer to cover foreign exchange rate movements and a 2% administration fee levied on the ADB-administered cofinancing from the Government of Australia.

**Figure A1.2: Performance of Projects Supported by Project Design Advances**




ADB = Asian Development Bank, PDA = project design advance.
Note: The year in parentheses next to the project name indicates the year of project approval.
Source: ADB.

### d. Project Design Advances without Approved Loans or Grants

12. While only seven of the projects that received PDAs have resulted in ensuing ADB financing, the remaining six projects are listed in the country operations business plans of the respective countries, indicating ADB's intention to consider financing these projects.

### e. Similar Assistance by Other Multilateral Development Banks

13. Multilateral development banks such as the African Development Bank (AfDB), the Asian Infrastructure Investment Bank, the Inter-American Development Bank (IADB), and the World Bank offer project design facilities similar to the PDF. The World Bank's project preparation facility (PPF) provides project advances that are approved by country directors under special authority granted by its board of directors. From time to time, the board adjusts the ceiling on the PPF's commitment authority and the maximum amount for individual project advances. In 2016, it raised the commitment authority to $750 million. The maximum size of a project advance for an individual operation is set at $6 million, or $10 million for countries that are classified as being in fragile or conflict-affected situations. Management sets indicative regional allocations within the commitment authority limit that are adjusted as needed and informs the board of directors about approved project advances. Box A1.1 provides details on changes to the PPF over time.

14. AfDB established the African Development Fund Project Preparation Facility (ADF-PPF) in 2000, under the African Development Fund-8, to provide an effective mechanism for delivering quick-response project preparation support. The ADF-PPF is a revolving fund with capital of UA19.2 million.[16] It provides advances for project preparation and design activities to eligible countries on a first-come first-serve basis that are later reimbursed under the ensuing loan. No interest or service charges are levied on project advances. Where no loan ensues, the advance may be repaid or refinanced using savings from another ongoing loan to the same borrower. The ceiling on project advances was initially UA500,000 but was raised to UA1,000,000 in 2013. At the end of September 2015, about UA12.87 million of ADF–PPF funding was available for commitment.[17] AfDB also established the NEPAD Infrastructure Project Preparation Facility Special Fund to support the design and preparation of regional infrastructure projects.

15. The Asian Infrastructure Investment Bank only provides preparation advances to support project preparation activities when there is a strong probability that a corresponding project loan will ensue. The total aggregate amount of approved preparation advances for a given project may not exceed the lesser of 10% of the total estimated financing amount for the ensuing project, or $10 million. The bank's president approves preparation advances.

16. IADB has several different facilities, including a PPF, the Project Preparation and Execution Facility (PROPEF), the Infrastructure Fund, and the Fund for Integration Infrastructure. PPF and PROPEF are the most similar to ADB's PDF. PPF provides up to $1.5 million to finance the design of projects in IADB's project pipeline. PROPEF provides financing for both project preparation and project start-up activities of up to $5 million per project.

17. The European Bank for Reconstruction and Development also established a PPF in 2015, with initial financing of €40 million, to provide nonreimbursable grants for project preparation and design activities.

[16] On 7 March 2018, UA1.00 = $1.45. UA stands for unit of account, which is AfDB's reporting currency.

[17] African Development Fund. 2015. *ADF-13 Midterm Review: Update on the Resource Allocation under ADF-13*. Abidjan.

**Box A1.1: World Bank Experience with the Project Preparation Facility**

The World Bank established its project preparation facility (PPF) in 1975 as a revolving fund to support project preparation activities. The PPF supports (i) preparatory and limited initial implementation activities for a project, including detailed engineering design; and (ii) preparatory activities for operations supported by a development policy and program-for-results financing.

Between 1996 and 2016, the World Bank provided 1,434 project advances. The majority (87.2%) were provided to countries that are eligible for concessional International Development Association (IDA) resources. The World Bank provided only 10 project design advances (PDAs) on International Bank of Reconstruction and Development terms during 2013–2016. In 2016, Africa accounted for 82.6% of all active PDAs, while the demand for such assistance declined in all other regions. In the same year, the World Bank's active PPF portfolio in Asia and the Pacific included 11 project preparation advances to Bangladesh (1), India (4), Kiribati (1), Marshall Islands (1), Nepal (1), Tajikistan (2), and Tuvalu (1). Most active PDAs (74%) had a value of less than $3 million in 2016.

PPF policy changes made in 2008 allowed project advances to refinance a project advance under any loan to the borrowing country, not just the loan for which the project advance was granted, when the loan for which the project advance had been granted was unlikely to ensue before the refinancing deadline. Further changes in 2012 allowed the use of grants from the PPF to finance World Bank-executed project start-up activities where no viable implementation alternative existed because of (i) the urgent need of assistance as a result of a natural or human-induced disaster or conflict, or (ii) capacity constraints stemming from fragility or specific vulnerabilities (including small states). Such activities are limited to the procurement of small contracts for goods and works, and the provision of technical assistance needed to enable the borrower to execute project activities.

As part of a 2016 policy review, the World Bank undertook several additional reforms to the PPF. The most significant changes included the (i) use of an individual project advance to support the identification and preparation of multiple projects in a pipeline in a borrowing country, and (ii) use of a PDA to provide broader cross-sector capacity-building activities within a country in the areas of financial management, procurement, and safeguards. These changes were largely driven by significant increases to country resource allocations under IDA18, where the World Bank recognized the need to provide additional assistance to borrowers to help them identify and prioritize a pipeline of projects. Also, greater lending volumes to weaker capacity IDA borrowers has also required assistance for institutional strengthening to more effectively and efficiently implement future projects. The World Bank has also proposed to implement extensive outreach activities to make its staff more aware of the PPF and its uses.

Source: World Bank. 2016. *Project Preparation Facility: Increase in Commitment Authority and Enhanced Scope.* Washington, DC.

## 2. Technical Assistance Loans

18. The TA loan modality can be used to finance detailed engineering design and broader project preparation activities.[18] TA loans can be processed independently of an ensuing loan, and there is no ceiling on the size of a TA loan. TA loans may also be used to finance pilot activities to test innovative project approaches that can then be scaled up under the ensuing loan.[19]

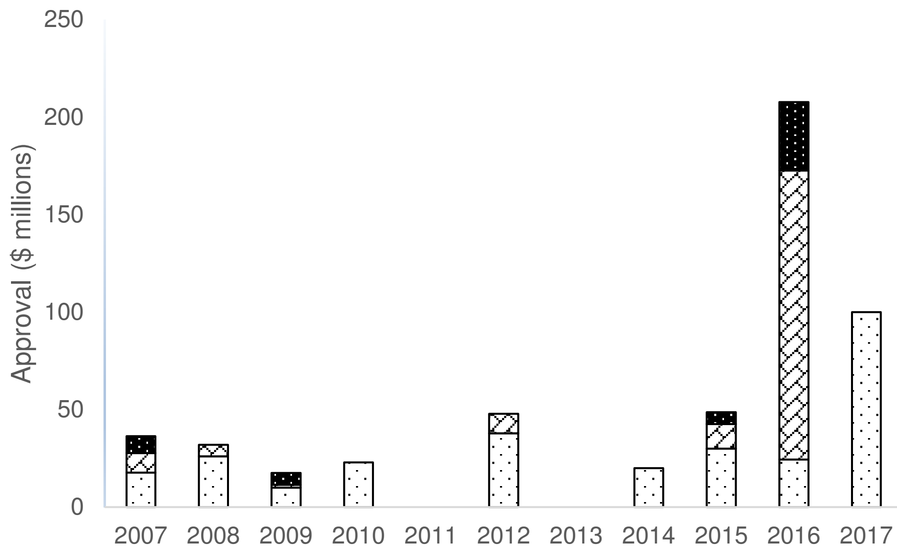
[18] ADB. 1977. *Technical Assistance Operations*. Manila.

[19] ADB. 1997. *Review of the Bank's Technical Assistance Operations*. Manila. Under the current policy, a TA loan may be used to prepare a corresponding project, whereas a TA program loan supports the preparation of multiple projects. The list of specific projects to be supported by each subproject under the TA program loan may be identified after

19. TA loans may be repaid or refinanced under an ensuing loan. TA loans financed by concessional ordinary capital resources (OCR) carry the same terms as project loans financed by concessional OCR. TA loans financed by regular OCR have a repayment period of 15 years, including a 3-year grace period, and do not carry any commitment charges.[20]

20. The current business process for preparing a TA loan is essentially the same as processing a project loan, except that no concept clearance is required if a TA loan proposal has been included in the country program for the developing member country (DMC) concerned.[21] Unlike the PDA and transaction TA proposals, all TA loans are submitted to the Board for consideration regardless of their size and the fact that they consist largely of consulting services and related support costs. Because of the high transaction costs of processing TA loans, which require an average of 8.4 months[22] from concept paper approval to Board approval, this modality is better suited for the preparation of very large or complex investments or for a pipeline of investment projects.

**Figure A1.3: Number and Size of Technical Assistance Loan Approvals, 2007–2017**




Note: Patterned blocks are used to distinguish the number and size of a technical assistance loan approved in a year, e.g., in 2016, three technical assistance loans were approved ($35.00 million, $148.20 million, and $24.42 million).
Source: Asian Development Bank.

21. As with the PDF modality, there has been limited use of the TA loan modality for project preparation. ADB approved only 19 TA loans during 2007–2017 (Figure A1.3).[23] The size of the approved TA loans over this period ranged from $1.5 million to $148.2 million. The average TA loan size is about $28.94 million, or $16.75 million when two exceptionally large recently approved

loan approval and need not be confined to a sector. After Board approval of the TA program loan, each subproject is approved by the President.

[20] TA program loans carry the same financing terms as TA loans.

[21] ADB. 1988. *Streamlining of Technical Assistance Loan Operations*. Manila.

[22] This estimate is based on an analysis of recently approved TA loans.

[23] This figure includes two additional financing operations that were approved for two TA loans.

TA loans are excluded.[24] TA loans to Bangladesh (5) and Viet Nam (4) accounted for almost half (47%) of all TA loans approved during this period.

22. In Bangladesh, Indonesia, the Philippines, Sri Lanka, and Viet Nam, TA loans have been used to set up PPFs to support the preparation of multiple projects, including feasibility studies, and detailed engineering designs, as well as broader project implementation capacity development activities for executing and implementing agencies (Box A1.2).[25] Experience from PPF TA loans in the South Asia transport sector has been positive in supporting project pipeline development and high project readiness. In Viet Nam, where the same government review and approval procedures apply to both PDAs and investment projects, the TA loan modality was chosen over a PDA since a TA loan requires a one-off approval that could be used to prepare multiple projects.

**Box A1.2: Technical Assistance Loans as Project Preparation Facilities**

**Bangladesh: Subregional Transport Project Preparation Facility.** The Asian Development Bank (ADB) Board of Directors approved a technical assistance (TA) loan of $23 million on 3 November 2010 to support the preparation of high-priority transport projects with a subregional impact in Bangladesh. Activities supported through the TA loan have included the preparation of feasibility studies and detailed engineering designs as well as the preparation of safeguards documentation. Based on the success of the TA loan in improving project readiness of ADB-financed investments, ADB approved additional financing of $30 million on 28 September 2015 to scale up project preparation activities under the facility.

**Sri Lanka: Road Project Preparatory Facility.** The Board approved a TA loan of $15 million on 13 April 2004 to support road project preparation activities. The TA loan was intended to support high project readiness of ensuing ADB-financed projects as well as to enhance road agencies' capacity to implement road projects. Activities financed by the TA loan included the preparation of feasibility studies, detailed engineering design, environmental and social assessment, land acquisition and resettlement plans, tender documents, and support for the bidding process.

Source: ADB.

23. In line with ADB's growing role as a knowledge bank that provides services to DMCs for the design of bankable projects, ADB approved a $100 million TA loan for the Philippines in 2017 to support improved project planning and preparation, including feasibility studies and detailed engineering design activities, for public-financed projects.[26] In 2016, ADB approved $148.2 million for a TA loan to Indonesia with a similar objective.[27]

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[24] ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Loan to the Republic of Indonesia for the Accelerating Infrastructure Delivery through Better Engineering Services Project*. Manila ($148.2 million); and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Loan to the Republic of the Philippines for the Infrastructure Preparation and Innovation Facility*. Manila ($100.0 million).

[25] ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Subregional Transport Project Preparatory Facility*. Manila; ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Loan to the Democratic Socialist Republic of Sri Lanka for the Road Project Preparatory Facility*. Manila; and ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Loan to the Socialist Republic of Viet Nam for the Project Preparation and Start-Up Facility*. Manila.

[26] ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Philippines Infrastructure Preparation and Innovation Facility*. Manila.

[27] ADB. 2016. *Report and Recommendation of the President to the Boards of Directors: Accelerated Infrastructure Delivery through Better Engineering Services Project*. Manila.

## C. Proposal

24. This paper proposes several changes to the TA loan modality to enable faster delivery of financing for project preparation and detailed engineering design activities. Given the similarities between TA loans and PDAs and the low usage of the PDF, this paper proposes not to mainstream the PDF. It is proposed to refine the TA loan by incorporating streamlined features of the PDF and to rename it project readiness financing (PRF). The PRF modality will provide many of the same efficiency benefits offered by the PDF. This will help ADB respond more flexibly to continued demand from a small number of DMCs for project preparation and design support to prepare ensuing ADB-financed loans with a high level of implementation readiness.

25. TA loans will only finance consulting services, related support costs, and limited pilot-testing activities. TA loans may be used to prepare and design emergency loans and projects under multitranche financing facilities, and to prepare policy-based loans and results-based loans.

26. **Simplified business process and documentation.** The current business process and documentation requirements for preparing a TA loan are largely the same as processing an investment project. This is even though TA loans, which consist largely of consulting services and related support costs, are more akin to transaction TA operations (footnote 21). Transaction TA follows a much simpler business process and uses simplified documentation. There has been a substantial delegation of transaction TA approval authority from the Board to Management.[28] Since TA loans can be considered as inputs into larger ADB-financed projects, much of the supporting due diligence assessments are presented twice: once for the TA loan proposal and again for the ensuing loan proposal. This results in inefficiencies and increases the time required to provide project design support to ensure high project readiness.

27. PDA proposals under the pilot PDF are presented for Management approval using simplified documentation. This reduces staff time and the resources needed to prepare PDA proposals. This paper proposes to adopt a format similar to PDA proposals for streamlined TA loan documentation which is submitted to the board for consideration. TA loan proposals will be required to present the result of governance due diligence assessments covering financial management, procurement, anti-corruption, policy and legal, capacity, and other institutional issues and mechanisms. They may also require e technical due diligence to be presented to ensure that the engineering designs to be financed by the TA loan will reflect best practice and will address any identified issues such as assessed climate change risks. Also, where pilot-testing is proposed, environmental and social safeguards due diligence will be undertaken, and the results presented in the TA loan proposal.

28. Finally, TA loans are considered as an input to an ensuing loan, since it is the actual follow-on physical investments under a project loan that will allow economic and financial benefits of a TA loan to be realized. Outputs produced under a TA loan, such as engineering designs and bidding documents, have little value without the resulting physical investments. As a result, this paper proposes to assess the economic and financial returns of a TA loan as part of the economic and financial analyses of the investments to be financed under the ensuing ADB-financed project loan.[29]

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[28] For example, Management may approve transaction TA up to $5 million financed by ADB Special Funds, and the President may approve the administration of all cofinancing for transaction TA.

[29] Detailed engineering designs will not be financed until proposed investments have been demonstrated to be feasible.

29. **Delegation of approval authority for small-value technical assistance loans**. To ensure that resources can be provided quickly for relatively small and low-risk project design activities, this paper proposes to delegate the authority to approve TA loans up to $15 million to the President. The President will further delegate approval of such loans to the vice-president of the relevant operations group. TA loans generally finance only consulting services and related support costs and, therefore, have a safeguard category of C in most cases. Should a TA loan have a safeguards Category of A for environment, resettlement or indigenous people, it will not be delegated to Management for approval, even when the value is $15 million or less. The size of the proposed ceiling is based on the successful experience with delegated approval arrangements during the pilot PDF period for PDAs with a value of up to $10 million or 4% of the ensuing loan value, whichever amount is larger. Since it is anticipated that a TA loan will support the preparation of multiple ensuing projects (para. 32), the proposed $15 million threshold is considered to be reasonable. There has also been a strong performance record with the delegation of transaction TA, which is approved by Management up to a limit of $5 million, when financed by ADB's Special Funds. Management will inform the Board of approval of each TA loan through the circulation of an information paper, following TA loan approval. Management's approval of small-value TA loans will also be subject to a maximum management commitment authority of $100 million per year.

30. **More flexible refinancing arrangements.** Under ADB policy, TA loans and PDAs may only be refinanced under the linked ensuing projects loans.[30] For ongoing loans, proposals to use surplus loans proceeds for activities that are not directly related or otherwise of any immediate help to the project may be considered in exceptional circumstances under the current policy.[31]

31. This paper proposes that a TA loan may be refinanced under any ensuing loan to the same borrower. Similarly, it proposes to use an ongoing project's surplus loan proceeds to refinance a TA loan to the same borrower, in lieu of cancellation, through a change in project scope. Where external loan and/or grant proceeds are involved, there should be prior consultation with the Office of Cofinancing Operations to ensure the co-financier's agreement. It is expected that such a measure will help to address the reluctance of some DMCs to seek separate financing approval for a TA loan in advance of the ensuing loan. Because it is simpler for many DMCs to amend an existing loan agreement than seek approval for a new loan, this may facilitate the use of TA loans.

32. **Project design support for multiple projects**. TA loans are increasingly being used as PPFs to support the design of multiple projects. This has proven to be an efficient and effective means of supporting the preparation and detailed design of a whole portfolio of projects under a single TA loan operation.[32] All projects to be designed under such PPFs need not be identified at the time of TA loan approval. However, ADB and the borrower should agree on the criteria to be used for identifying and selecting eligible subprojects at the time of TA loan approval.[33]

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[30] That is, the ensuing loans that were prepared by the TA loan or PDA.

[31] ADB.1983. *Streamlining of Loan Administration.* Manila.

[32] TA loans have been used in this manner in the Bangladesh and Sri Lanka transport sectors as well as in multiple sectors in Indonesia, the Philippines, and Viet Nam.

[33] The approach to be adopted will be similar to that used for sector loans. Under a sector loan, sample subprojects are presented in the financing proposal as the basis for Board approval. The financing proposal also includes subproject eligibility and selection criteria to guide the selection of future subprojects to be financed by the loan, which are identified during project implementation.

33. **Renaming technical assistance loans as project readiness financing.** Consultations have indicated that there is confusion among DMCs between transaction TA, which supports project preparation and is generally financed on a grant basis, and TA loans because of the similar names. This has sometimes created the expectation that TA loans should be grant-financed like transaction TA.[34] Similarly, when TA loans are financed by Asian Development Fund grants, the term "TA grant" becomes confused with transaction TA. The Strategy, Policy and Review Department will prepare a new operations manual that sets out the policy for PRF and a linked staff instruction that sets out the procedural requirements for processing PRF.[35]

34. **Eligible activities for project readiness financing**. Under the current policy (footnote 18), TA loans support project preparation and design activities.[36] Project implementation support should normally be financed as part of the ensuing loan. Where financing for nonphysical investments unrelated to project preparation is required, or where a borrower has requested project preparation assistance but ADB is not expected to finance the investments under an ensuing loan, such loans should be processed as project loans and administered under the sovereign lending policy.[37] PRF may, however, finance broader capacity building for future projects in areas such as procurement, safeguards, financial management, institutional strengthening and gender mainstreaming to build a DMC agency's capacity to implement one or more ensuing projects.

35. In addition, where DMCs have insufficient capacity to initiate basic project start-up activities in a timely manner, PRF may be used to finance initial start-up activities. This may include the procurement of small-value contracts for goods[38] and consulting services. However, such expenditures should be limited to the minimum level required to initiate project start-up, after which the ensuing loan will be used to finance project implementation activities.

36. **Financing terms.** No changes to the current TA loan financing terms are proposed.

37. **Reporting**. For loan commitment reporting purposes, even when PRF is refinanced under an ensuing or other ADB-financed loan, both the committed PRF and the other loan amount will be reported separately with an explanation of the refinancing arrangements that apply.

38. **Evaluation**. A completion report will be required when PRF does not result in an ensuing ADB-financed loan or where PRF is supporting the preparation and design of more than one ensuing loan. Otherwise, a completion report will not be required, and the performance of PRF will be assessed as part of the project completion report for the ensuing loan.

39. **Outreach to raise awareness about project readiness materials.** To ensure that there is sufficient ADB staff and DMC awareness on PRF and the related business process, ADB will

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[34] Processing of TA loans follow ADB. 2017. Sovereign Operations. *Operations Manual*. OM D11. Manila.
[35] The pilot period of the PDF was extended until 31 December 2018. Transitional arrangements will be established for PDA and TA loan proposals that are already in the processing stage, and such proposals may be approved as PDAs or TA loans (if it is not practical to convert to PRFs) up to 31 December 2018. The PDF policy applies to PDAs that were already approved, while ADB's sovereign lending policy applies to ongoing TA loans.
[36] This may also include upstream project pipeline development, sector studies, and investment plans, which are required to identify priority investments to be financed under an ensuing project.
[37] For example, a project loan for capacity building that supports the implementation of a policy-based loan (PBL), may be presented with the PBL proposal in one report and recommendation of the President. A PBL and a linked project loan for capacity building will be distinguished from a sector development program since in such cases the project loan will not finance any physical investment. Where an operation consists of a PBL and a project loan that finances physical investments, the sector development program policy will apply.
[38] For example, this may include equipment and furniture to establish a project management office.

allocate sufficient resources to design and deliver an effective outreach campaign. Activities will include briefings for ADB staff and DMCs, as well as developing reference materials. Staff from ADB's Strategy, Policy and Review Department will also join country programming and project teams as requested by regional departments to provide hands-on support for processing PRF.

40. **Other project readiness financing sources.** TA loans are normally financed through regular OCR, concessional OCR, or ADB-administered cofinancing. TA loans may only be financed on a grant basis for DMCs that are eligible for Asian Development Fund grants, and/or where grant cofinancing is available. Consultations with DMCs have indicated that some borrowers are still reluctant to use loan financing to fund detailed engineering design activities before approval of an ensuing loan. ADB will explore the feasibility of establishing a fund that can be used to finance TA loans initially on a grant basis. To ensure the sustainability of such a fund, financing would be subject to cost recovery if a project loan ensues.

## D. Development Impact of Proposed Measures

41. The proposed measures are expected to result in more efficient processing of project design support either through (i) the preparation of a single PRF proposal to cover the design of multiple ensuing loans, which will result in greater efficiencies compared with processing design assistance individually for each ensuing project; or (ii) faster processing of stand-alone PRF through more efficient procedures. Processing time is expected to drop from the current 8.4 months for TA loans to an average of 6 months for regular PRF and 3–4 months for small-scale PRF.[39]

42. The greater flexibility and streamlined processing approach offered by PRF may induce more borrowers to request PRF to support high implementation readiness of ensuing projects, particularly when combined with greater outreach efforts to raise awareness of this modality.

[39] It required about 10 months to process a PDA, but this was because consultant recruitment must be substantially completed before PDA approval. Given that it can take around 6 months to recruit a consulting firm, this adds significant time to the PDA processing time frame.

## SMALL EXPENDITURE FINANCING FACILITY

### A. Background and Issues

1. **Consulting services.** Despite reviews of operations continually emphasizing project readiness,[1] some projects do not achieve it because they lack a detailed engineering design (DED) at approval of investment loan. The consulting services that prepare DEDs are often financed as part of investment loans, rather than separately supported before the investment loan, because (i) the grant funding source for transaction Technical Assistance (TA) is limited and (ii) the current policy[2] does not allow transaction TA that is funded by the Technical Assistance Special Fund—the main funding source of transaction TA—to finance DEDs.[3] Combining DED and capital investment in one loan results in slow project start-up with limited disbursements initially.

2. Although the Asian Development Bank (ADB) may provide loans that cover only consulting services (i.e., TA loans) for DEDs, it is not efficient for ADB and its borrowers to prepare small stand-alone TA loans separately from investment loans. ADB introduced the project design facility (PDF) in 2011 to simplify its approval process for financing consulting services. However, the approval process of governments has not been always simplified, and some countries follow the same approval process for regular investment loans and TA loans. Appendix 1 provides a detailed analysis of TA loans and the PDF.

3. **Small equipment, works, and services.** Small equipment, works, and services are often financed as part of major investment projects. When small equipment, works, and services are required before or after a major investment project, they tend to be excluded from the project scope and are not implemented despite their potential importance. Many borrowers are not willing to extend the project implementation period just for small expenditure items, and it is tedious to prepare a separate loan for each of them.

4. For example, pilot testing is required to be carried out before an investment project. Some activities may also be required after the investment project—e.g., equipment or services for operations and maintenance (O&M). These activities are particularly important for projects using high-level technologies since they require (i) pilot programs to test the applicability of technology or (ii) service contracts with professional service providers. The costs of these activities are incurred before or after the investment project, so there is no ongoing project that can be used to finance them. Because the expenditures are relatively small, the government and ADB do not have an incentive to make a stand-alone loan for them.

5. Governments sometimes face unexpected and urgent financing needs. For example, natural hazards may damage critical infrastructure and cause governments to appeal for international aid for urgent financial support. External funding is especially important for less developed countries with limited fiscal resources. Humanitarian relief is not ADB's mandate, but prompt disaster rehabilitation is an important ADB operation that leads directly to longer term development efforts. Developing member countries can tap the Asia Pacific Disaster Response Fund for immediate expenses to restore life-saving services, but the available resource is limited to $3 million per incident. An emergency assistance loan may also be prepared. Although it can

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[1] For example, ADB. 2017. *2016 Annual Portfolio Performance Report*. Manila.

[2] ADB. 2002. *Review of the Management and Effectiveness of Technical Assistance Operations of the Asian Development Bank*. Manila.

[3] Excluding TA funded with a donor's trust funds that allow funding DEDs.

be prepared more rapidly than a regular loan, it still requires loan negotiations and signing at a time when governments' administrative capacity is limited. Even without disasters, governments may face unexpected financing needs. For example, if an accident were to damage a sewer after completion, quick rehabilitation would be required to avoid serious environmental damages.[4] ADB does not have a product to quickly respond to these unexpected financial needs.

6. **ADB's business process.** ADB cannot quickly prepare a loan and provide financing even for small, relatively low-risk activities. Commercial banks provide a line of credit, often in parallel with a project loan, to respond quickly to clients' small financial needs. ADB does not have an equivalent financial product, and its existing products and their business processes are primarily designed for large investment projects.[5] The Board of Directors even needs to approve small or low-risk projects, such as TA loans, through standard business processes. Exceptions include the PDF and Faster Approach to Small Nonsovereign Transactions (FAST). For these modalities, the Board approves the overall framework, under which Management approves individual activities.

## B. Proposal

7. This paper proposes to introduce the small expenditure financing facility (SEFF). The SEFF is a facility to finance multiple small activities. If the Board approves the facility, the borrower could propose eligible activities under it and ADB could fund them through simple business processes. The SEFF would help ADB to respond quickly to DMCs' small financing needs.

### 1. Eligible Expenditures

8. A SEFF can finance the following expenditures:[6]
   (i) consulting services that support project preparation and implementation, such as feasibility studies, detailed engineering design, bidding support, safeguard assessments, surveys for impact assessment, and capacity building;[7] and
   (ii) small equipment, works, and services that are associated with an ADB-financed project, such as pilot testing and other preparatory works, O&M service contracts,[8] post-disaster early recovery, and rehabilitation works.[9]

9. Activities supported under the SEFF should adhere to the following criteria:[10]
   (i) The total estimated contract values per activity should not exceed $15 million.
   (ii) They are associated with an ADB-financed project and support its preparation or implementation.

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[4] This happened in Cambodia. An ADB project built a sewer that was later damaged by an accident. ADB could not prepare funding or repairs, and the government resorted to another donor to rehabilitate the facility.

[5] While financial intermediary loans, policy-based loans, and results-based loans are not used to finance large investment projects, they are not designed to support small expenditures to complement investment projects.

[6] Ancillary expenditures—such as taxes and duties, local transportation and insurance, and bank charges—and capitalized interest during construction can also be financed.

[7] The expenditure may include payments for ADB's reimbursable TA and transaction advisory services.

[8] The O&M services may be part of a public–private partnership concession contract, under which the government makes payment to the concessionaire as long as the facility is made available for use (e.g., availability payments and service payments).

[9] When emergency rehabilitation is included as an eligible expenditure, discussions during country programming need to ensure consistency with the possible use of policy-based loans as contingent financing for disasters triggered by natural hazards.

[10] SEFFs only finance consulting services and small works and equipment, and are unlikely to have a *category A* safeguard classification. Should an activity under SEFF have a *category A* classification, Board approval should be sought for a major change in scope of the SEFF and such activity.

10. For each facility, the borrower and ADB would agree what types of expenditures would be covered and describe them in the legal agreement. Once the facility was established, the borrower and ADB would discuss potential activities to be supported under it during country programming missions and other occasions.

11. A SEFF can be established at the national level to cover all activities in the borrowing country or can be limited to a specific sector or entity (i.e., state or provincial governments, line ministries, agencies, or state-owned enterprises). For example, if a provincial government plays an important role and expects sizable ADB operations, a SEFF could be established for it. A SEFF for an entity (e.g., state or provincial governments and state-owned enterprises) could be funded through (i) on-lending through the government to the entity or (ii) direct lending to the entity with a government guarantee.

### 2. Facility Size

12. The facility size will be discussed and agreed with the borrower for each facility, subject to the following conditions.

(i) For facilities funded with regular ordinary capital resources (OCR), the facility size should not exceed 20% of the average annual commitments of regular OCR in the last 3 years or $150 million, whichever value is smaller.[11]

(ii) For facilities funded with concessional OCR or the Asian Development Fund (ADF), the facility size should not exceed 20% of the average annual performance-based allocation (PBA) of the country concerned.

(iii) Notwithstanding items (i) and (ii), the facility size can exceed 20% of the annual commitment or PBA, but not more than $10 million, to ensure a reasonable facility size in small DMCs.

13. For countries with access to different financing sources, the facility size funded with each financing source should follow the conditions in para. 12. For example, if a DMC has access to concessional OCR loans and ADF grants, the facility size funded with concessional OCR loans (or ADF grants) should be limited to 20% of PBA of concessional OCR loans (or ADF grants).

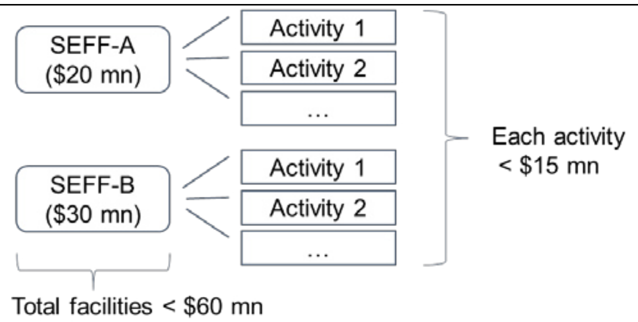
14. Multiple SEFFs could be established in a country if the sum of facilities established in the country does not exceed the maximum facility size of the country as specified in para. 12 (Box A2.1).[12] The central government should assess and manage the total size of SEFFs in the country, as is the case for regular sovereign loans.

[11] Commitment is the amount of the loan that is signed and made effective.

[12] If the country has access to different financial resources from ADB (e.g., concessional OCR loans and ADF grants, or regular OCR loans and concessional OCR loans), each SEFF funded with a particular resource should follow the conditions in para.12.

**Box A2.1: An Illustration of Facility Size**

Suppose a country with $300 million of the average annual commitments of regular ordinary capital resources (OCR). The size of the small expenditure financing facility (SEFF) in the country cannot exceed $60 million (= $300 million x 20%). If the country has two SEFFs (SEFF-A and SEFF-B), the total size should be less than the country cap ($60 million < $20 million + $40 million).




mn = million.
Source: Asian Development Bank.

### 3. Financing Terms

15. When funded of regular OCR, the lending terms are the same as the standard terms, except for the following modifications:

(i) **Repayment period.** The period is a 5-year tenor from the commitment of each activity with a bullet repayment (i.e., all principals of each activity are repaid in the fifth year from the commitment of the activity);

(ii) **Interest spread.** There will be an interest deduction of 20 basis points from the standard spread for a shorter tenor. Based on the current spread of 50 basis points, the net spread will be 30 basis points.[13] Any rebates or surcharges apply in the same manner as the standard loan; and

(iii) **Other charges.** No commitment fee but a front-end fee of 15 basis points for the facility upon effectiveness and subsequent rollovers.

16. When funded with concessional OCR or ADF, the financing terms are the same as the standard terms of concessional OCR loans and ADF grants.[14]

### 4. Revolving and Refinancing

17. **Revolving.** When funded with regular OCR loans or concessional OCR loans, the SEFF may be a revolving facility. New commitments can be made if the total net commitments (i.e., total cumulative commitment minus total cumulative repayments) do not exceed the facility size (Box A2.2). As the principals are repaid, new commitments can be made multiple times. Funds revolve over a relatively short period through refinancing for regular OCR loans or concessional OCR loans, and through a shorter repayment period for regular OCR loans. When funded with ADF grants, the SEFF will be a facility without revolving funds.

18. **Refinancing.** A disbursed portion of a SEFF that is funded with regular OCR loans or concessional OCR loans can be refinanced by an ensuing loan or surplus loan proceeds under

[13] The current terms of regular OCR loans include a base rate (6-month London Interbank Offered Rate), standard spread (50 basis points), maturity premium (0–20 basis points), commitment charge (15 basis points), and no front-end fee. The interest payment can be deferred until the refinance or end of the facility period. The spread may be updated at the rollover using effective spread at rollover.

[14] The terms will be determined by the country classification at the time of commitment of each activity.

an ongoing loan to the same borrower.[15] Using surplus loan proceeds will require a change in scope of the original loan.

19. The refinancing addresses possible concerns of the borrower with the shorter repayment period of the SEFF funded with regular OCR loans. Refinancing is an option for the borrower, and the borrower may continue to make repayments in accordance with the repayment schedule under the SEFF.

20. **Rollover.** The SEFF has a fixed facility period of 5 years for new commitments. Within the facility period, ADB can make commitments for new activities and sign the short form agreements. To the extent possible, the facility period should be synchronized with the period of the country partnership strategy. At the end of the term, the SEFF can be rolled over for an additional term of 5 years subject to Board approval.

**Box A2.2: A Simplified Example of Revolving Small Expenditure Financing Facility**

Suppose the following scenario:

Year 0: A SEFF is approved with a facility size of $15 million.

Year 1: Consulting service A ($8 million) is prepared and agreed upon. Funds are disbursed in year 1–2. The disbursed portion for the consulting service A is refinanced by the ensuing loan in year 3.

Year 2: Pilot testing B ($5 million) is prepared and agreed upon. Funds are disbursed in year 2. The disbursed portion for the pilot testing B is repaid in year 7.

Year 4: Rehabilitation works C ($7 million) is prepared and agreed upon. Funds are disbursed in year 4. The disbursed portion for the rehabilitation works C is refinanced in year 9.

| | Y1 | Y2 | Y3 | Y4 | Y5 | Y6 | Y7 | Y8 | Y9 |
|---|---|---|---|---|---|---|---|---|---|
| **Consulting service A** | | | | | | | | | |
| Commitment | 8.0 | | | | | | | | |
| Disbursement | 5.0 | 3.0 | | | | | | | |
| Principal repayment | | | 8.0 | | | | | | |
| Net commitment | 8.0 | 8.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Pilot testing B** | | | | | | | | | |
| Commitment | | 5.0 | | | | | | | |
| Disbursement | | 5.0 | | | | | | | |
| Principal repayment | | | | | | | 5.0 | | |
| Net commitment | | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 0.0 | 0.0 | 0.0 |
| **Rehabilitation works C** | | | | | | | | | |
| Commitment | | | | 7.0 | | | | | |
| Disbursement | | | | 7.0 | | | | | |
| Principal repayment | | | | | | | | | 7.0 |
| Net commitment | | | | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 | 0.0 |
| **Total net commitments** | 8.0 | 13.0 | 5.0 | 12.0 | 12.0 | 12.0 | 7.0 | 7.0 | 0.0 |

Under this scenario, the net commitments increase to $13 million in year 2 but subsequently reduce in year 3 because of refinancing consulting service A. As a result, the Asian Development Bank can make a new commitment for rehabilitation works C in year 4. The total commitment ($8 + $5 + $7 = $20 million) exceeds the facility size ($15 million), but the net commitment ($20 - $8 = $13 million) is below the facility size ($15 million).

SEFF = small expenditure financing facility, y = year.
Source: Asian Development Bank.

15 Prepayments, including those through refinancing, are possible without penalty in accordance with ADB's standard regulations.

21. The facility size may be amended subject to the conditions described in para. 12, based on the annual commitment size or PBA at the time of the rollover. The spread may be updated when the SEFF is rolled over by using the effective spread at the time of rollover.

### 5. Business Process

22. **Programming and resource allocation**. The use of a SEFF could be discussed during country programming missions and other occasions, and country operations business plans could indicate activities that could be supported. It will not be mandatory for an activity to be listed as supported under a SEFF for the activity to be approved since the timing and size of disbursements are uncertain.

23. ADB starts using commitments rather than approvals to manage resources and monitor performance. For SEFF, the total commitments of activities within the year—rather than the approval of the SEFF—will be counted against the allocated resources for resource management and be reported for performance monitoring.

24. When a SEFF is financed with concessional OCR loans or ADF grants, the PBA of the concerned country will be consumed when individual activity is committed through the signing of a short form agreement. Further, when a SEFF is financed with concessional OCR loans and the disbursed portion is refinanced by an ensuing loan, the commitment of the ensuing loan will consume the PBA of the concerned country in the amount of the total loan approval net of the loan amount for refinancing.

25. **Approval process**. The business process of SEFFs comprises processing the facility and activities to be supported under the facility. Processing a facility includes conducting due diligence of its framework, preparing a report and recommendation of the President, obtaining Board approval, and executing a facility agreement with the borrower.

26. Within the agreed framework, individual activities are identified and appraised through simplified business processes. Processing an activity includes conducting due diligence of the activity, preparing a concise report that summarizes the results of the due diligence, and having a short form agreement signed. ADB and the borrower will confirm the agreement legally through a letter.

**Table A2: Processing of the Facility and Activities**

| | **Facility** | **Activities under the facility** |
|---|---|---|
| Main elements of due diligence | Eligible expenditures, implementation arrangements, facility size | Scope and costs, economic and financial analysis, safeguard assessments, procurement, and financial management capacity |
| Documentations | Report and Recommendation of the President | A report on the activity |
| Legal documents between the Asian Development Bank (ADB) and the borrower | Facility agreement | Short form Agreement from ADB to be countersigned by the borrower |

Source: ADB.

### 6. Other Matters

27. **Cofinancing.** Cofinancing with one or more third parties can fund activities under SEFFs. For example, expenditures for pilot testing can be funded partly with loan proceeds from a SEFF and partly with concessional financing from a trust fund. Financing from third parties could also be used to refinance the disbursed portion of a SEFF. The cofinancier and ADB will specify activities to be cofinanced under the SEFF in the cofinancing agreement.

28. **Compliance with policies and guidelines.** The SEFF follows standard policies and guidelines of sovereign operations for procurement, selection of consultants, disbursement, social and environmental safeguards, the public communications policy, anticorruption, integrity due diligence, and the prohibited investment list. Because activities supported under a SEFF are small and low risk, using alternative procurement arrangements or framework contracts for the supply of goods and small works or consulting services may be considered in line with provisions of ADB's Procurement Policy (2017, as amended from time to time).

29. **Safeguards.** Safeguard measures generally follow the procedures for sector loans. When a SEFF is appraised, the operation unit will prepare a draft environmental assessment and review framework, draft resettlement framework, and/or draft indigenous peoples planning framework, as required. A safeguard category will be assigned for each activity to be supported under the facility.

30. **Administration**. The administration of a SEFF—such as monitoring, disbursement, and change in scope—would follow the standard procedure of sovereign loans. The facility and ongoing activities can be cancelled or suspended during the implementation in accordance with standard procedures.

31. **Board reporting.** Approval of the SEFF would follow the standard procedure for Board approval. Management prepares and circulates to the Board an annual report that summarizes the activities approved.

## C. Expected Impacts

32. **Enhanced responsiveness.** By introducing the SEFF, ADB will enhance its responsiveness to clients' needs. The SEFF would enable ADB to support consulting services and small goods and works, which would not have been otherwise considered.

33. **Improved project readiness.** By providing easier access to funding of consulting services, DEDs and bidding documents would be more likely to be prepared at project approval. Start-up delays would be minimized with enhanced project readiness.

34. **Enhanced project sustainability.** By supporting the funding of professional O&M services, which tend to be excluded from ADB funding, a SEFF would enhance a project's sustainability and reduce its life cycle costs.

35. **Promotion of innovation.** By providing access to funds for pilot testing, SEFFs would promote the use of innovative initiatives and technologies under ADB projects.

# REVIEW OF ADDITIONAL FINANCING OPERATIONS

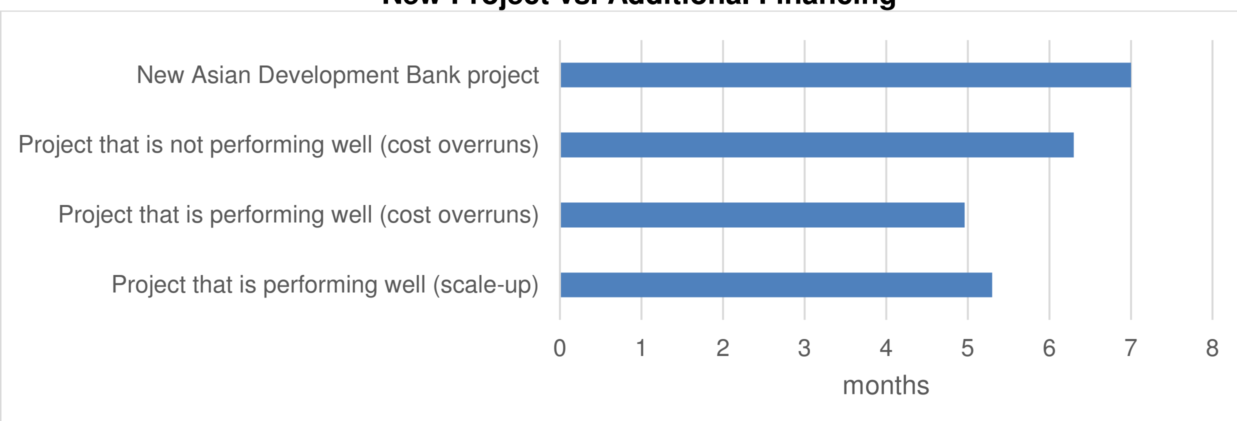
## A. Introduction

1. The Asian Development Bank (ADB) can provide additional financing to an ongoing operation to finance (i) changes in project scope, including scaling up successful operations or restructuring a project that is not performing well; (ii) cost overruns; (iii) financing gaps; or (iv) a combination of these. Scaling up a project involves carrying out additional activities that are similar to the original project scope to reach a greater number of beneficiaries.

2. ADB approved almost $3 billion from its own resources for 50 additional financing operations, which accounted for 3.5% of project loan and guarantee approvals during 2011–2017.[1] ADB also approved $732 million in ADB-administered cofinancing for 64 additional financing operations during the same period.[2] About 25 additional financing operations involving ADB's own resources are anticipated for 2018–2020.[3]

3. During 2012–2016, the average time for ADB to process a new loan was 7.0 months from fact-finding to Board approval.[4] Processing additional financing took an average of 5.3 months for projects that were performing well and 6.2 months for projects that were not performing well (Figure A3.1). Although the additional financing reforms introduced in 2010 have resulted in the faster delivery of additional financing, processing additional financing to scale up a successful project is only marginally faster than processing a new loan.[5]

**Figure A3.1: Average Processing Time, 2012–2016**
**—New Project vs. Additional Financing**




Source: Asian Development Bank.

4. A review of operations during 2011–2017 suggests there is scope to make the delivery of additional financing more efficient. Additional financing to scale up successful projects can strengthen the development impact of ADB operations without incurring as much risk as new projects that have not demonstrated a successful track record. This approach can also be more

[1] A single additional financing operation for an ongoing project may include more than one loan or guarantee. This figure excludes additional financing for seven individual multitranche financing facility tranches valued at $429.1 million, since additional financing for the individual tranches was within the overall approved facility amount.
[2] The additional financing operations only involved ADB-administered co-financing and no ADB resources.
[3] ADB. 2017. *Work Program and Budget Framework, 2018–2020*. Manila.
[4] ADB. 2017. *2016 Development Effectiveness Review*. Manila.
[5] ADB. 2010. *Additional Financing: Enhancing Development Effectiveness*. Manila.

efficient since additional financing activities build on existing project structures and can incorporate lessons from the initial project implementation phase.

5. While it is too early to assess the performance of the completed projects that were approved after the 2010 additional financing policy became effective, additional financing for scaling up has allowed ADB to be more flexible and responsive in meeting client needs (Box A3). An analysis of World Bank projects in the transport and information and communication technology sectors also indicates that projects that receive additional financing perform marginally better than projects that did not receive such financing.[6]

**Box A3: Expanding ADB's Development Impact in Timor-Leste's Transport Sector**

As a young nation, Timor-Leste faces significant challenges in building its physical infrastructure, institutional capacity, and human resources to support sustainable and inclusive growth. The country has 1,440 kilometers of national roads, of which only 5%–10% were in good condition in 2015. Since 70% of its population lives in rural areas, better road transport links are essential for improving access to social services and economic opportunities. The Asian Development Bank (ADB) has been supporting Timor-Leste's transport sector since 2000, and until 2009 the focus of its assistance was on periodic maintenance and rehabilitation of existing projects. ADB initiated a transformational approach in 2011 by supporting the reconstruction and upgrade of more heavily trafficked roads through the following investments:

(i) Road Network Development Sector Project, approved in 2009 with ADB financing of $46 million;
(ii) Road Network Upgrading Project, approved in 2012 with ADB financing of $40 million;
(iii) Road Network Upgrading Project (additional financing), approved in 2014 with ADB financing of $12 million;
(iv) Road Network Upgrading Sector Project, approved in 2013 with ADB financing of $50 million; and
(v) Road Network Upgrading Sector Project (additional financing), approved in 2015 with ADB financing of $76 million.

By the end of 2018, ADB is expected to have directly supported the upgrading of 280 kilometers or 20% of the national road network. Given weak planning and institutional and project implementation capacity, a multitranche financing facility was not considered suitable for supporting the government's national roads investment program. Instead, the use of additional financing has allowed ADB to remain flexible and responsive by scaling up ongoing projects in line with government demand and improving project implementation capacity.

Source: Asian Development Bank.

## B. Background

### 1. Policy Reforms, 1973–2015

6. ADB adopted its supplementary financing policy in 1973 to address project cost overruns and financing gaps.[7] The policy included certain restrictions to discourage the use of supplementary financing, such as requiring the borrower to first consider using its own resources. ADB would only consider providing supplementary financing if alternative financing on reasonable terms were not available.

[6] Independent Evaluation Group. 2015. *Learning Note: Additional Financing for Transport and Information and Communication Technology*. Washington, DC: World Bank.
[7] ADB. 1973. *Cost Overruns of Bank-Financed Projects and Supplementary Loans*. Manila.

7. The 2005 supplementary financing policy review identified widespread cost underruns in ADB-financed projects caused by the overestimation of project costs, which were attributed to the overly strict supplementary loan policy.[8] Because of the significant time and resources required to prepare loan proposals, staff were overly cautious in preparing cost estimates to avoid having to seek supplementary financing. The policy review concluded that better estimations would have resulted in (i) the approval of more smaller-sized loans, (ii) lower borrowing costs for developing member countries (DMCs) in the form of reduced commitment charges on undisbursed loan balances, and (iii) a more efficient commitment of ADB resources.

8. The policy review also introduced a more flexible and efficient approach to supplementary financing. Recognizing the important development impact benefits associated with such an approach, the policy was changed to allow supplementary financing to address cost overruns and to expand well-performing projects. These changes aimed to increase the relevance of supplementary financing, extend support to well-performing operations, cut processing times, and reduce cost underruns and loan cancellations. The 2005 revision led to an increase in the use of supplementary financing and may have also contributed to fewer loan cancellations during 2005–2010; however, no project used supplementary financing to expand well-performing operations.

9. In 2010, ADB renamed supplementary financing to additional financing (footnote 5). The revised policy aimed to build on earlier reforms and further reduce the time required to deliver additional financing. It also sought to promote the use of additional financing to scale up projects that were performing efficiently to expand ADB's development impact. ADB also introduced a differentiated business process linked to project performance under the 2010 additional financing policy. The process was substantially streamlined to reduce the overall time frame for the delivery of additional financing for well-performing projects. However, projects that are not performing well follow a lengthier business process since they are subjected to a greater level of scrutiny. The 2010 policy also simplified documentation requirements for processing additional financing to maximize efficiency by using existing loan documents and retaining, revising, and updating them as required to adequately present the additional financing proposal.

10. The 2010 policy also lifted the restriction that only ADB financing could be used to finance supplementary loans. Recognizing that ADB-administered cofinancing needed to be efficiently processed, it allowed Management to approve cofinancing of up to 15% of the original loan amount. This policy became effective in February 2011.

11. The 2010 policy also provides guidance on the use of additional financing in a multitranche financing facility (MFF). When ADB financing requirements exceed the original MFF allocation, Board approval is required to increase the overall size of the MFF. The President approves additional financing for the tranche when additional funding is needed to increase the size of individual tranches without changing the overall MFF size, outcome indicators, and targets.

12. Management's authority to approve ADB-administered cofinancing was expanded further in 2015 with the operational efficiency reforms, which allows the President to approve additional financing funded by ADB-administered cofinancing regardless of the amount.[9]

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[8] ADB. 2005. *A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs*. Manila.
[9] ADB. 2015. *Enhancing the Operational Efficiency of the Asian Development Bank*. Manila.

### 2. Eligibility and Performance Requirements

13. To be eligible for additional financing, a project must (i) remain technically feasible, economically viable, and financially sound; (ii) be accorded high priority by the government; (iii) be consistent with the project's development objectives; and (iv) be consistent with the current country partnership strategy.

14. To be considered performing well, a project must (i) deliver the expected outputs, (ii) have satisfactory implementation progress, (iii) comply satisfactorily with safeguard policy requirements, (iv) manage risks successfully, and (v) receive a project performance rating of *highly satisfactory* or *satisfactory*.[10] The operations department evaluates the performance of a project, and other departments carry out a quality assurance review of the proposal for additional financing. Projects should address any problems and be performing well for a reasonable period before additional financing could be approved (footnote 7).

### 3. Type and Size of Additional Financing Operations, 2011–2017

15. While most additional financing approvals were for sovereign project loans or sector loans, ADB also approved additional financing for one nonsovereign loan and two guarantee operations during 2011–2017. It also approved additional financing for seven individual tranches under MFFs (Table A3.1).

**Table A3.1: Additional Financing by Modality**

| Modality | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total |
|---|---|---|---|---|---|---|---|---|
| Guarantees | 0 | 0 | 0 | 0 | 1 | 1 | 0 | 2 |
| Nonsovereign project loans | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 1 |
| MFF tranches | 1 | 0 | 0 | 2 | 2 | 2 | 0 | 7 |
| Sovereign project loans | 8 | 5 | 4 | 5 | 9 | 8 | 2 | 41 |
| Sector loans | 0 | 0 | 0 | 2 | 1 | 1 | 2 | 6 |
| Technical assistance loans | | 0 | 0 | 0 | 1 | 0 | 0 | 1 |
| **Total** | **9** | **5** | **4** | **9** | **14** | **13** | **4** | **58**[a] |

MFF = multitranche financing facility.

[a] While the Board approved 50 additional financing proposals for ongoing projects during this period, one proposal sought the approval of both a loan and a guarantee; additional financing for seven individual tranches was also approved, where amounts were within the overall facility amount.

Source: Asian Development Bank.

16. Well-performing projects accounted for 81% of additional financing approvals funded by ADB.[11] More than half of the approved additional financing operations were to scale up the scope of activities for projects that were performing well (31 projects), about one-quarter were to address cost overruns (12), and the rest were to address a combination of reasons. In dollar terms, of the $2.95 billion approved for additional financing during 2011–2017, $2.22 billion (75.24%) was for scaling up, $481.30 million (16.31%) for cost overruns, and $249.38 million (8.45%) for a combination of reasons (Table A3.2).

[10] This rating system was replaced in June 2011 with the issuance of ADB. 2011. Project Performance Monitoring. *Project Administration Instructions*. PAI 5.08. Manila.

[11] This excludes purely cofinanced operations and additional financing processed for an individual tranche under an MFF, which are not categorized by project performance.

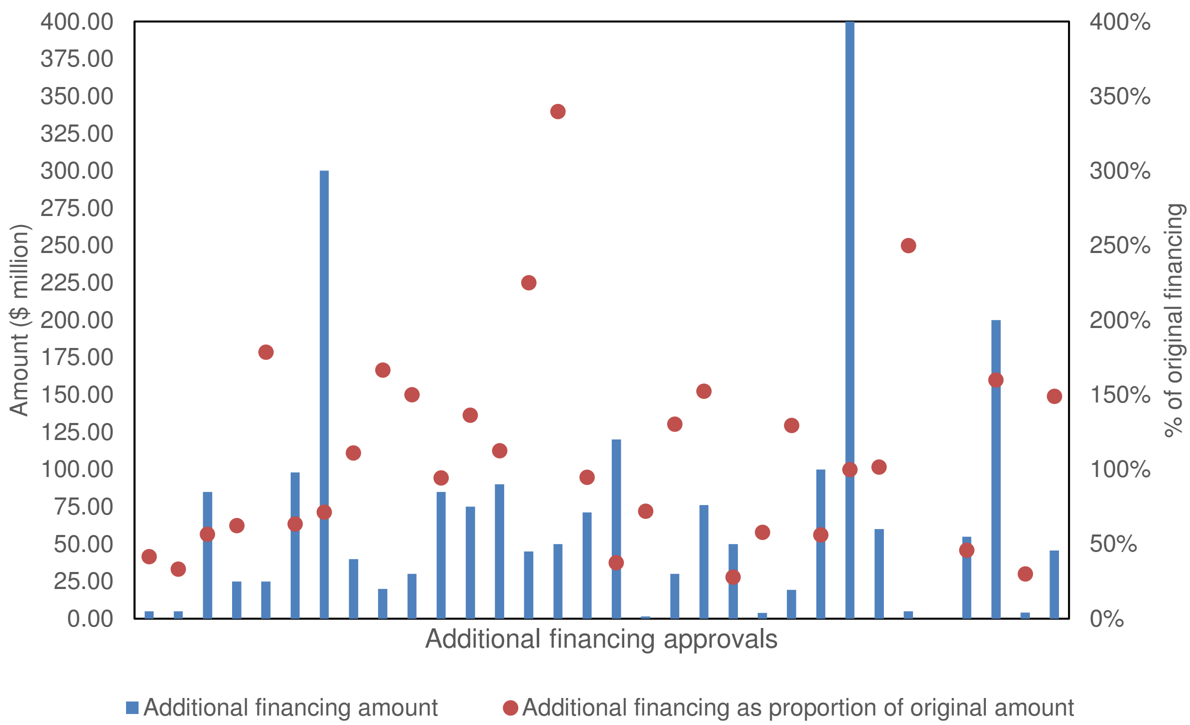
**Table A3.2: Reason for Additional Financing**
($ million)

| Reason | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total |
|---|---|---|---|---|---|---|---|---|
| Scale-up | 120 | 463 | 20 | 190 | 534 | 643 | 250 | **2,220** |
| Cost overrun | 22 | 40 | 51 | 172 | 67 | 9 | 120 | **481** |
| Combination | 149 | 0 | 25 | 42 | 18 | 15 | 0 | **249** |
| **Total** | **291** | **503** | **96** | **404** | **619** | **667** | **370** | **2,951** |

Source: Asian Development Bank.

17. The average size of additional financing was 111% of the original loan amount ($71.61 million) for scaling up, 33% for cost overruns ($40.11 million), and 83% for a combination of reasons ($35.63 million).[12] For 15 of the 31 additional financing operations that were approved to scale up projects that were performing well, the value of the additional financing was more than 100% of the original financing amount (Table A3.3). Figure A3.2 presents approved additional financing to scale up well-performing projects in dollar terms and as a proportion of the original amount.

**Figure A3.2: Size of Additional Financing for Scaling Up Well-Performing Projects**




Source: Asian Development Bank.

[12] Includes only additional financing using ADB's own resources and excludes additional financing for individual MFF tranches.

**Table A3.3: Additional Financing as Proportion of Original Financing**
(number)

| Proportion | Scale-Up | Cost Overrun | Combination |
|---|---|---|---|
| More than 100% | 15 | 1 | 2 |
| 75%–100% | 3 | 0 | 1 |
| 50%–75% | 7 | 0 | 2 |
| 25%–50% | 6 | 5 | 2 |
| Less than 25% | 0 | 6 | 0 |
| **Total** | **31** | **12** | **7** |

Source: Asian Development Bank.

### 4. Time Required to Process Additional Financing

18. Despite the significant streamlining of business processes for well-performing projects in the 2010 policy reform, the average processing time for additional financing to scale up the project scope was 5.31 months during 2011–2016 (slightly above the 5-month target in the 2010 policy paper) and 4.96 months to address cost overruns in well-performing projects (Figure A3.3). However, the average processing time for additional financing to meet cost overruns (including restructuring) for projects that were not performing well required 6.30 months, which is close to the average time of 7.00 months to process a new project over the same period.

**Figure A3.3: Average Processing Time for Additional Financing for Project Scale-Up**


Source: Asian Development Bank.

### 5. Project Performance of Additional Financing Operations

19. It is not possible to compare the performance of projects that have received additional financing since 2011 with the performance of regular loans. This is because many of the projects that have received additional financing since 2011 are still under implementation or have recently closed, and no project completion report is available.

### 6. Comparison with Other Multilateral Development Banks

20. ADB's additional financing policy is similar to the World Bank's policy, which was introduced in 2005 and allows additional financing for project scale-up and cost overruns. The Inter-American Development Bank also allows the use of supplementary financing to expand a project without changing the project description. Other multilateral development banks, such as the African Development Bank, limit the use of supplementary financing to cost overruns.

21. The World Bank has a relatively higher rate of usage of the additional financing modality than ADB. During 2007–2016, the World Bank processed an average of 54 additional financing operations for investment projects annually, accounting for more than one-fifth (22%) of total investment project approvals over the same period. Additional financing averaged 13.5% of approved commitments over the 5-year period ending in fiscal year 2016.[13] About 85% of additional financing approvals were for project scale-up. The high use of this modality may be explained in part by the fact that until 2017, additional financing was one of the few instruments that enabled the longer-term provision of financing in a programmatic manner. The World Bank introduced its multiphase programmatic approach (similar to ADB's MFF) in 2017.

22. Given the different project processing milestones used by ADB and the World Bank, it is not possible to directly compare processing times for additional financing. In 2016, on average, it took 14.4 months to process a new World Bank investment project from concept paper approval to board approval and 6.6 months to process additional financing operations from initiating memo approval to Board approval (Table A3.4). Based on consultations with World Bank staff, much of the time savings are captured in the early stages of processing because unlike new investment loans, a concept paper to seek approval for additional financing is not required. This is similar to ADB's additional financing business process for well-performing projects, where in most cases a concept paper is not required.[14]

**Table A3.4: Comparison of World Bank Approvals and Processing Time New Project vs. Additional Financing**

| | New Project[a] | | Additional Financing | |
|---|---|---|---|---|
| **Year** | **Number** | **Months[b]** | **Number** | **Months[b]** |
| 2013 | 159 | 16.0 | 49 | 7.5 |
| 2014 | 210 | 13.9 | 63 | 5.0 |
| 2015 | 192 | 13.7 | 47 | 7.3 |
| 2016 | 158 | 14.4 | 52 | 6.6 |

[a] Investment projects only.
[b] From concept paper (project) or initiating memo (additional financing) approval to financing approval.
Source: World Bank.

[13] World Bank. 2017. *Multiphase Programmatic Approach*. Washington, DC.
[14] A concept paper is only required when the additional financing is not listed in the country operations business plan or when transaction technical assistance to prepare the additional financing is proposed.

# CREDIT ENHANCEMENT PRODUCTS

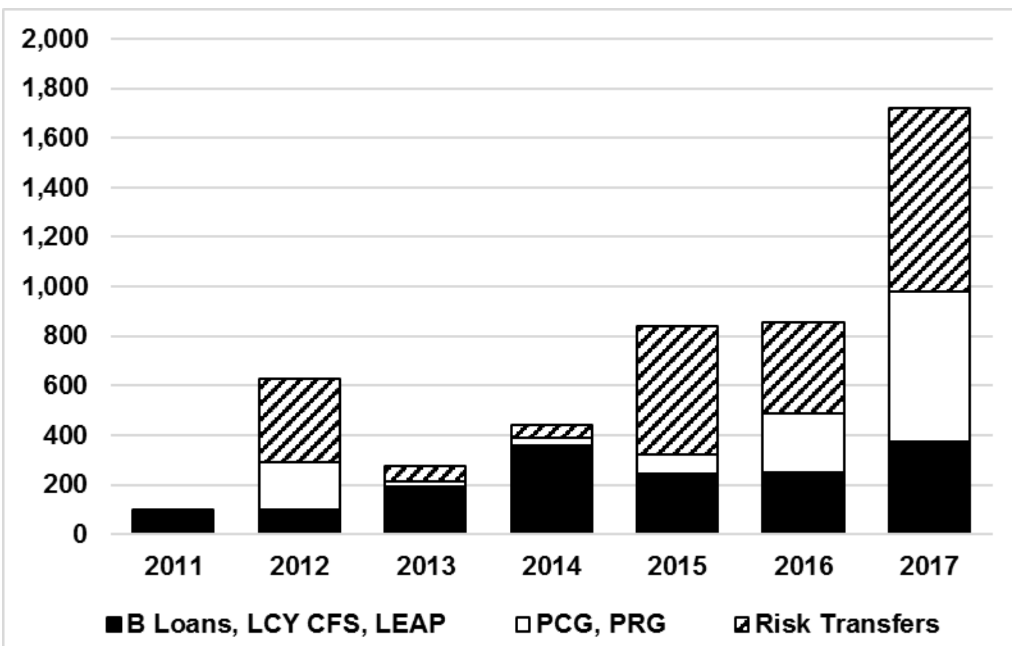
## A. Background

### 1. Overview of ADB's Credit Enhancement Product Operations

1. Given the large financing needs in Asia and the Pacific, the role of the Asian Development Bank (ADB) as a catalyzer of development finance is becoming increasingly important. Credit enhancement products (CEPs), such as lender-of-record structures, guarantees,[1] and risk transfer arrangements, can play an important role in catalyzing private capital for development purposes. CEPs catalyze private financing by mitigating risks for private financiers especially in the initial phase of their market entry. In a report published in 2017, the Independent Evaluation Department recommended that ADB should strengthen its deployment of CEPs.[2]

2. ADB's use of CEPs has grown in recent years, with CEP commitments for nonsovereign operations (NSO) increasing from $100 million in 2011 to $1,721 million in 2017 (Figure A4.1).

**Figure A4.1: Principal Amount of Credit Enhancement Products Committed**
($ million)




LCY CFS = local currency complementary finance, LEAP = Leading Asia's Private Sector Infrastructure Fund, PCG = partial credit guarantee, PRG = partial risk guarantee.
Note: Figures on top of bars indicate number of projects closed. Includes sovereign risk transfer arrangements.
Source: Asian Development Bank (Private Sector Operations Department).

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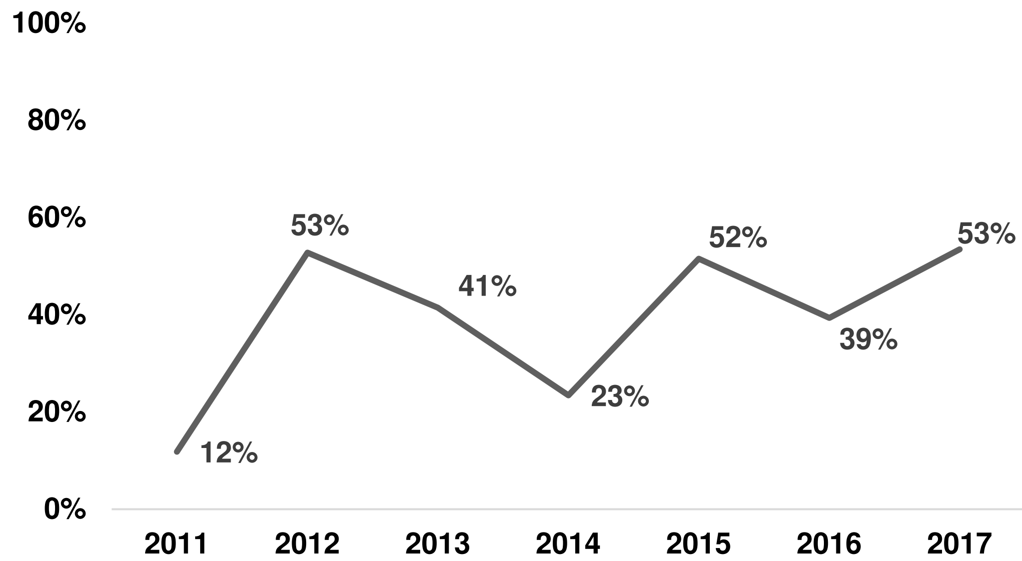
[1] In this paper, guarantees include risk participation where credit risk is transferred from third parties to ADB.
[2] Independent Evaluation Department. 2017. *Boosting ADB's Mobilization Capacity: The Role of Credit Enhancement Products*. Manila: ADB.

3. ADB's use of CEPs has gradually increased in relative terms to ADB's total NSO. As a share of total nonsovereign commitments, nonsovereign CEP commitments grew from 41% in 2013 to 53% in 2017 (Figure A4.2).[3]

**Figure A4.2: Use of Credit Enhancement Products as a Percentage of ADB Nonsovereign Commitments**




NSO = nonsovereign operations.
Note: Sovereign operations are excluded.
Source: Asian Development Bank (Private Sector Operations Department).

4. CEPs are used in sovereign and nonsovereign operations, but sovereign CEP operations are limited.[4] Most sovereign CEP operations are guarantees backed with a sovereign counterindemnity.[5] These are particularly challenging because of the availability of direct ADB sovereign loans that are priced below commercial rates. The all-in margin to the borrower of a commercial loan guaranteed by ADB is larger than the margin on an ADB direct sovereign loan. Independent power producers (IPPs) or public–private partnership (PPP) projects whose revenues depend on availability payments or government offtake are attractive candidates for sovereign partial risk guarantee (PRG) operations.[6] These projects, however, require substantial time to develop.

### 2. Lender-of-Record Structures

5. ADB's lender-of-record structures include (i) traditional B loans in hard currency, for which ADB acts as lender of record for foreign banks; (ii) complementary financing in local currency, for

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[3] The 2017 figure is computed as year-to-date nonsovereign CEP commitments as of October 2017, divided by the estimated annual commitment for NSO.

[4] ADB executed a $500 million partial credit guarantee on a commercial loan to a project in Azerbaijan in 2017. ADB also executed a risk transfer arrangement of sovereign loan assets with the Swedish International Development Cooperation Agency in 2016. ADB used B loans for sovereign operations in the past but suspended the practice because of concerns about dilution of the preferred creditor status of multilateral development banks.

[5] ADB has not provided B loans to sovereign borrowers on commercial terms since the early 1990s. Risk transfers on sovereign loans or guarantees are also very limited.

[6] ADB's earlier policy (ADB. 2006. *Review of ADB's Credit Enhancement Operations*. Manila.) used the term political risk guarantee. This paper uses the term partial risk guarantee, following ADB internal practice.

which ADB acts as lender of record for onshore banks; and (iii) management of third-party funds, such as the ASEAN Infrastructure Fund, and the Leading Asia's Private Sector Infrastructure Fund (LEAP).[7] B loans are in demand in high-risk markets where ADB's preferred creditor status is most needed. But these markets have a relatively low number of bankable projects that take a long time to process and ultimately close. Some borrowers also view B loans as more complex and expensive than direct ADB loans, and B loans cannot be deployed in key markets for technical reasons. Despite these factors, ADB has kept B loan commitments at between $200 million and $400 million during 2013–2017. To address the demand for local currency financing, ADB has recently started offering local currency complementary loans, for example in the People's Republic of China in 2016.

6. LEAP was established in 2016 with a $1.5 billion investment commitment from the Japan International Cooperation Agency. It can make debt and equity investments on a parallel and nonparallel basis with ADB's Private Sector Operations Department (PSOD). ADB staff and clients prefer LEAP because it can commit to participate alongside ADB at an early stage in the project cycle at terms that are similar to or better than ADB's, with limited extra cost and documentation requirements. In line with initiatives at other multilateral development banks (MDBs), ADB might explore setting up third-party funds to mobilize debt funds from institutional investors on parallel terms with ADB.

### 3. Guarantees

7. ADB's guarantee products include PRGs and partial credit guarantees (PCGs).[8] Total guarantee commitments increased from $21 million in 2013 to $605 million in 2017. In terms of volume, PCG is the dominant instrument. The transaction volume is relatively low because it is difficult to receive market-based returns on ADB's credit guarantee operations, and the all-in costs to the borrower tend to be higher than a direct ADB loan. ADB can often obtain higher returns by providing direct loans, compared with issuing guarantees, because when it issues a guarantee, the margin needs to be shared between the guarantor and the guaranteed lender or bondholder. In many ways, risk transfer arrangements are a more efficient instrument than credit guarantees to leverage ADB's capital. ADB's costs of funds are generally lower than those of commercial lenders and ADB's risk transfer counterparties are often able to offer comprehensive cover to ADB at rates that are lower than ADB's return requirements.[9] While ADB's PRG is priced at a market-based return, sponsors often have access to cheaper direct (untied) loans as well as guarantees priced at below market rates that are provided by export credit agencies.

### 4. Risk Transfer Arrangements

8. Risk transfer arrangements, or risk transfers, allow ADB to provide loans or guarantees that exceed nonsovereign prudential limits because risks on the transferred portion are taken by an eligible third party. The volume of risk transfers increased substantially from $33 million in 2013 to $740 million in 2017. Risk transfers have proven popular with operational units because they allow ADB to exceed prudential limits and count as ADB's own ordinary capital resources (OCR) commitments as well as net direct value-added commercial cofinancing. Moreover, some clients

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[7] B loans are syndicated loans that are funded in a foreign currency (usually United States dollars) by eligible offshore financial institutions. Complementary loans are ADB-syndicated loans funded in local currency by eligible onshore financial institutions. ADB is the lender of record for B loans and complementary loans, and each such loan may only be provided if ADB provides cofinancing in the form of an A loan from its ordinary capital resources.

[8] ADB can also offer risk participation, which has the same economic effect as a guarantee, where ADB will reimburse the covered lender for amounts unpaid by the borrower following a payment default under the covered loan or bond.

[9] This is partly because ADB has higher administrative and operative costs for NSO than commercial insurers.

prefer dealing with ADB as direct lender only rather than a syndicate of lenders, and the client is not a party to the risk transfer arrangements. ADB is currently exploring whether insurance and reinsurance companies are interested in offering a line of risk transfers on an automatic basis to cover new nonsovereign exposure on financial institutions that exceed ADB's risk appetite.

### 5. Comparison with other Multilateral Development Banks

9. **B loans.** The European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), and the Inter-American Investment Corporation use B loans more because their operational departments have stronger incentives to use the product. At these institutions, the B loan portion does not compete with the direct loan because operations departments receive equal recognition for $1 of mobilization as $1 of direct loan. Furthermore, their general business volume is larger, and syndicate desks are better staffed.

10. **Guarantees.** EBRD, IFC, and the Inter-American Investment Corporation do not offer PRGs and issue few PCGs. The International Bank for Reconstruction and Development (IBRD) has an active sovereign guarantee operation. It focuses on providing offtake support to IPP and PPP (limited recourse) projects with private sponsors, but it occasionally issues credit guarantees in support of sovereign projects as well. The Multilateral Investment Guarantee Agency (MIGA) is successful in issuing political risk cover on equity and loan investments. It operates in more sectors than ADB does (e.g., mining), and can, because of its record, offer lower pricing than ADB nonsovereign PRGs. Unlike ADB, MIGA does not have an anchor requirement.

11. **Risk transfers.** Among the MDBs, ADB is the most active in using risk transfers because its incentive structure is more geared toward direct loans than B loans, compared with other MDBs.[10]

## B. Issues to be Addressed

### 1. Weak Incentive to Use Credit Enhancement Products

12. ADB operations units and clients have weak incentive to use guarantees and B loans. As with B loans, ADB sets targets for commitments on own account and through cofinancing. Despite encouragement for cofinancing, operations units have tended to prioritize commitments on its own account. This tendency became stronger since the balance sheet merger loosened lending headroom limitations, and the scale-up drive pressed operations units to deliver commitments on own account.

13. ADB's clients, particularly sovereign borrowers, have weak incentive to pursue guarantees in lieu of ADB direct loans. Under the current pricing framework,[11] guarantee fees are set at the equivalent level with the required return on a loan.[12] This typically makes all-in costs for the borrower of a guaranteed loan higher than that for a direct loan. When the guaranteed percentage is high, providing a guarantee requires a similar amount of lending headroom as the equivalent loan, and hence using a guarantee does not significantly save lending headroom.[13]

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[10] Excluding MIGA, which uses reinsurance of its political risk insurance contracts on a large scale.
[11] ADB. 2006. *Review of ADB's Credit Enhancement Operations*. Manila.
[12] Nonsovereign guarantee pricing also reflects reinsurance costs if risk exposure is transferred to the reinsurance company.
[13] This paper is not proposing to lower the return requirements on ADB guarantees to make the product more attractive.

### 2. Limited Instrument Types

14. ADB's Charter (the Charter) does not allow for the issuance of PRGs to cover equity investments. The Charter also requires an anchor investment by ADB (i.e., direct loan) when a guarantee is provided. In practice, ADB has limited flexibility to respond to the restriction on guarantees of equity investments[14] and is therefore absent from this market. The anchor investment requirement is broadly interpreted, and hence does not impose severe restrictions.

15. ADB does not offer policy-based guarantees either. A policy-based guarantee is similar to a policy-based loan (PBL), but it provides a guarantee in support of commercial lenders' financing to the government, rather than a direct loan to the government. IBRD, the International Development Association, the Inter-American Development Bank, and the African Development Bank offer policy-based guarantees. IBRD, for example, approved eight policy-based guarantees during 2011–2016, with the most recent one in Pakistan. This instrument could potentially be used to support international sovereign bond issues by ADB's developing member countries.

16. Under the current policy framework, Asian Development Fund grants and concessional OCR loans cannot be used for guarantee operations with a sovereign counterindemnity; therefore, such guarantees need to be financed with regular OCR.[15] Under the current framework, sovereign guarantee operations (i.e., guarantees with a sovereign counterindemnity) backed by regular OCR can be provided in group A countries only if the projects generate sufficient foreign exchange earnings.[16] This restriction is an important impediment to sovereign guarantee operations since (i) many infrastructure projects generate only local currency revenues, and (ii) MDBs' credit enhancements are particularly important for private financiers in group A countries.[17]

### 3. Policy and Guidelines

17. **Need to update guidelines.** ADB approved its policy on CEPs in 2006 (footnote 11) and prepared the Operations Manual on Credit Enhancement Operations (OM D9) accordingly. These policies and guidelines do not reflect the current operational environment. For example, CEP function has been transferred from Office of Cofinance to PSOD. For sovereign CEP operations, they still require convening the Pricing and Credit Enhancement Committee (which can only be convened after concept clearance) before indicative terms can be shared with a client. This process leads to unnecessary delays.

18. For NSO, the business process of additional B loans could be streamlined. An increase in the B loan amount currently requires Board approval if the increase is more than 20% of the original B loan amount. The current approval process discourages pursuing increases in B loan amounts after Board approval. Staff have an incentive to obtain a B loan approval that is larger than the expected size of the B loan, which could result in subsequent partial cancellation.

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[14] ADB can guarantee shareholder's loans or standby credit arrangement, rather than direct equity investments, but generally clients do not prefer such complication.

[15] ADB. 1998. *A Graduation Policy for the Banks' DMCs.* Manila.

[16] OCR lending and guarantee with sovereign counter-guarantees in group A countries are allowed "on exceptional basis for … projects that are foreign exchange earning and able to fully service their foreign debt from their net foreign exchange earnings." Footnote 15, p. ii.

[17] As of January 2018, the group A countries were Afghanistan, Bhutan, Cambodia, Kiribati, Kyrgyz Republic, the Federated States of Micronesia, the Lao People's Democratic Republic, Maldives, the Marshall Islands, Myanmar, Nauru, Nepal, Samoa, Solomon Islands, Tajikistan, Tonga, Tuvalu, and Vanuatu.

### 4. Staffing and Organization

19. **Limited availability of specialized staff.** CEP operations are constrained by the limited number of specialized staff. Most staff in operations units, especially in sovereign operations, are not familiar with the CEPs and require substantial support by the Guarantees and Syndication Unit (GSU) in PSOD. GSU only had three international staff plus one vacancy and one national staff plus one vacancy as of March 2018.

## C. Proposal

### 1. Enhancing Incentives

20. **Performance metrics.** Though ADB sets targets and monitors commitments on ADB's own account and through cofinancing, the emphasis tends to be placed on commitments on own account. To incentivize departments and staff, this paper proposes to use "total financing," or the sum of own account financing and cofinancing, as a primary performance metric for nonsovereign operations. "Total financing" gives equal weight to own account financing and cofinancing. Reporting will be made in terms of commitments during the fiscal year. IFC and EBRD also use "total investment" as a primary performance metric.

21. **Flexible resource allocation for sovereign guarantee operations.** ADB will more flexibly allocate regular OCR for sovereign guarantee operations (i.e., guarantees with a sovereign counterindemnity). The allocation is on top of regular country allocations and will create an incentive for ADB and sovereign clients to use guarantees. Because such operations will not interfere with the existing lending pipeline, it will make country programming easier. Private sponsors drive some sovereign guarantee projects (e.g., PRGs that support PPP projects with a sovereign counterindemnity). It is difficult to fully integrate these projects in standard country programming that covers sovereign projects over 3 years in line with the country resource allocation.

22. **Partial risk guarantees with a sovereign counterindemnity**. Under the current framework, regional departments lead projects with PRGs with a sovereign counterindemnity, while GSU supports them. Private sector sponsors often own and drive these projects, such as PPP projects and IPPs. PSOD has a closer relationship with private sector clients, and its skill set is more closely aligned with the project finance knowledge that is needed to structure these complex guarantees. However, securing government counterindemnity requires regional departments to have relationships with governments and understand their systems. Therefore, this paper encourages a joint project team comprising the regional departments and PSOD for guarantee projects with a sovereign counterindemnity, following the One ADB approach.[18]

### 2. Product Development

23. **Policy-based guarantee**. This paper proposes to introduce policy-based guarantees. The policy-based guarantee will be anchored with policy conditions, similar to a PBL, but will cover the credit risk of government borrowing from private lenders in lieu of a direct loan to the government. This type of guarantee would also be suitable for PCGs on sovereign bonds. In

[18] The joint team will be led (or co-led) by a regional department staff member. When the regional department confirms it is not able to process the project within a reasonable time frame (e.g., because of a lack of staff with required skills), PSOD may lead the processing of the PRG projects with a sovereign counterindemnity through consultation with ADB's Strategy, Policy and Review Department.

general, a policy-based guarantee will be offered in parallel with a PBL to facilitate monitoring the policy conditions. It will be provided with a sovereign counterindemnity, and the guarantee fee will be equivalent to the sovereign loan spread following the existing policy (footnote 11).

24. A policy-based guarantee will broadly follow the PBL policy and requirements.[19] ADB's financial support, for example, will be subject to compliance with policy conditions agreed with the government. In formulating the policy conditions, ADB must take into account the link between the loan and the macroeconomic conditions, and the direction of macroeconomic policies must be deemed satisfactory. ADB will systematically consult and closely coordinate with the International Monetary Fund, the World Bank, and other agencies. Approvals of policy-based guarantees will be subject to the PBL ceiling.

25. **Guarantee in group A countries**. To promote the use of sovereign guarantee operations in group A countries, this paper proposes to adjust the conditions providing guarantees backed by regular OCR in group A countries.[20] To avoid undermining a country's debt sustainability, this paper proposes to expand the use of regular OCR for guarantees in group A countries on the condition that the project does not undermine the debt sustainability of the country. While the current condition focuses on the project-level impact of foreign debt, the proposed condition focuses on macroeconomic debt sustainability (Table A4.1).

**Table A4.1: Current and Proposed Condition to Use Guarantee in Group A Countries**

| Current Condition | Proposed Condition |
|---|---|
| Projects should be able to fully service their foreign debt from their net foreign exchange earnings.[a] | Projects are not expected to undermine the debt sustainability of the country. Namely, countries are not currently classified as high risk of debt distress as defined in the Asian Development Bank's Concessional Assistance Policy,[b] and the proposed project is not expected to change the country's debt distress classification. |

[a] Asian Development Bank. 1998. *A Graduation Policy for the Bank's DMCs.* Manila (p. ii).
[b] Asian Development Bank. 2016. *Concessional Assistance Policy*. Manila. Countries are classified into high, moderate, and low risk of debt distress based on debt sustainability analyses using the joint International Monetary Fund–World Bank debt sustainability framework for low-income countries. Countries classified as high risk of debt distress receive Asian Development Fund grants only.
Source: Asian Development Bank.

26. **Guarantee covering equity investment**. ADB's Charter does not allow ADB to provide guarantees to cover equity investments. While ADB can potentially formulate legal structures to respond to the restriction,[21] the requirement might have resulted in missed business opportunities. Given the significant time and resource required to revise the Charter, ADB will consider removing the restriction if and when a set of amendments of the Charter is considered in the future.

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[19] ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila.
[20] Another option is to revise the concessional assistance policy through consultations with Asian Development Fund (ADF) donors to introduce ADF-backed guarantees. The World Bank's International Development Association and the African Development Bank's African Development Fund can be used to support PRGs in eligible countries. This is not the best option because ADF resources are limited. Even if the ADF is used to support a guarantee, the guarantee project involves private lending, which is more expensive than a grant; and requires ensuring the country's debt sustainability.
[21] For example, ADB could guarantee shareholder loans (as an alternative to equity) or look at structures where a third-party bank makes a payment and ADB covers the repayment obligations. To date, these structures have not been attractive for project sponsors.

27. **Nonsovereign operations in challenging markets**. CEPs are more relevant in frontier markets since private financiers often find it difficult to enter these markets without credit enhancement. In some cases, however, risks are too high to take on a nonsovereign basis or the current NSO pricing approach makes the all-in cost for guarantees prohibitive. In 2016, the World Bank Group established, through the 18th replenishment of the International Development Association, a Private Sector Window that allows IFC and MIGA to offer submarket pricing in frontier markets. ADB will explore third party funding that will allow it to improve pricing and/or take difficult risks. ADB and other MDBs have developed common principles of blended finance. ADB follows these principles when it considers submarket pricing in private sector operations.

28. **New applications of partial risk guarantees.** Demand for guarantees that cover infrastructure or capacity payments by government agencies is increasing, as concessions and other PPP infrastructure are used more widely. ADB can provide guarantees to cover non-honoring of sovereign obligations through its existing guarantee products but has yet to use it. One of the reasons is that it tends to require lengthy negotiations to obtain a sovereign counterindemnity from the host government. ADB may enter into a framework agreement with host governments in advance, so that approval of individual transactions can be streamlined and negotiated quickly. Further, ADB will explore whether PRGs can cover the inability of a well-performing project to refinance its bank debt in the capital markets because of market disruption.

### 3. Updating Policies and Guidelines

29. **Capital requirement**. ADB will commission a study to examine if the capital requirement can be lowered for PRGs.[22] Under the current capital framework, providing a guarantee requires the same amount of capital as the equivalent loan. This is the case even for PRGs that only cover a small portion of the default risks (e.g., expropriation, currency inconvertibility or nontransferability, political violence, and/or breach of contract) on a loan. Based on the study, ADB might lower the capital requirement for PRGs,[23] which may lower the lending headroom required for a given amount of PRGs compared with the equivalent loan amount.

30. **Delegation of approval of increases in B loans**. To facilitate more active and responsive use of B loans, this paper proposes to streamline the approval process for increasing the amount of a B loan. Currently, the Board approves an increase in a B loan if the increase is more than 20% of the original B loan, and the President approves an increase if it is 20% or less. For sovereign operations, the President approves administration of additional cofinancing regardless of size. This paper proposes to delegate to the President the approval of an increase in the B loan, provided it does not exceed 100% of the original approved B loan amount. The approval authority will not be delegated to Management for additional B loans that (i) require an exception to an existing ADB policy; or (ii) involve the potential for significant adverse environmental, economic, and/or social impacts, particularly on vulnerable groups that may be unable to absorb such impacts[24] unless such cofinancing is for a project whose loan has already been approved by ADB's Board and no new significant adverse impacts are envisaged. An additional B loan may result in partial substitution of an A loan by the incremental B loan.

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[22] ADB will commission the study in 2018.

[23] The lower capital requirement would increase the return on capital for nonsovereign PRGs (guarantee fees for sovereign operations are a fixed loan spread). The impact will be limited, however, because (i) nonsovereign PRGs are currently priced at market and ADB has access to reinsurance rates, and (ii) the guarantee fee is a small portion of the all-in cost of a guaranteed loan.

[24] Management may apply a liberal interpretation of these criteria in determining whether to submit a project proposal to the Board for approval if such impacts can be sufficiently mitigated.

31. **Policies and guidelines for sovereign credit enhancement products**. This paper proposes the following updates and revisions in the existing policies and related guidelines, including OM D9.

(i) Instead of convening the Pricing and Credit Enhancement Committee after concept clearance, operations units should propose sovereign CEPs at Management Review Meetings or Staff Review Meetings. The interdepartmental review of the concept paper and Board document of sovereign projects that deploy CEPs will include GSU and the Office of Risk Management in addition to standard parties (footnote 11). The Management Review Meeting's approval will not be required for issuing the indicative terms of sovereign CEPs.

(ii) The revised OM D9 will reflect the transfer of the CEP function from the Office of Cofinancing Operations to PSOD in 2010.

(iii) The revised OM D9 will clarify the procedures of sovereign CEP operations, including guarantees, risk transfer arrangements, and lender-of-record structures.

32. **Processing of nonsovereign partial risk guarantees.** PRGs have so far not been widely used within ADB. The institutional knowledge of PRGs, including the rating of political risks, needs to be improved. The Office of Risk Management, with the support of PSOD, will prepare instructions to streamline the processing of PRGs.

### 4. Staffing

33. **Staffing and unit**. The lack of expert staff is a critical constraint in expanding CEP operations. In addition to the origination of new deals, GSU needs staff to grow its portfolio, implement these initiatives, and function as an agency. The existing guarantee team is part of the Office of the Director General at PSOD. With limited resources and ambitious cofinancing targets, it is difficult to equally support sovereign and nonsovereign operations. ADB upgraded the guarantee team as a formal unit within PSOD in April 2018 with a director-level advisor and increased the number of staff. ADB plans to assign dedicated staff for sovereign CEP operations.

34. **Capacity building**. ADB's general operations staff, particularly in sovereign operations departments, need to be more familiar with CEPs to identify opportunities. ADB will strengthen the capacity building program for staff to improve CEP origination.

### Table A4.2: Guarantee Operations of Other Development Finance Institutions

| MDB | Type of Guarantee Provided | | | Approval[a] | Amount of Claims Paid[a] | Sector Distribution | Geographic Distribution |
|---|---|---|---|---|---|---|---|
| | PRG | PCG | PBG | | | | |
| ADB | X | X | | $5.6 billion | $0.15 million | Energy projects dominate the guarantee portfolio. | The focus of ADB guarantees has been on the Philippines, Thailand, and South Asian countries such as India and Pakistan. |
| MIGA | X | X | | $30.0 billion | $16.00 million | The sector distribution of MIGA guarantees has become relatively stable over time. Infrastructure and finance are the dominant sectors. | There has been a notable shift since 2000 away from the Latin America and Caribbean region toward Europe, Central Asia, and to a lesser extent, sub-Saharan Africa. |
| IBRD | X | X | X | $5.5 billion | $250.00 million | The primary focus of IBRD and IDA has been on energy projects. Policy-based operations are the next largest sector by value. | Europe and Central Asia (particularly the Balkan countries) and sub-Saharan Africa have been the principal beneficiaries, particularly during 1994–2013. |
| IDA | X | | X | | | | |
| IFC | | X | | $4.3 billion | NA | The finance sector is the dominant area of operations. | East Asia and the Pacific stands out as the largest beneficiary (25% of total) largely because the People's Republic of China has received 70% more in guarantee financing than any other country. |
| IADB | X | X | X | $2.8 billion | 0 | The finance sector is the dominant area of operations. | Although Mexico has been the principal beneficiary, there appears to be no relationship between country size and the ability to attract guarantee financing. |
| AfDB | X | X | X | UA0.5 billion | 0 | Insufficient data. | Insufficient data. |

ADB = Asian Development Bank, AfDB = African Development Bank, IADB = Inter-American Development Bank, IBRD = International Bank for Reconstruction and Development, IDA = International Development Association, IFC = International Finance Corporation, MDB = multilateral development bank, MIGA = Multilateral Investment Guarantee Agency, NA = not applicable, PBG = policy-based guarantee, PCG = partial credit guarantee, PRG = partial risk guarantee, UA = unit of account.

[a] IBRD/IDA is 1994–2013, IFC is 2001–2013 (data not available for 2004; pre-2006 includes a small share of trade guarantees), MIGA is 1990–2013, ADB is 1988–2013, IADB is 1997–2013, and AfDB is 2002–2013. UA is the AfDB's unit of account.

Sources: C. Humphrey and A. Prizzon. 2014. *Guarantees for Development: A Review of Multilateral Development Bank Operations*. London: Overseas Development Institute; and Asian Development Bank.

## PUBLIC–PRIVATE PARTNERSHIP STANDBY FINANCING FACILITY

### A. Issues

1. Public–private partnership (PPP) remains an important policy agenda in many developing member countries (DMCs), given the large need for infrastructure finance and limited fiscal space.[1] Asian Development Bank (ADB) support for DMCs' PPP initiatives are based on four pillars: (i) advocacy and capacity development, (ii) enabling environment, (iii) project development, and (iv) project financing (Table A5.1).[2] ADB's regional departments support the first two pillars through technical assistance, and the Office of Public–Private Partnership (OPPP) primarily supports the third pillar through transaction advisory services (TAS). While the fourth pillar can be supported by nonsovereign lending by the Private Sector Operations Department and sovereign lending by the regional departments, ADB support so far is mainly through nonsovereign lending, especially in the energy sector.

**Table A5.1: ADB's Four Pillars of Public–Private Partnership Operations**

| Item | Pillar 1 | Pillar 2 | Pillar 3 | Pillar 4 |
|---|---|---|---|---|
| Type of support | Advocacy and capacity development | Enabling environment | Project development | Project financing |
| Main instrument | Technical assistance/ PBL | Technical assistance/ PBL | Transaction advisory services | Lending |
| Main departments responsible | Regional departments | Regional departments | Office of Public–Private Partnership | Private Sector Operations Department and regional departments |

ADB = Asian Development Bank, PBL = policy-based loan.
Source: ADB. 2012. *Public–Private Partnership Operational Plan, 2012–2020—Realizing the Vision for Strategy 2020: The Transformational Role of Public–Private Partnerships in Asian Development Bank Operations*. Manila.

2. PPP energy projects in upper middle-income countries, such as power generation projects with an independent power producer under a power purchase agreement, are often commercially viable without direct financial support from the government. However, PPP projects are expanding into non-energy sectors, such as water and transport. In these sectors, projects are often not commercially viable without government financial support because of low tariffs (e.g., water and sanitation) and/or high risks (e.g., demand risk in transport projects). Some governments support these projects by reducing up-front capital requirements and enhancing private investor's return (e.g., viability gap funding), taking more risks (e.g., availability payment unrelated with demand volume), or implementing other forms of cost or risk sharing (e.g., revenue sharing and minimum revenue guarantees).

3. Government support for PPP projects may take various forms, including
   (i) up-front equity or grant contributions to the project company,
   (ii) cost sharing of capital expenditure during the construction period,

[1] "A PPP refers to a contractual arrangement between public (national, state, provincial, or local) and private entities through which the skills, assets, and/or financial resources of the public and private sectors are allocated in a complementary manner, thereby sharing the risks and rewards, to seek to provide optimal service delivery and good value to citizens." Asian Development Bank (ADB). 2012. *Public–Private Partnership Operational Plan, 2012–2020—Realizing the Vision for Strategy 2020: The Transformational Role of Public–Private Partnerships in Asian Development Bank Operations*. Manila (para. 4). p. 2.

[2] ADB. 2012. *Public–Private Partnership Operational Plan, 2012–2020—Realizing the Vision for Strategy 2020: The Transformational Role of Public–Private Partnerships in Asian Development Bank Operations*. Manila.

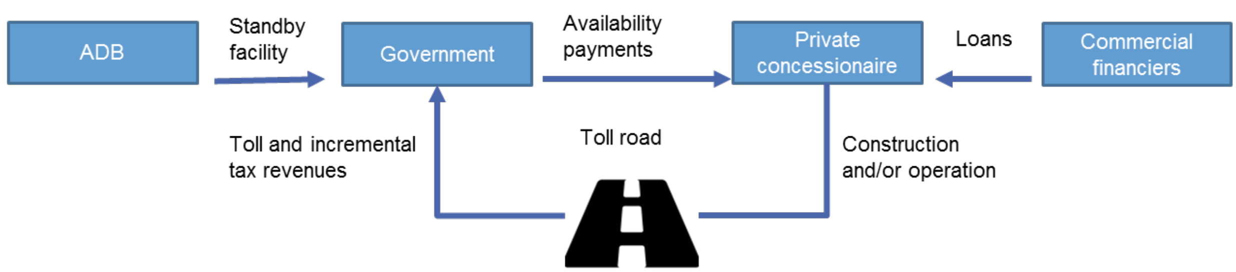
(iii) availability payments or other similar types of payments during the concession period, and
(iv) a combination of items (i)–(iii).

4. **Up-front equity or grant contribution and cost sharing of capital expenditure.** The government (or its agency) may make up-front payments to the concessionaire in the form of an equity or a grant or share part of the capital expenditure with the concessionaire. ADB can support these types of government financing through regular project lending or policy-based lending. The government obtains competitive funding from ADB for high-priority projects and private parties gain comfort from ADB's involvement, which lowers the overall funding costs.

5. **Availability payments.** The government (or its agency) may make availability payments (also called service payments or annuity payments) to the concessionaire throughout the concession period. The government often will collect user charges and pay the concessionaire as long as the facility is made available for use following certain performance criteria laid out in the concession agreement. Availability payments are not subject to changes in demand, such as traffic levels, and are adjusted typically only for lack of performance (Figure A5.1).

6. Because no payment by the government is due until the facility is fully operational, the private sector is responsible for raising the financing for the capital investment. Availability payments cover operating and maintenance costs, debt service costs for capital investment borrowing, and equity returns. Because the concessionaire is often a special purpose company that relies on project revenues, securing timely payments from the government is critical to make the project viable.

**Figure A5.1: Example of Public–Private Partnership Project with Availability Payment**




ADB = Asian Development Bank, PPP = public–private partnership.
Source: Asian Development Bank.

7. The government is not required to provide financial support up-front, but it assumes demand risks because the availability payments are often based on the standard of service, rather than on the volume of traffic. This is important for lenders because they are often not ready to take demand risks in transport projects, especially "greenfield" (new) projects that do not have any operational history.

8. ADB's sovereign lending to support availability payments or similar types of payments is limited. ADB's standard loan is not a good fit for supporting governments' availability payments because payments are made over a long concession period (e.g., 15–30 years) and are contingent on the concessionaire's performance. Under these circumstances, borrowers are not willing to block their country resource allocation to cover payments that may or may not happen over the concession period. Small and occasional withdrawals imply large commitment charges incurring on the borrower of regular ordinary capital resources (OCR).

## B. Proposal

9. This paper proposes to introduce a PPP Standby Financing Facility on a pilot basis for 5 years, during which new facilities may be approved. The facility will support a PPP project for which the government owes a financial obligation over a long concession period (e.g., availability payments). The government can withdraw funds from the facility when needed, such as during a cash shortage because of revenue fluctuation. The facility will help the private concessionaire secure timely payments from the government.

10. The Board will approve each facility and authorize the President to approve legal commitments (each typically for 1–3 years but not exceeding 15 years) under the approved facility. When the concession period is longer than 15 years, Board approval will be sought to authorize the President to approve legal commitments (none exceeding 15 years) for the next 15 years with a report on project implementation. Board approval may also be sought for a further period.

11. ADB and the borrower will enter into a facility agreement up to 15 years. Under the facility agreement, ADB and the borrower will enter into a series of loan agreements that define ADB financing for a shorter period (e.g., 3 years). ADB will make a legal commitment to extend credit to the borrower upon effectiveness of the loan agreement, not the facility agreement, and the borrower can withdraw funds when needed and according to the terms and conditions. The borrower needs to use its country resource allocation and pay commitment charges on the loan amount in the loan agreement, not the facility agreement. If the loan proceeds are not fully withdrawn over the loan period, the undisbursed amount can be carried over for the next period of loan agreement. Through this structure, the borrower can avoid blocking a large resource allocation and paying commitment charges for a long concession period.

12. PPP concession contracts have diverse payment structures, which depend on the nature of the project, the government’s fiscal policy, the risk appetite of private parties, and market practices. The design of the specific structure of each facility will be flexible to accommodate the diverse characteristics of PPP concession contracts. For example, a loan agreement may have a longer coverage period (e.g., 5 years) if the private party needs stronger security, but this will incur a larger financing cost to and resource commitment from the government. Based on lessons learned from the initial cases, the design of the facility will be reviewed and refined at the end of the 5-year pilot period.

13. **Eligible expenditure.** The PPP Standby Financing Facility will support the financial obligations of a government (or its agency) to private concessionaire for PPP projects under concession contracts, such as availability payments, service payments, annuity payments, and other similar payments. Each facility can support one PPP contract or a group of similar PPP contracts under the same borrower.

14. **Legal agreements.** ADB and the borrower will enter into two legal agreements: (i) a facility agreement and (ii) a loan agreement to cover government payments for a shorter period.

15. ADB and the borrower may enter into a facility agreement covering one or more PPP projects for which the government borrower (or its agency) owes financial obligations over a long concession period. The facility agreement will not impose a legally binding commitment on ADB to lend at the time of signing. It will set out (i) the aggregate amount of financing that could be provided under the entire facility, (ii) the term of the facility, and (iii) the conditions that the government must satisfy before it may request to enter into a loan agreement.

16. Under the framework of the facility agreement, ADB and the borrower may enter into a loan agreement. The loan agreement will document (i) ADB's obligation to provide standby financing to the government (or its agency), (ii) the amount of the standby facility and the terms of borrowing, (iii) the conditions precedent to drawdown, and (iv) other borrowing terms and conditions, among other things. Upon signing and effectiveness of the loan agreement and upon the satisfaction of the conditions precedent, ADB will be obligated to extend credit to the borrower and the government can withdraw funds from the facility when needed.

17. **Financing terms.** Each facility will be funded from regular OCR, concessional OCR, or the Asian Development Fund. Standard financing terms will be applied to loan agreements, in accordance with the financing source.

18. **Business process.** Management will propose each facility to the Board for approval, following standard business procedures. Management will carry out due diligence and appraisal on the PPP projects to be covered under the facility, including technical soundness, economic and financial viability, and environmental and social safeguards. Following the approval of the facility, ADB and the borrower may sign the facility agreement. Under the approved framework for the facility, ADB will make a series of legal commitments through loan agreements.

19. The economic and financial analysis of the project should include detailed assessments of the PPP concession contracts, including the level and terms of government payments to the concessionaire and the risk allocation between the government and private parties. ADB needs to confirm that (i) the proposed structure is likely to achieve the best value for money for the government, (ii) the expected return for the private concessionaire is adequate but not excessive, and (iii) risks are allocated properly among the concerned parties. The government's payment obligations and use of ADB's sovereign financing should not grant excessive concessionality to support an unviable project. ADB financing should not crowd out commercial financing and be considered only when the project cannot materialize without ADB financing.

20. **Possible collaboration with transaction advisory services.** One way to ensure proper structuring of a concession contract is through active involvement with TAS or technical assistance by OPPP. ADB can directly advise and ensure the government on the financial structure of the concession contract. While ADB's financing decision should be made independently from TAS, such advice through TAS helps ensure the project's financial soundness.

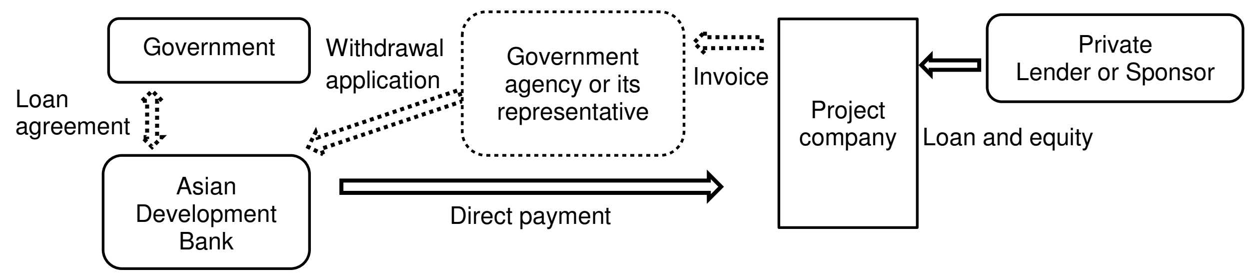
21. **Management of conflicts of interest.** When both TAS and funding support through the facility are provided to the same project, concerned operation units need to carefully manage any potential conflict of interest. For example, ADB must not seek a TAS mandate from the government by offering or implying ADB's potential financing.[3] When ADB acts as a financier or advisor to governments or private sector parties, it must manage conflicts of interest by separating concerned staff and limiting information flow among them, obtaining a consent of full disclosure from clients, and other appropriate measures.

22. **Compliance with policies and guidelines.** The PPP Standby Financing Facility will follow standard policies and guidelines regarding disbursement, procurement, selection of consultants, social and environmental safeguards, the public communications policy, anti-corruption measures, integrity due diligence, and the prohibited investment list.

[3] TAS mandates should clearly state that ADB is under no obligation to the TAS client to provide financing and that ADB's financing decision will be made entirely independent of TAS mandates after the appropriate due diligence and Management's review of the proposed financing transaction.

23. **Disbursement.** The facility proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time) and the arrangements agreed upon between the borrower and ADB. ADB will disburse loan proceeds against the contractual payments by the borrower (or its agency) to the concessionaire. ADB may also disburse payments directly to the concessionaire (Figure A5.2). Compared with government payments to the concessionaire, ADB's direct payments may reduce the risk perception of the concessionaire. Withdrawal applications need to be duly signed by a representative authorized by the borrower (government). If the government authorizes an independent engineer or verifier to sign withdrawal applications according to the performance contract, then it may give further comfort to the private lender.[4]

**Figure A5.2: Availability Payments for Projects with Direct Payment Procedure**




Source: Asian Development Bank.

24. **Procurement.** The selection process of concessionaires, bidding documents, and contracts of PPP projects is quite different from those of standard civil works and services. ADB will follow specific principles for PPP projects stipulated in the Procurement Regulations for ADB Borrowers (2017, as amended from time to time): (i) be transparent and competitive; (ii) include several stages to arrive at the optimal combination of criteria for the purpose of establishing the most economic and efficient proposal that provides value for money; (iii) be compliant with ADB's core procurement principles, the eligibility criteria, and the integrity requirements; and (iv) ensure an appropriate allocation of risk. When OPPP provides TAS to a government that is considering ADB financing, such TAS may assist the government in ensuring that procurement follows the Procurement Regulations.

25. **Programming and resource allocation.** Because it is uncertain when and whether the PPP bidding process will be concluded and the funding will become necessary, including a PPP project in country programming tends to be difficult. ADB will more flexibly allocate regular OCR for sovereign operations to support PPP on top of regular country allocations. ADB will monitor signed and effective facility agreements, as well as expected commitments through loan agreements for proper long-term resource management.

## C. Expected Impact

26. **Expansion of public–private partnership projects.** By introducing this facility, ADB can help DMC governments expand PPP projects, especially challenging projects in non-energy sectors.

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[4] It may not be easy for the government to give such authority to an independent engineer. However, independent engineers in PPP contracts are vested power to some degree to determine the payment amount from the government to the private concessionaire.

27. **Strengthening the "One ADB" approach.** ADB adopted this approach to bring the institution together to build synergies and provide knowledge solutions. By introducing a new facility for sovereign operations, regional departments will have stronger incentives to work on PPP projects, particularly in close collaboration with OPPP. The facility will strengthen ADB's ability to provide an integrated solution through close cross-departmental collaboration.

## SUMMARY TABLES

### Table A6.1: Multilateral Development Bank Products and Modalities

| | | World Bank Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Item** | **ADB** | **IBRD/IDA** | **IFC** | **MIGA** | **IADB/IIC** | **AfDB** | **EIB** | **EBRD** | **AIIB** |
| Loan and grant | | | | | | | | | |
| Project loan | X | X | X | | X | X | X | X | X |
| Sector loan | X | | | | X | | X[a] | | |
| Financial intermediation loan | X | X | | | X | | X | X | |
| Policy-based lending | X | X | | | X | X | | | |
| Results-based lending | X | X | X | | X[b] | X[c] | | | |
| Sector development program | X | | | | X | | | | |
| Guarantee | | | | | | | | | |
| Partial risk guarantee | X | X | | X | X | X | | X[d] | |
| Partial credit guarantee | X | X | X | X | X | X | | X[d] | |
| Policy-based guarantee | | X | | | X | X | | | |
| Equity | X | | X | | X | X | X | X | X |
| Modality and financing facility | | | | | | | | | |
| Additional financing | X | X | | | X | X[e] | | | |
| Multitranche financing facility or equivalent facility | X | X | | | | | | | |
| Project design facility | X | X | | | X | X | | X | X |

ADB = Asian Development Bank, AfDB = African Development Bank, AIIB = Asian Infrastructure Investment Bank, EIB = European Investment Bank, EBRD = European Bank for Reconstruction and Development, IADB = Inter-American Development Bank, IBRD = International Bank for Reconstruction and Development, IDA = International Development Association, IFC = International Finance Corporation, IIC = Inter-American Investment Corporation, MDB = multilateral development bank, MIGA = Multilateral Investment Guarantee Agency.

Note: The table summarizes available products at MDBs. The name, applicability, and features of some products may not be the same as with ADB products.

[a] EIB provides multicomponent loans under one framework loan.

[b] IADB introduced performance-driven loans in 2003 under a 6-year pilot and allowed the pilot period to lapse pending further review of the instrument.

[c] In December 2017, AfDB introduced results-based financing on a 5-year pilot basis.

[d] EBRD provides guarantees under its trade finance program.

[e] AfDB supplementary financing is only provided to address cost overruns and not to scale up projects.

Sources: ADB, official homepages of institutions, and ODI. 2014. *Guarantees for development*. London.

## Table A6.2: Proposals and Practices of other Multilateral Development Banks

| Modality | Proposals | Practices of other MDBs |
|---|---|---|
| Project readiness financing | Refine technical assistance loan with streamlined features of the project design facility to establish project readiness financing | Other MDBs offer similar products. It is equivalent to the World Bank's project preparation facilities. |
| Small expenditure financing facility | Introduce the small expenditure financing facility | Other MDBs do not have this type of product. |
| Additional financing | Provide additional financing through streamlined business process under certain conditions | Other MDBs provide additional financing through various business process. |
| Guarantee in group A countries[a] | Expand guarantee operations in group A countries by allowing the use of regular ordinary capital resources to support guarantees in group A countries | Similar to current ADB practice, IBRD can support guarantees in IDA countries only if the projects generate foreign exchange revenues. However, the World Bank's IDA and AfDB's African Development Fund can be used to support partial risk guarantees in IDA- or African Development Fund-eligible countries. |
| Policy-based guarantee | Introduce policy-based guarantees | The World Bank, IADB, and AfDB provide policy-based guarantees. |
| Additional B loan | Delegate approval authority for additional B loans to ADB Management | At IIC, management is authorized to approve additional B loans. |
| Capital requirement for partial risk guarantee | By commissioning a study on best practices, examine if the capital requirement for partial risk guarantees can be lowered | In most MDBs, all types of guarantees require the same amount of capital as an equivalent loan. MIGA has its own capital allocation model, differentiated by the covered risks. |
| Performance metric for nonsovereign operations | Introduce "total investment" (sum of ADB's own financing and cofinancing actively mobilized) as a performance metric for private sector operations | IFC and EBRD use "total investment" as a primary performance metric. |
| PPP Standby Financing Facility | Introduce the PPP Standby Financing Facility | MDBs do not offer this type of product. |

ADB = Asian Development Bank, AfDB = African Development Bank, AfDF = African Development Fund, EBRD = European Bank for Reconstruction and Development, IADB = Inter-American Development Bank, IBRD = International Bank for Reconstruction and Development, IDA = International Development Association, IFC = International Finance Corporation, IIC = Inter-American Investment Corporation, MDB = multilateral development bank, MIGA = Multilateral Investment Guarantee Agency, PPP = public–private partnership.

[a] Countries with access to the Asian Development Fund and concessional ordinary capital resources only.

Source: ADB.

## Table A6.3: Approval Authority and Board Reporting

| Modality | | Approval Authority | Board Reporting |
|---|---|---|---|
| Proposed products | Project readiness financing | a. Board approves large-scale PRFs exceeding $15 million.<br>b. Management approves small-scale PRFs not exceeding $15 million, subject to total annual commitments for small PRFs of $100 million. | a. For small PRFs, Management will circulate a summary of individual PRFs to the Board after Management approval.<br>b. Management will circulate an annual operational summary to the Board. |
| Existing products | Project design facility (pilot) | a. Board approves the bank-wide facility.<br>b. Management approves individual projects (PDA, capped at $10 million or 4% of the loan amount). | Management will circulate a PDA report for each project to the Board after Management approval. |
| | FAST (pilot) | a. Board approves a bank-wide envelope.<br>b. Management approves individual projects (less than $20 million for loans). | a. Management will circulate a FAST report for each project to the Board after Management approval.<br>b. Management will circulate an annual summary report to the Board. |
| | MFF | a. Board approves facilities.<br>b. Management approves individual activities under the facility. | a. For *category A*[a] tranche, Management will submit a tranche report to the Board for a decision to authorize Management to convert the tranche (21-day circulation period).<br>b. For other tranches, Management will circulate a Tranche at a Glance to the Board 10 days before Management approval.<br>c. Management will circulate an annual MFF report to the Board. |

FAST = Faster Approach to Small Nonsovereign Transactions, MFF = multitranche financing facility, PDA = project design advance, PRF = project readiness financing.

[a] Under ADB's Safeguards Policy Statement (2009), a proposed project is classified as *category A* for environmental impact if it is likely to have significant adverse environmental impacts that are irreversible, diverse, or unprecedented. These impacts may affect an area larger than the sites or facilities subject to physical works.

Source: Asian Development Bank.

**Table A6.4: Implementation Plan**

| Actions | Period | 2018 | | | 2019 | 2020 |
|---|---|---|---|---|---|---|
| | | Q2 | Q3 | Q4 | | |
| Board approval | Q3 2018 | | | | | |
| Developing and refining manuals | Q2 2018 - Q3 2018 | | | | | |
| Approval of projects using new products and modalities | Q3 2018 and onward | | | | | |
| Outreach to DMC governments | Q2 2018 - Q4 2019 | | | | | |
| Study to review the captial requirement of PRGs | Q3 2018 - Q2 2019 | | | | | |
| Flexible allocation of regular-OCR to PPP standby facility and sovereign guarntee operation | Q3 2018 and onward | | | | | |
| Capacity building of staff on gurantee and PPP operations | Q3 2018 and onward | | | | | |

Q = quarter, DMC = developing member country, OCR = ordinary capital resources, PPP = public–private partnership, PRG = partial risk guarantee, Q = quarter.
Source: Asian Development Bank.

## Table A6.5: Approved Project Design Advances, 2011–2017

| **Country** | **Project Design Advance** | **Sector** | **Approval Date** | **Amount** ($ million) |
|---|---|---|---|---|
| Bangladesh | Coastal Towns Infrastructure Improvement Project | WUS | 6 August 2012 | 3.50 |
| Kyrgyz Republic | Central Asia Regional Economic Cooperation Corridors 1 and 3 Connector Road Project | TRA | 2 June 2015 | 3.00 |
| Fiji | Urban Water Supply and Wastewater Management Project | WUS | 9 December 2015 | 2.65 |
| Nauru | Port Development Project | TRA | 16 December 2015 | 3.00 |
| Tuvalu | Outer Island Maritime Infrastructure Project | TRA | 16 November 2015 | 2.00 |
| Pakistan | Jalalpur Irrigation Project | ANR | 1 February 2016 | 5.00 |
| Bangladesh | Rural Infrastructure Maintenance Program | TRA | 7 June 2016 | 2.00 |
| Pakistan | Karachi Bus Rapid Transit Project | TRA | 29 September 2016 | 9.70 |
| Bangladesh | City Region Development Project II | WUS | 15 December 2016 | 5.00 |
| Pakistan | Peshawar Sustainable Bus Rapid Transit Corridor Project | TRA | 23 November 2016 | 10.00 |
| Sri Lanka | Northern Province Sustainable Fisheries Development Project | ANR | 8 March 2017 | 1.03 |
| Kiribati | South Tarawa Water Supply Project | WUS | 24 November 2017 | 2.00 |

ANR= agriculture and natural resources, TRA= transport, WUS= water and other urban services.
Source: Asian Development Bank.

## Table A6.6: Project Design Advance and Ensuing Loan and Grant Performance

| Project Title | Country | PDA Effectiveness | Ensuing Loan/Grant Approval | Ensuing Loan/Grant Effectiveness | Launch Bid Date (First Major Civil Works Contract) | Award Date (First Major Contract) |
|---|---|---|---|---|---|---|
| Coastal Towns Environmental Infrastructure Project | Bangladesh | 29 October 2012 | 27 June 2014 | 19 September 2014 | 1 September 2014 | 15 December 2014 |
| Central Asia Regional Economic Cooperation Corridors 1 and 3 Connector Road Project | Kyrgyz Republic | 25 January 2016 | 27 September 2016 | 23 May 2017 | 24 May 2017 | … |
| Urban Water Supply and Wastewater Management Investment Program | Fiji | 22 December 2015 | 9 December 2016 | … | 31 March 2017 | … |
| Port Development Project | Nauru | 22 December 2015 | 25 January 2018 | … | … | … |
| Outer Island Maritime Infrastructure Project | Tuvalu | 7 December 2015 | 16 November 2016 | 30 August 2017 | 3 March 2017 | 22 August 2017 |
| Jalalpur Irrigation Project | Pakistan | 11 March 2016 | 24 November 2017 | … | … | … |
| Rural Infrastructure Maintenance Program | Bangladesh | 11 July 2016 | … | … | … | … |
| Karachi Bus Rapid Transit Project | Pakistan | 17 November 2016 | … | … | … | … |
| City Region Development Project II | Bangladesh | 1 February 2017 | … | … | … | … |
| Peshawar Sustainable Bus Rapid Transit Corridor Project | Pakistan | 5 January 2017 | 30 June 2017 | 15 November 2017 | 9 May 2017 | 14 November 2017 |
| Northern Province Sustainable Fisheries Development Project | Sri Lanka | 20 March 2017 | … | … | … | … |
| South Tarawa Water Supply Project | Kiribati | … | … | … | … | … |

… = data not available, PDA = project design advance.
Source: Asian Development Bank.

## Table A6.7: Technical Assistance Loans Approved, 2007–2017

| Country | Name | Year Approved | ADB financing ($ million) |
|---|---|---|---|
| Bangladesh | Padma Multipurpose Bridge Design Project | 2007 | 17.60 |
| Viet Nam | Ho Chi Minh–Long Thanh–Dau Giay Expressway Technical Assistance Project | 2007 | 10.00 |
| Pakistan | Capacity Building for Punjab Government Efficiency Improvement | 2007 | 8.80 |
| Viet Nam | Greater Mekong Subregion Ha Noi–Lang Son, Greater Mekong Subregion Ha Long–Mong Cai, and Ben Luc–Long Thanh Expressways Technical Assistance Project | 2008 | 26.00 |
| Pakistan | Preparing the Lahore Rapid Mass Transit System Project | 2008 | 6.00 |
| Bangladesh | Padma Multipurpose Bridge Design Project (Supplementary Loan) | 2009 | 10.00 |
| Maldives | Capacity Development for Economic Recovery Project | 2009 | 1.50 |
| India | Developing Public Resource Management Program in Mizoram | 2009 | 6.00 |
| Bangladesh[a] | Subregional Transport Project Preparatory Facility | 2010 | 23.00 |
| Pakistan | Public Sector Enterprise Reforms Project | 2014 | 20.00 |
| Bangladesh[a] | Subregional Transport Project Preparatory Facility (Additional Financing) | 2015 | 30.00 |
| Viet Nam[a] | Project Preparation and Start-Up Support Facility | 2012 | 37.88 |
| Bangladesh | Dhaka–Chittagong Expressway Public–Private Partnership Design Project | 2012 | 10.00 |
| Viet Nam | Ho Chi Minh City Third Ring Road Technical Assistance Project | 2015 | 12.58 |
| Lao PDR | Health Sector Governance Program (Technical Assistance Loan for Subprogram 1) | 2015 | 6.00 |
| Sri Lanka[a] | Transport Project Preparatory Facility | 2016 | 24.42 |
| Indonesia[a] | Accelerating Infrastructure Delivery through Better Engineering Services Project | 2016 | 148.20 |
| Mongolia | Strengthening Institutional Framework and Management Capacity Project | 2016 | 35.00 |
| Philippines[a] | Infrastructure Preparation and Innovation Facility | 2017 | 100.00 |

ADB = Asian Development Bank, Lao PDR = Lao People's Democratic Republic.
[a] Adopted a facility approach, where the technical assistance loan supports the design of multiple projects.
Source: Asian Development Bank.

**Table A6.8: Comparison of Transaction Technical Assistance, Project Design Advance, and Technical Assistance Loans**

| Item | Transaction TA | TA Loan | PDA |
|---|---|---|---|
| Scope | a. Feasibility studies and due diligence<br>b. Preliminary engineering design and cost estimates<br>c. Detailed engineering design activities for cofinancing and if cofinancing regulations allow<br>d. Support for undertaking advance procurement actions<br>e. Capacity building<br>f. Policy advice to support reform actions<br>g. Transaction advisory services for PPP | a. Feasibility studies and due diligence<br>b. Preliminary and detailed engineering design and cost estimates, and preparation of bidding documents<br>c. Safeguards pre-implementation work<br>d. Support for undertaking advance procurement actions<br>e. Capacity building<br>f. Transaction advisory services for PPP<br>g. Advisory and capacity building support to implement policy reforms in policy-based lending operations<br>h. Pilot-testing activities | a. Feasibility studies and due diligence<br>b. Preliminary and detailed engineering design and cost estimates, and preparation of bidding documents<br>c. Safeguards pre-implementation work<br>d. Support for undertaking advance procurement actions<br>e. Legal services<br>f. Capacity building<br>g. Transaction advisory services for PPP<br>h. Preparatory work to support policy-based lending operations |
| Eligible borrowers | All ADB DMCs | All ADB DMCs | All ADB DMCs |
| Policy and business process | Processed following OM D12 and its associated staff instructions[a] | Processed as a sovereign loan following OM D11 and its associated staff instructions[b] | Processed in line with PDF policy paper and its associated staff instructions[c] |
| Legal agreement | a. TA agreement<br>b. TA framework agreement | Loan or grant agreement | a. Loan or grant agreement<br>b. PDA master agreement |
| Approving authority | a. ≤$225,000: director (unless authority is retained by the head of department)<br>b. ≤$5 million (low risk): director general<br>c. ≤$5 million (complex): vice-president<br>d. >$5 million (ADB Special Funds): Board of Directors<br>e. >$5 million (ADB-administered fund): President | Board of Directors | Within the loan ceiling:<br>Operations vice-president with Board information paper circulated to the Board of Directors<br><br>Above the loan ceiling:<br>Operations vice-president with no objection from the Board |
| Required documents | Transaction TA report | a. Project concept paper<br>b. RRP and linked documents | PDA report (includes project administration manual) |
| Source of funds | a. Technical Assistance Special Fund<br>b. Grant trust funds | a. Regular OCR<br>b. Concessional OCR<br>c. Asian Development Fund<br>d. Cofinancing | a. Regular OCR<br>b. Concessional OCR<br>c. Asian Development Fund |
| Grant/loan ceiling | None | None | a. $10 million equivalent or 4% of the ensuing financing, whichever is larger<br>b. PDAs with a value that exceeds the ceiling considered on a case-by-case basis |

| Item | Transaction TA | TA Loan | PDA |
|---|---|---|---|
| Repayment terms | a. Not applicable for most grant-financed transaction TA<br>b. May include provisions for cost recovery | a. Regular OCR: repayment period of 15 years, including a 3-year grace period; no commitment charges.<br>b. Concessional OCR: same terms as concessional OCR project loans<br>c. May be refinanced under an ensuing loan | a. Carries interest and charges of a regular or concessional OCR loan and generally refinanced under the ensuing loan<br>b. Commitment charges on undisbursed balance of a regular OCR-financed loan waived for the first 2 years<br>c. Payment of accrued charges deferred until the PDA is repaid from the ensuing loan<br>d. Withdrawn principal repaid in about 10 equal installments over 5 years when a loan does not ensue |

≤ = less or equal to, > = greater than, ADB = Asian Development Bank, DMC = developing member country, OCR = ordinary capital resources, OM = operations manual, PDA = project design advance, PDF = project design facility, PPP = public–private partnership, TA = technical assistance.

[a] ADB. 2017. Technical Assistance. *Operations Manual*. OM D12. Manila.

[b] ADB. 2017. Sovereign Operations. *Operations Manual*. OM D11. Manila.

[a] ADB. 2011. *Establishing the Project Design Facility*. Manila.

Source: Asian Development Bank.