ADB

Chair's Summary of Meeting of the Board of Directors

18 March 2008

REVIEW OF THE ASIAN DEVELOPMENT BANK'S CAPITAL ADEQUACY FRAMEWORK

1. This paper reviews the Capital Adequacy Framework of ADB and proposes the adoption of an income-based stress test methodology for assessing its capital adequacy. The objective of this review is to replace the existing static measure of capital adequacy that sets minimum equity to loan ratio (ELR) at 35% with a more dynamic and forward looking framework.

2. Directors supported the paper and generally appreciated that the proposed framework is in line with best practices in other multilateral institutions. Many Directors endorsed the key assumptions used by the framework, including (i) two rounds of nonaccrual shocks; (ii) 10-year time frame; (iii) loss provisioning rate of 30%; (iv) post shock loan growth target of 3% annually; and (v) remedial measures through discontinuation of transfer and waivers and pricing increase of 60 basis points for new loans to be approved after the nonaccrual shock; however, some Directors felt that the assumption on the loss provisioning rate may be too conservative. Some also suggested that the remedial measures should not be activated automatically. Several Directors emphasized that ADB should not play the role of lender of last resort as this is the responsibility of the International Monetary Fund (IMF). Some Directors indicated that the use of data from rating agencies and IBRD may not be appropriate and suggested that ADB consider alternative data sources that would better reflect regional characteristics. One Director suggested that there should also be a ceiling or maximum Post-Shock ELR to monitor both overcapitalization and undercapitalization, and that the risk mitigation measures should be well established in this policy paper.

3. Many Directors indicated the need for greater clarity regarding the linkage of the proposed framework with the lending headroom constraint as well as the implications of the current stress test results for ADB's operations. Some Directors noted ADB's strong capital position and emphasized the need to ensure efficient use of ADB's capital for lending operations. Several Directors asked the reasons for not considering IBRD's recent adoption of an ELR target range of 23-27% for purposes of long-term strategic capital adequacy management. Several Directors raised the issue of resources allocated to RMU.

4. The Chair agreed that the term "lender of last resort" is not appropriate for ADB and indicated the need for an alternative wording that would better reflect the expected role of ADB during a credit shock. The Chair also indicated that a section would be included in the R-paper explaining the link between capital adequacy, and borrowing and lending headroom, but without prejudice to the issue of a future GCI. The Chair thanked the Board members for their constructive comments and support of the proposed framework and indicated that these comments will be carefully considered in the preparation of the R-paper.