

ADB Financial Products





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Asian Development Bank



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Foreword

The Asian Development Bank (ADB), a development finance institution consisting of 67 member countries, is engaged in promoting the economic and social progress of its developing member countries in the Asia and Pacific region.

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This brochure introduces ADB's financial products, including the LIBOR-based Loan (LBL), the Local Currency Loan (LCL), and Debt Management Products; explains the main features of these products; and provides an overview of the basic terms and conditions.

We hope this brochure will create a better understanding of ADB's financial products and assist borrowers in making informed decisions when using them.

Thierry de Longuemar

Treasurer



LIBOR-based Loan Product

The Asian Development Bank (ADB) offers its sovereign and nonsovereign borrowers London Interbank Offered Rate (LIBOR)-based Loans (LBL) with a floating rate based on 6-month LIBOR and an effective contractual spread.

The LBL was initially introduced July 2001. In November 2006, ADB introduced a series of enhancements to the LBL product based on the feedback of borrowers.

The new LBL product provides a high degree of flexibility for borrowers:

- Choice of currency;
- Choice of interest rate basis;
- A wide selection of repayment terms;
- Option to change the currency and interest rate basis at any time during the life of the loan; and
- Option to cap or collar the floating rate at any time during the life of the loan.

The LBL is a market-based loan product that allows ADB's efficient intermediation on the finest possible terms, provides transparent and market-based pricing, and meets borrowers' needs to tailor currencies and interest rate basis to suit project needs and external risk management strategies.

Choices Available for the Original LBL Terms

When choosing the financial terms of a loan, it is prudent debt management practice to structure the loan profile to accord with the needs and risk exposure of the project and the borrower's overall external debt portfolio. ADB gives due consideration to the currency of the loan, the interest rate, the loan repayment terms, the loan charges, and other debt management features to make available more flexible terms, thereby giving the borrowers more options.

Loan Currencies

Borrowers may choose to denominate their LBLs in euro, Japanese yen (Yen), US dollar (USD), or in a currency in which ADB can efficiently intermediate. The currency opted for by the borrower will be the currency of the loan. The currency of choice will likewise be the currency to be paid by the borrower for its debt service payments. At the choice of the borrower, ADB may act as agent for the borrower in purchasing the currency required to disburse for procurement purposes.

Interest Rate

Loans can be drawn on a *floating-rate* or on a *fixed-rate* basis. In fixed-rate loans, the rate fixing is done at disbursement, on regular time intervals, or when



disbursements reach a threshold amount, as specified by the borrower in a Specified Rate-Fixing Schedule.

Floating-Rate Loan

In a floating-rate loan, the lending rate is reset every 6 months on each interest payment date, also referred to as the **lending rate reset date**. The lending rate is the cost base rate plus an effective contractual spread that is prevailing at the time of loan signing.

Lending Rate Reset Dates. The semiannual interest payment dates or lending rate reset dates of LBLs will be standardized on the 1st or the 15th of any month, and then every 6 months thereafter.

Cost Base Rate is 6-month LIBOR for USD and Yen, the standard reference interest rate used in the market for pricing of floating-rate loans for most currencies. The 6-month EURIBOR¹ is used for euro-denominated loans. Other recognized commercial bank reference rates would be used in other markets.

Effective Contractual Spread. A spread benchmarked against LIBOR offers a transparent basis for borrowers to compare LBL terms with those of other lenders and is consistent with market practice. It also allows for improved currency and interest rate risk management as it makes it easier to fully hedge such risk.

- For *sovereign or sovereign-guaranteed borrowers*, regardless of the loan currency:
 - 30 basis points for loans negotiated from 1 Jul 2010 to 30 Jun 2011, and
 - 40 basis points for loans negotiated on or after 1 Jul 2011.
- For *nonsovereign borrowers*, the effective contractual spread will reflect the credit risks of the specific project and borrower.

Fixed-Rate Loans with Specified Rate-Fixing (SRF) Schedule

The borrower may direct ADB to automatically implement a series of interest rate fixings either by period (i.e., regular time intervals as specified by the borrower) or by amount (i.e., upon reaching certain levels of disbursements as specified by the borrower).

SRF by Period. The borrower will specify the frequency of rate fixing (e.g., semiannually, annually). For example, the borrower can instruct ADB to fix the rate semiannually for loan amounts disbursed during the preceding 6-month period. The rate-fixing dates will have to coincide with interest payment dates. The fixed rate obtained will take effect immediately. Hence, an LBL with SRF by period will be divided into tranches of disbursed amounts, with each tranche having its applicable fixed rate.

SRF by Amount. The borrower will specify a “threshold” amount for disbursed amounts subject to rate fixing (e.g., every \$5 million; after disbursements exceed \$5 million, \$10 million, \$20 million, etc.). For example, the borrower can instruct ADB to fix the rate on disbursed amounts every time cumulative loan disbursements totaling \$15 million have been reached. The fixed interest rate will be applicable only at the beginning of the next interest period after the threshold amount has been reached.

The borrower may arrange the SRF schedule at the time of loan signing or at any time during the life of the loan. Borrowers may cancel such arrangements at any time, thus, giving the borrower control and flexibility in deciding when to fix the interest rate on its loans. Prior to rate fixing, the loan will carry a floating rate.

ADB will cover rate fixings by a corresponding hedge in the swap market, the rate or cost of which will be passed through to the borrowers. Generally, the fixed rate will be equivalent to the swap rate of 6-month LIBOR in the currency that corresponds to the maturities of the disbursed amount plus the effective contractual spread.²

Repayment Terms

For all Sovereign LBLs negotiated after 1 January 2007, the borrowers can choose any of the two repayment options:

Repayments Fixed at Loan Signing

The loan will have a grace period followed by a schedule of principal repayments, fixed at time of loan signing. To facilitate hedging for ADB and its borrowers, the schedule of loan repayments in the loan agreement will be expressed as a percentage of the total principal amount (installment share). The billed principal amount will be determined by applying the installment share on

¹ Euro Interbank Offered Rate, used for euro-denominated loans.

² In the interest rate swap market, the market price equivalence between fixed rates and 6-month LIBOR for major currencies is continuously established. This equivalence is also known as the “swap rate.”



the loan amount outstanding. The installment shares in the loan agreement apply to cumulative disbursements during grace period. The installment shares are adjusted for disbursements after grace period in each interest period according to the loan agreement. Subject to ADB's approval, the borrowers can choose any of the following terms to determine the schedule of installment share to suit their financial projection:

- Annuity-type repayment
- Straight-line repayment
- Bullet repayment³
- Custom-tailored repayment⁴

Repayments Linked to Actual Disbursement

Under this type of repayment terms, repayment schedules are linked to actual disbursements. Cumulative disbursements during each 6-month period (a "disbursed amount") will have their own specified amortization schedule.

The grace period and repayment period for each semiannual "disbursed amount" will be the same and will be fixed at the time of loan signing. The grace period will begin only as actual disbursements take place. When actual disbursements begin, the repayment schedule will be established for that semester's disbursed amounts, and the borrower will be informed of the schedule.

The loan can only be amortized during the repayment period on an equal principal payment basis instead of the flexible repayment terms applicable to the other repayment option.

The foregoing repayment options allow sovereign borrowers to choose the optimum structure that matches the financial projections of the projects.

Nonsovereign LBLs maintain a flexible repayment schedule to suit each project's financing requirements, cash-flow projections, and credit situation.

Prepayment and Cancellation

Sovereign borrowers may prepay, in part or in full, the disbursed and outstanding loan balance at any time during the life of a loan by notifying ADB in writing at least 45 days prior to the prepayment.⁵ Partial prepayments are applied to the loan repayment schedule in inverse order of maturity, with the latest maturity being repaid first.

Prepayment can be made only after the loan has been fully disbursed and the loan account for disbursement has been closed.

For floating-rate loans, borrowers may prepay any outstanding amounts on the interest payment date of the loan without a prepayment premium. However, prepayments of floating-rate loans on dates other than interest payment dates will be charged a prepayment premium based on the difference, if any, between the rate at which the proceeds from the prepayment could be reinvested and ADB's funding cost for the period up to the next interest payment date. In the event of prepayment of fixed-rate loans or floating-rate loans that involve conversions and the corresponding hedge transactions have to be terminated, the borrowers will be charged the unwinding costs of the hedge transaction, if ADB incurs such costs.

Sovereign borrowers may cancel all or part of the undisbursed loan balance at any time before loan account is closed without a fee, subject to the same notice period.

Rebates and Surcharges

Rebates and surcharges will be standard features for all sovereign LBLs but not for nonsovereign LBLs.

ADB can generally fund LBLs at cost lower than 6-month LIBOR (i.e., sub-LIBOR funding cost margin). Maintaining the principle of automatic cost pass-through pricing, the actual sub-LIBOR funding cost margin will be returned to the borrower through a rebate. For this purpose, ADB will calculate twice a year (on 1 January and 1 July) its actual average funding cost margin relative to LIBOR (rebate rate), and this will form the basis for determining the amount of rebate due to each individual LBL borrower. A surcharge could arise if ADB's funding cost is above 6-month LIBOR.

ADB could also vary its fixed spread over LIBOR because of evolving income objectives. Given the cooperative nature of ADB, any change in the fixed spread with respect to new LBLs will be applied to the outstanding balances of all LBLs through a rebate or surcharge.

The announced rebate/surcharge rate is applied to the interest period that begins after the rate announcement.

³ Bullet repayment refers to a single repayment at the end of loan term.

⁴ Custom-tailored repayment refers to an amortization structure that would meet the cash-flow structure of the project. Such customization will be expressed in (potentially uneven) percentage terms that cannot be changed after loan signing.

⁵ Prepayment and cancellation rules for Nonsovereign LBLs are subject to the specific clauses in their relevant loan agreements.



Other Loan Charges

For all sovereign project or program LBLs negotiated on and after 1 October 2007, ADB will apply a commitment fee of 15 basis points on a flat basis on the full amount of all undisbursed loan balances. The commitment charge will be calculated 60 days after the date of the related loan agreement and will be accrued after loan effectiveness.

Flexibility to Alter the Original LBL Terms

In contracting an ADB loan, a borrower is assuming a liability that is expected to be part of its balance sheet for a long time (up to 30 years). Even though the borrower has carefully considered the loan's financial terms prior to negotiation, its debt management needs and risks may change over time.

The borrower may, thus, wish to review its original selection of currency choice and interest rate structure. To that effect, the borrower can use the conversion provisions in the LBL agreement any time after loan effectiveness, subject, however, to the relevant provisions of the Loan Regulations and the Conversion Guidelines.

"Conversion Guidelines" is a unilateral document that ADB can change any time to provide flexibility in executing conversion requests. The guidelines set out the procedures for requesting, accepting, and effecting conversions as specified in the loan agreement.

Changing the Currency Characteristic of the LBL

The borrowers may change the loan currency of all or part of the undisbursed and/or disbursed loan amounts at any time during the life of the loan.

Currency Conversion of Unwithdrawn Balances

The amount of a currency conversion of unwithdrawn balances of the loan to an approved currency is determined on the basis of the prevailing exchange rate as defined in the Conversion Guidelines. The interest rate applicable to the converted unwithdrawn balances subsequently withdrawn and outstanding will be the floating rate applicable to the approved currency (chosen

by borrower). The partial amount converted will be applied pro rata across all maturities of the loan.

Currency Conversion of Outstanding Loan

On currency conversion of outstanding loan, the interest rate applicable to the converted outstanding loan can either be floating rate or fixed rate applicable to the approved currency. The terms of the currency conversion will reflect the cost of ADB's currency hedging transaction, including the exchange rate actually used in the transaction.

For existing LBLs that have been fully disbursed and are outstanding, ADB offers an option to convert the currency in which the loan is denominated into local currency,⁶ subject to ADB's ability to enter into appropriate hedging arrangements in such local market. The rationale for introducing such local currency conversion options is to reduce or eliminate currency mismatches that may arise if a borrower's revenues are denominated in local currency while the underlying liability is denominated in foreign currency.

In many cases, the borrower may want a currency conversion for the remaining full maturity of the outstanding amount of the loan to which the conversion will apply. If long-term currency swaps are unavailable and combine with asset and liability management (ALM) considerations preclude ADB from meeting such requests, the currency of denomination will revert to the original loan currency (i.e., currency before a conversion) upon the expiry of the corresponding currency swap hedge transaction (end of conversion period). The interest rate will also revert to the original interest rate applicable to the loan currency. The principal amount remaining at the end of the conversion period expressed in the original loan currency will not be known until the end of the conversion period, depending on the then prevailing exchange rate. The borrower, therefore, must assume the exchange rate risk.

Changing the Interest Rate Characteristic of the LBL

Borrowers may request, at any time during the life of the loan, an interest rate conversion to fix or unfix the interest rate. They can also buy a cap or a collar, subject to relevant swap market opportunities available to ADB.

⁶ Local currency conversion options for LBLs are available only on a case-to-case basis. An annual fee of two basis points of the outstanding principal hedged amount will be charged.



If ADB is not able to execute a market transaction for the full maturity of a loan, the interest rate payable on the amount of the loan to which a conversion request applies will revert to the original interest rate (i.e., interest rate before conversion) upon the end of conversion period.

Rate Conversion for Floating-Rate Loans

The borrower may request, at any time, a conversion of all or part of a floating-rate loan into a fixed-rate loan. Upon conversion, the interest rate would be determined on the basis of the cost of the hedge transaction in the swap market.

Borrowers may wish to arrange rate fixing through an SRF schedule. Otherwise, borrowers will be responsible for deciding when to request ADB to fix the rate on their loans. Borrowers may cancel such SRF schedules, but not once ADB has executed the applicable trade.

Rate Conversion for Fixed-Rate Loan

The borrower may, at any time, request a conversion of all or part of a fixed-rate loan into a floating-rate loan. Upon conversion, the interest rate would be determined on the basis of the cost of the corresponding hedge transaction in the swap market.

Interest Rate Cap and Interest Rate Collar

If borrowers wish to mitigate their exposure to interest rate volatility, but not eliminate it altogether, they can purchase an interest cap or collar.

An **interest rate cap** will keep the borrower’s interest cost on a floating rate basis, while providing the insurance that the borrower’s base rate LIBOR will never exceed the cap. If the floating rate exceeds the interest rate cap on any LIBOR reset date, the borrower will pay the interest rate at the cap. Such a cap has, like any insurance, a price—the premium, which is normally payable in advance. The premium is expressed as a percentage of the outstanding loan amount to which the cap is applied. The premium may be paid in cash or capitalized if there is a budget for capitalization of loan charges and the loan account is open.

Table 1: Transaction Fees for Loan Conversions (expressed as percentage of the principal amount involved)

Transaction Type	Loan Conversion Fees ^a
Currency conversion	
Of undisbursed loan amount	0.0625%
Of disbursed loan amount	0.125%
Local currency conversion	0.02% ^b
Interest rate conversion	
Rate fixings for up to the full maturity of the loan for amounts up to the outstanding loan amount	No charge
Additional rate fixing/unfixing	0.0625%
Interest rate cap and collar	0.0625%

^a Loan Conversion Fees are expressed as percentage of the principal amount involved and it is a one-time fee payable at the time of conversion except for Local Currency Conversion.
^b For Local Currency Conversion, an annual fee of 0.02% of the outstanding principal hedged amount will be charged to the borrower.

An **interest rate collar** ensures that the borrower’s floating-rate payments remain within a certain band. This is mainly used to reduce the premium payable on an interest rate cap. Thus, the borrower not only pays premium for establishing a cap on its floating rate but also establishes a lower limit (a floor). The premium the borrower pays is settled against the premium it receives.

Pricing of Conversions

For all conversions and interest rate caps and collars, ADB will pass through to borrowers the rates or cost of the corresponding hedge prevailing at the time of execution of the conversion. In addition, a transaction fee—ranging from 0.0625% to 0.125% of the principal amount involved—will apply. Table 1 summarizes the current transaction fees. These fees may change during the life of the loan.





Borrower's Selection of the Loan's Financial Terms

Borrowers can focus on three key loan terms that are central to external debt management strategy:

- Currency
- Interest rate basis
- Repayment terms

LBLs allow borrowers to tailor the cash flows of their loans to suit their project or overall debt management needs. Therefore, borrowers should become familiar

with the features of the LBL product as early as possible during project cycle. Borrowers must consider the available options for the loan terms during project preparation and analyze the advantages and risks well before project appraisal.

While ADB staff are not permitted to recommend loan options or make decisions for borrowers, they are available to explain alternatives within the new LBL package, as well as assist in the evaluation of the possible risks these entail.



Local Currency Loan Product

Rationale for the Local Currency Loan Product

When the Asian Development Bank (ADB) introduced the London interbank offered rate (LIBOR)-based loan (LBL) product in 2001, ADB responded to evolving needs of borrowers. ADB provides a product that is based on transparent market-based parameters, offers significant flexibility to tailor the product to the actual requirements of a specific project, and allows ADB's intermediation on the finest possible terms.

As the LBL product is primarily targeted at sovereign borrowers and those nonsovereign borrowers able to absorb or hedge foreign currency risks, a number of borrowers have requested ADB to consider introducing a local currency loan (LCL) product. Such borrowers include entities that derive most of their revenues in local currencies and may not be able to manage or hedge the currency risk that is associated with borrowing in foreign currency.

ADB's Board of Directors approved its first LCL in 2003 to nonsovereign borrowers. Since then, certain sovereign borrowers have also expressed interest in borrowing in local currency from ADB. In response to this emerging demand, ADB's Board of Directors approved, in August 2005, the introduction of the LCL product that will be made available to both nonsovereign and sovereign borrowers in selected currencies.

ADB aims to help reduce currency mismatches in its developing member countries (DMCs) by extending LCLs in close cooperation with the local financial sector to complement and catalyze local financial resources. Currency mismatches have played an important causal role in past financial crises (Box 1).

Box 1 Reducing Currency Mismatches in Emerging Economies

Until the 1990s, currency mismatches did not figure prominently as an explanatory factor in theories of economic growth and business cycles. This view changed after the Asian financial crisis of 1997 and other crises in emerging markets over the last decade. Important economic research has been conducted since these crises. Theoretical research and empirical studies have shown a strong causal link between excessive foreign currency-denominated debt and economic growth.

Since the Asian financial crisis, emerging economies have developed their local capital markets and reduced their dependence on international borrowings. The Asian Development Bank (ADB) has played a vital role in assisting its developing member countries (DMCs) to develop local financial markets. For ADB to offer local currency loans is, therefore, a logical consequence of its focus on developing local financial markets and helping DMCs reduce or eliminate currency mismatches in the economy.



In addition, ADB's local currency funding activities can have important benefits for developing local capital markets. In international capital markets, ADB is known as an innovative issuer that has opened new markets, introduced new financial instruments, and filled important gaps in the investment and issuer landscape. ADB can play a similar role in local capital market development by

- following best practices when issuing local currency bonds;
- setting new benchmarks;
- providing role model transactions in terms of documentation and execution;
- stretching the yield curve;
- introducing innovations for available financial instruments in local capital markets;
- enhancing liquidity in swap markets; and
- providing significant diversification opportunities for local institutional investors, such as insurance companies and pension funds (Box 2).

terms and conditions of local currency lending in relation to a specific market.

Eligible borrowers include nonsovereign borrowers and certain sovereign entities. Under ADB's Innovation and Efficiency Initiative, approved by the Board of Directors in August 2005, ADB will be able to lend directly to subsovereign borrowers, such as local governments and public enterprises.

Main Features of the Local Currency Loan Product

ADB's Funding Approach

ADB follows two approaches regarding its local currency funding: (i) back-to-back funding, defined as raising local currency financial resources to exclusively finance a specific project; and (ii) pool funding, where ADB maintains a pool of liquidity in a certain local currency. ADB's Treasury Department will advise borrowers in which currencies ADB has established local currency pools. At present, ADB has established local currency pools in Indian rupee and Chinese yuan and chosen suitable floating-rate benchmarks for each currency.

ADB is able to source local currency funding primarily via two routes: (i) by issuing local currency bonds; and (ii) by entering into a cross currency swap (CCS) with a commercial counterparty in markets, where such CCSs exist. The decision for ADB to raise local currency funds through a bond or a CCS (where available) would depend primarily on cost considerations. For back-to-back financings, ADB's Treasury Department will work with the borrower to source the most cost-efficient funding that meets the project's requirements.

Pricing

ADB aims to price its LCL product according to transparent pricing principles. Pricing is based on the following parameters:

ADB's cost base rate. The cost base rate depends on whether financing in a local currency is based on back-to-back funding or the pool-based approach. For back-to-back funding, the cost base rate comprises ADB's cost of a funding transaction undertaken to finance a specific loan. For a pool-based funding approach, the cost base rate is based on the local floating-rate benchmark (equivalent to LIBOR).

Eligible Borrowers

ADB can only offer the LCL product in selected DMCs where it has secured all relevant approvals to access the local capital market.

ADB's Treasury Department will inform interested borrowers of the status of regulatory approvals and the

Box 2 Contributing to Local Capital Market Development

Academic researchers have found empirical evidence on the correlation of local capital market development and economic growth. Similarly, credit rating agencies have noted that sovereigns can improve their credit ratings by deepening local capital markets and reducing reliance on offshore borrowings.

By becoming an active participant in the local capital market, ADB can also contribute to local market development. For example, ADB bond issues often have a positive "icebreaker" effect, opening the local market to international issuers and investors. In addition, ADB bond issues, which carry the highest possible credit rating, contribute to diversification benefits that accrue to local investors who are often overexposed to domestic economic and financial risks. Finally, ADB bonds can help develop the longer end of the market and help create or enhance local currency swap markets.



Interest rate basis. All LCLs will initially have a floating rate until borrowers request for fixing. For a floating-rate loan, the lending rate will change based on the underlying local currency benchmark. For fixed-rate loans, the lending rate will be based on the swap equivalent of ADB's cost base rate, with value applied on the rate fixing date that corresponds to the maturity and amortization schedule of the disbursement. Rate fixings are subject to ADB being able to enter into hedging transactions in the local market.

Effective contractual spread. The effective contractual spread follows similar principles as those applied to ADB's LBL product. The effective contractual spread for loans guaranteed by the sovereign government negotiated from 1 Jul 2010 to 30 Jun 2011 is 30 basis points, and on or after 1 Jul 2011 is 40 basis points. For nonsovereign loans, risk-based pricing is used to determine the effective contractual spread, negotiated separately for each loan. In determining the effective contractual spread for these loans, security arrangements, market-based pricing levels, and credit risk factors for a specific loan, among others, must be considered.

Front-end fee. No front-end fee will be charged for sovereign loans. For nonsovereign loans, the front-end fee would be loan-specific, typically ranging from 1.0% to 1.5% of the loan amount or less if the overall project return justifies it.

Commitment charge. The commitment charge for local currency sovereign project or program loans is a flat fee of 15 basis points on the amount of undisbursed loan balances. For nonsovereign loans, the commitment charge is loan-specific, typically in a range of 50–75 basis points on undisbursed loan balances.

Prepayments and Cancellation

Borrowers are allowed to prepay all or part of the disbursed and outstanding balance during the life of the loan, by notifying ADB in writing according to the relevant prepayment notice period stated in the loan agreement. Partial prepayments are applied to the loan repayment schedule in inverse order of maturity, with the latest maturity being repaid first. In addition, prepayment can be made only after the loan has been fully disbursed and the loan account for disbursement has been closed.

However, prepayment charges would apply based on the costs, if any, that ADB incurs as a result of the prepayment for the remainder of the term of the prepaid loan. If a fixed-rate loan is prepaid and the corresponding hedge transactions terminated, the borrowers are charged the unwinding costs of the hedge transactions, if any. No prepayment charge applies for floating-rate loans funded under the pool-based funding approach if prepayments occur on interest payment dates.

Borrowers are allowed to cancel all or part of the undisbursed balance before the loan account is closed. No cancellation charge applies if ADB follows a pool-based funding approach. For back-to-back funding, if ADB has agreed with the borrower to pre-fund the local currency requirement for a particular loan and the borrower later decides to wholly or partially cancel the loan, a cancellation charge may apply to compensate ADB for any costs incurred as a result of the cancellation.

Charges for prepayment and cancellation, and their calculation principles, are included in the loan documents to ensure full transparency for borrowers.

Rebates and Surcharges

Rebates and surcharges would apply for sovereign loans that are funded under the pool-based approach. These are calculated based on ADB's funding cost relative to the local floating rate benchmark. Thus, the actual sub-benchmark funding cost margin is returned to the borrower through a rebate, and over-benchmark funding cost margin is recouped from the borrower through a surcharge. This principle is identical to the pricing approach for ADB's LBL product and upholds the principle of automatic cost pass-through pricing.

Interest Rate Conversion Options of Local Currency Loans

Borrowers are allowed to change the interest rate basis of a local currency loan, at any time during the life of the loan, by requesting an interest rate conversion to fix or unfix their interest rate, subject to relevant swap market opportunities available to ADB in the local market. The terms and conditions that ADB can achieve by executing the necessary hedging transactions would be passed on to the borrower, plus a transaction fee of 0.0625%, which is identical to the fee charged for these transactions under the LBL policy, except for the first series of interest rate conversions for which no fee shall be charged.



Local Currency Loans in Practice: Two Case Studies

Case Study 1

INDIA: Using ADB Rupee Bond Proceeds to Finance a Power Transmission Line

When Powerlinks Transmission Limited, a public limited company incorporated in India and promoted by Tata Power Company Limited and Power Grid Corporation of India Limited, was to set up an approximately 1,150-kilometer power transmission line from Siliguri in West Bengal to Mandaula near Delhi, it requested the Asian Development Bank (ADB) to provide fixed interest rate financing in Indian rupee. ADB proposed a local currency loan of up to about \$70 million equivalent in Indian rupee, considering that all project revenues were to be denominated in local currency and that the company wanted to match the currency of its liabilities with that of its assets.

Based on the demand for Indian rupee loans from Powerlinks and other Indian borrowers, ADB decided to launch its inaugural Indian rupee bond issue in February 2004 with an aggregate principal amount of Rs5.0 billion (about \$110 million equivalent), a coupon rate of 5.4% per annum, and a 10-year maturity. The issue, priced at 17 basis points over the comparable government rate, constituted several firsts in the Indian capital market—first issue by a foreign entity; first supranational issue; and first issue rated AAA by Fitch, Standard & Poors, and Moody's Investor Services.

The proceeds of ADB's rupee bond issue were used to extend a fixed-rate, 15-year local currency loan from ADB to Powerlinks and, thus, provide the much-needed long-term fixed interest rate local currency finance required by infrastructure projects in India.

Case Study 2

Philippines: ADB Provides Local Currency to Resolve Nonperforming Loans and Assets

To address the issue of nonperforming loans (NPLs), several Philippine financial institutions have been selling off significant portions of their NPLs in the last 2 years. In one such NPL auction in July 2005, Bayrische Hypo- and Vereinsbank (HVB) won the bid to acquire an NPL portfolio from PCI Equitable Bank. Since the auctioned NPLs were purely domestic and denominated in Philippine pesos, HVB requested a local currency loan from the Asian Development Bank (ADB) as part of their financing package for this acquisition. Given that ADB does not hold a Philippine peso liquidity pool, funding for the proposed loan was arranged via a "back-to-back arrangement" where ADB sourced the required local currency by means of a cross-currency swap with a commercial counterparty.

The cross currency swap funding route provided a flexible mechanism to meet the borrower's requirement—a 3-year floating-rate loan based on the local floating-rate benchmark and denominated in local currency. By providing this local currency loan, ADB allowed the borrower to access acquisition debt finance, which fully matched the denomination of its liabilities with that of its acquired assets.



Debt Management Products

As approved by the Board of Directors in November 2006, ADB is now offering sovereign clients (including sovereign-guaranteed clients) debt management products for their third-party liabilities. Third-party liabilities refer to loans provided to the sovereign clients by financial institutions and agencies other than ADB, which include loans from commercial financial institutions, outstanding bond issues, or bilateral loans. Based on sound justification and an existing debt management framework, sovereign clients can use such debt management products to optimize their debt management strategy.

The following debt management products are currently available:

- Interest Rate Swaps
- Cross Currency Swaps
- Local Currency Swaps (transforming a foreign currency liability into a local currency liability; currently only available in selected countries).

Background

Sovereign borrowers in developing member countries (DMCs) have gained more experience in managing their debt portfolios over the last decade. However, improvements in public debt management capacity have not always been matched by access to key risk

management tools. For example, many DMCs' access to risk management tools is limited to short-dated swaps or swaps with strict collateral requirements.

ADB's debt management products are launched to address the problem of swap market access by such DMCs, thus facilitating best-practice debt management efforts. Acting as a financial market intermediary, ADB will stand between market financial institutions and the DMC client, having separate financial contracts with both. The pricing achieved on ADB's market transaction will be passed directly to the DMC client. DMC clients will benefit in many ways from ADB's role as market intermediary. First of all, based on the cost pass through principle, DMC clients may achieve more favorable transaction pricing on the swaps, as well as longer maturity terms as such pricings and maturity terms would reflect ADB's superior credit rating. Secondly, DMC clients will benefit from ADB's transaction execution experience, knowledge of derivatives pricing methods, as well as its extensive network of major financial institutions from which it can solicit transaction bids. Finally, using ADB as an intermediary may also save DMC clients valuable credit lines with nonsovereign institutions.



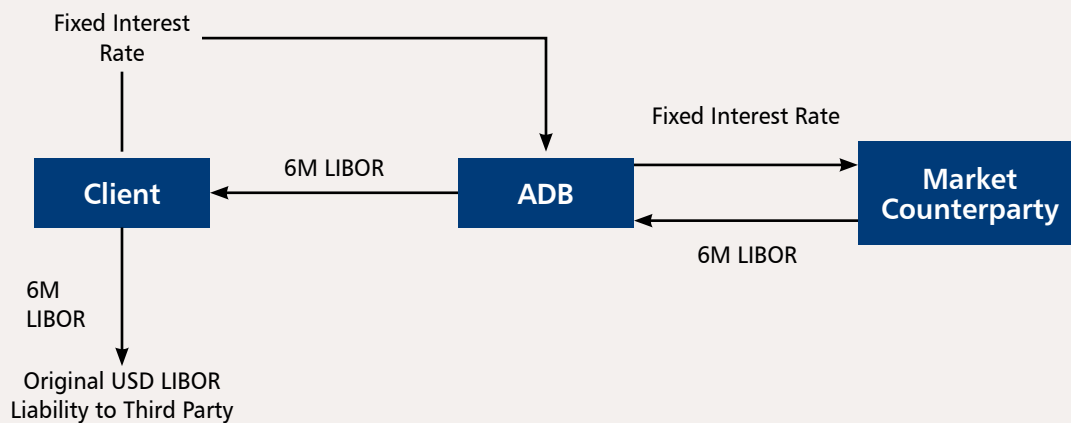
Interest Rate Swaps for Third-Party Liabilities

The clients may use ADB's Interest Rate Swap products to manage interest rate risks in their third-party liabilities or to alter the interest rate sensitivities of their external debt portfolios by transforming the interest rate basis of one or more existing third-party loans. Interest Rate Swaps for third-party liabilities can be either from floating interest rate to fixed interest rate, or vice versa.

For example, DMCs may want to fix the interest rate of the third-party loan so that the loan will not be exposed to future interest rate risks; in other cases, DMCs may achieve the fix-floating rate borrowing mix target in their overall external debt portfolios by adjusting the fixed interest rate borrowings via interest rate swaps.

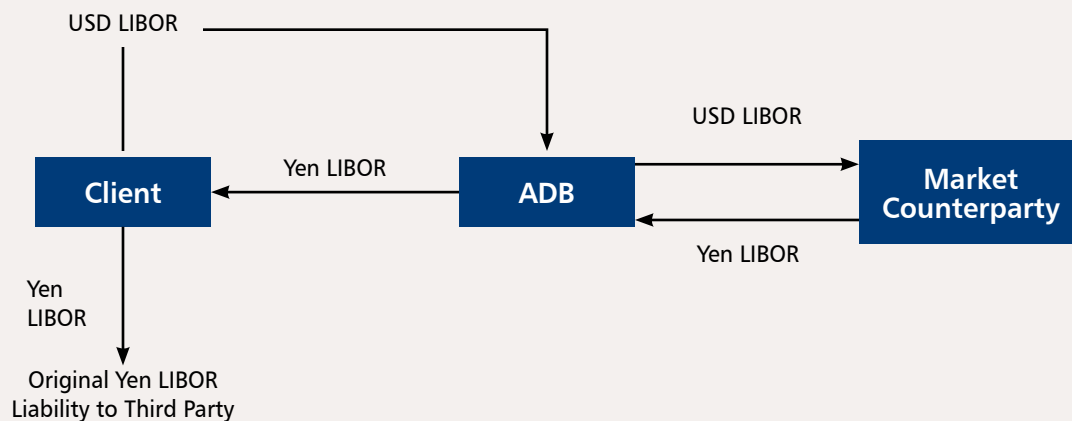
Figure 1 provides an example of how a client could transform an original US dollar floating-rate (LIBOR) based liability to a third party into a US dollar fixed-rate liability by entering into the appropriate interest

Figure 1: Example of an Interest Rate Swap for Third-Party Liability



LIBOR = London interbank offered rate.

Figure 2: Example of a Cross Currency Swap for Third-Party Liability



LIBOR = London interbank offered rate.



rate swap with ADB. ADB would offset the interest rate risk associated with the swap by entering into a fully offsetting swap with a market counterparty.

Cross Currency Swaps for Third-Party Liabilities

Cross Currency Swaps can change currencies of specific debts, adjusting the currency composition in DMC government’s debt portfolios to eliminate currency mismatch or to achieve government’s evolving currency composition targets.

For example, a DMC may be overexposed to certain currencies as a result of having borrowed significantly in that currency. By using ADB’s third-party liability cross currency swap, the DMC would be able to adjust the target mix of currencies of its liability portfolio.

Figure 2 provides an example of how a client could transform an original yen liability to a third party into a US dollar-based liability by entering into the appropriate Cross Currency Swap with ADB. ADB would offset the currency risk associated with the swap by entering into a fully offsetting swap with a market counterparty.

Pricing of Debt Management Products for Third-Party Liabilities

Table 2: ADB Debt Management Products for Third-Party Liabilities—Transaction Fee Schedule (expressed as percentage per annum on the principal amount being hedged)

Transaction Type	1 Jul 2010– 30 Jun 2011	1 Jul 2011 onwards
Interest Rate Swaps	0.03%	0.04%
Cross Currency Swaps	0.075%	0.10%

Procedure for Usage of Debt Management Products

How to proceed with debt management products for third-party liabilities

1. Enter into a Master Derivatives Agreement with ADB.
2. Provide ADB (and keep up-to-date) a list of signatures of officers authorized to enter into ADB Debt Management Product transactions.
3. Submit, in original form, the Debt Management Product Request Form. Request must include rationale for use of ADB Debt Management Products, hedge terms being requested, and specific third-party loan(s) to be hedged. Forms can be downloaded from www.adb.org/finance.
4. Upon receipt of the client’s request, ADB will start the review and approval process of such request. During approval process, client may be contacted for more information or clarification. ADB reserves the right to reject a request for a hedge transaction.
5. ADB will endeavor to execute hedges within 20 calendar days from the approval of the client’s request. Final terms of hedge will be sent to the client promptly following execution. The client will be billed for annual hedge transaction fee.
6. A legal confirmation containing the terms of the hedge will be submitted to the client for signature.

Legal Considerations

Clients that wish to use ADB’s debt management products for their third-party liabilities must enter into a master derivatives agreement with ADB. This agreement provides the contractual framework between the client and ADB. Once this agreement is in place, each debt management transaction executed by the client and ADB would be documented by a legal confirmation, which would form part of the master agreement.

Before entering into any of the above derivatives agreements, ADB will work with the client to ensure that the client’s debt management strategy meets best-practice standards and that debt management decisions assisted by ADB are undertaken as part of a comprehensive debt management approach.



Term Sheet

LIBOR-based Loan Product and Conversion Options

16

Features	Loan Terms
Currencies	Euro, Japanese yen, US dollar, plus other currencies in which ADB can efficiently intermediate
Maturity and Repayment Schedule	<p>Sovereign Loans New loans will be made on existing standard terms for grace period and final maturity.</p> <p>All Sovereign borrowers can opt for one of two types of repayment options:</p> <p>Repayments Fixed at Loan Signing: The loan will have a grace period followed by a schedule of principal repayments, fixed at time of loan signing. Subject to ADB's approval, the borrowers can choose any of the following repayment terms to match their cash-flow projection in a manner acceptable to the Asian Development Bank (ADB):</p> <ul style="list-style-type: none"> – annuity-type repayment – straight-line repayment – bullet repayment – custom-tailored repayment <p>Repayments linked to Actual Disbursement: Cumulative disbursement amounts during each 6-month period (disbursement tranches) will be repayable on a schedule commencing from the beginning of the interest period following disbursement. The grace period, final maturity, and repayment term (straight-line only) will be the same for all disbursement tranches.</p> <p>Nonsovereign Loans New loans will continue to be based upon project needs for grace period and final maturity. The repayment terms may be annuity or mortgage style, or tailored to meet project needs in a manner acceptable to ADB.</p>
Floating Lending Rate	The lending rate will consist of a base rate plus a fixed spread.



Features	Loan Terms
a. Cost Base Rate	The cost base rate is the 6-month LIBOR for the US dollar and yen, and the 6-month euro interbank offered rate (EURIBOR) for the euro. Other recognized commercial bank reference rates will be used in other markets.
b. Effective Contractual Spread	<p>Sovereign Borrowers Set at the time of loan signing and fixed for the entire life of the loan, ADB’s effective contractual spread is 30 basis points for loans negotiated from 1 Jul 2010 to 30 Jun 2011, and 40 basis points for loans negotiated on or after 1 Jul 2011.</p> <p>Nonsovereign Loans Set approximately 1 month prior to loan signing, the effective contractual spread is fixed for the entire life of the loan and will depend on the assessment of the credit and project risks of the loan.</p>
Fixed Lending Rate with Specified Rate-Fixing Schedule	
a. Cost Base Rate	At the time of fixing, the cost base rate will be ADB’s fixed-rate funding cost for the relevant maturity payable by ADB under the related hedge swap transactions.
b. Schedule of Fixing	At any time during the life of the loan, the borrower may direct ADB to implement a series of interest rate fixings, either fixing by period, i.e., regular time interval of semiannual or annual; or fixing by amount, i.e., upon reaching certain levels of disbursements. Prior to fixing, the lending rate will be floating.
Lending Rate with Reset Dates	<p>For floating-rate loans, the lending rates will be reset every 6 months on the interest payment dates for the loan.</p> <p>Interest payment dates will be on the 1st and 15th day of the month and semiannually thereafter, as specified in the loan agreement.</p>
Rebates and Surcharges	<p>Sovereign Loans ADB may grant rebates or impose surcharges if there are future changes in the fixed spread and/or ADB’s funding cost margin relative to the interest rate references.</p> <p>Nonsovereign Loans Not applicable.</p>
Loan Conversion Options	The borrower may exercise these options at any time during the life of the loan.
a. Currency Conversion	<p>Undisbursed Amounts All or part of the undisbursed balance may be converted into one of the offered currencies.</p> <p>Disbursed Amounts All or part of the disbursed balance may be converted into one of the offered currencies for the full or part of the loan’s residual life. The maturity of conversion is no longer than the remaining maturity on the loan or portion that is being hedged. Maximum maturities for hedge may further be limited to those available to ADB in financial markets. Conversions will be executed at prevailing market rates.</p>
b. Interest Rate Conversion	The floating lending rate on all or part of the disbursed balance may be converted into a fixed rate, or vice versa, for the full or part of the loan’s residual maturity. The maturity of conversion is no longer than the remaining maturity on the loan or portion that is being hedged. Maximum maturities for hedge may further be limited to those available to ADB in financial markets. Conversions will be executed at the prevailing market rates.
c. Interest Rate Caps and Collars	A cap or collar on the floating lending rate may be purchased for up to the entire disbursed amount, for the full or part of the residual maturity.



Features	Loan Terms
d. Conversion Guidelines	Conversions will be executed in accordance with ADB procedures prevailing at the time of conversion request, as explained in the conversion guidelines. The guidelines document will set out the procedures for requesting, accepting, and effecting conversions; information on conversion limitations and restrictions; illustration of financial cost of conversion; and transaction fees.
Commitment Fee	Sovereign Loans 15 basis points on flat amounts of undisbursed loan balances. Nonsovereign Loans Negotiated with the borrower.
Front-End Fee	Sovereign Loans None. Nonsovereign Loans Negotiated with the borrower.
Transaction Fees for Conversions and for Caps and Collars	
a. Currency Conversions	Disbursed loan amounts: 0.125% of the transacted amount. Undisbursed loan amounts: 0.0625% of the transacted amount.
b. Interest Rate Conversions	No fee for the first series of interest rate conversions undertaken by borrowers to convert the floating interest rate of the loan into a fixed rate, for up to the full amount and maturity of the loan. All subsequent interest rate swaps undertaken to reverse the initial conversions to a floating rate, and thereafter to convert the floating rate to a fixed rate, will be charged a fee of 0.0625% of the transacted amount.
c. Interest Rate Caps and Collars	0.0625% of the transacted amount.
Prepayments and Cancellations	All or part of the disbursed and outstanding balance may be prepaid at any time during the life of the loan. Borrowers may cancel all or part of the undisbursed balance before loan account is closed. For floating-rate loans, borrowers may prepay any outstanding amounts on the interest payment due date of the loan without a prepayment premium. However, prepayments of floating-rate loans on dates other than interest payment dates will be charged a prepayment premium based on the difference, if any, between the rate at which the proceeds from the prepayment could be reinvested and ADB's funding cost for the period up to the next interest payment date. In the event of prepayment of fixed-rate loans or floating-rate loans that involve conversions and the corresponding hedge transactions have to be terminated, the borrowers will be charged the unwinding costs of the hedge transaction, if any.
Currency Substitution	In the unlikely event of an access constraint in the loan currency, ADB will retain the right to replace the currency of the loan by a substitute currency until ADB's access to the loan currency is restored.



Term Sheet

Local Currency Loan Project for Sovereign Loans

Features	Loan Terms
Currencies	Loans will be offered in selected local currencies if local market conditions provide suitable opportunities.
Maturity	Loans will be based on project needs for the grace period and final maturity, and subject to suitable funding opportunities available in the local market.
Floating Lending Rate	Loans will initially have a floating rate until borrowers request a fixed rate. For floating-rate loans, the lending rate will consist of a cost base rate plus a spread. The cost base rate for floating-rate loans will be based on a suitable local floating rate market benchmark. The spread will be the prevailing effective contractual spread set at the time of loan signing. The effective contractual spread is 30 basis points for loans negotiated from 1 Jul 2010 to 30 Jun 2011, and 40 basis points for loans negotiated on or after 1 Jul 2011.
Fixed Lending Rate	At the time of fixing, the cost base will be the fixed-rate funding cost of the ADB for the relevant maturity payable by ADB under the relevant hedge swap transaction.
Lending Rate Reset Dates	For floating-rate loans, the lending rates will be reset according to the specific terms of the loan agreement.
Rebates and Surcharges	Rebates and surcharges would apply for sovereign loans that are funded under the pool-based approach.
Loan Conversion Options	The floating rate on the whole or part of the disbursed balance may be converted into a fixed rate, or vice versa, for the whole or part of the loan's residual maturity, if ADB is able to transact appropriate hedging transactions in the local market. Conversions will be executed at the prevailing market rates.
Commitment Charge	A flat fee of 15 basis points on the amount of undisbursed loan balances.
Transaction Fees	No fee for the first series of interest rate conversions that the borrower undertakes. All subsequent interest rate swaps will be charged a transaction fee of 0.0625% of the transacted amount.



Features	Loan Terms
Prepayments and Cancellations	<p>For floating-rate loans, borrowers may prepay any outstanding amounts on the interest payment due date of the loan by notifying ADB in writing according to the relevant prepayment notice period stated in the loan agreement. However, prepayment charges will be applied based on the difference, if any, between the rate at which the proceeds from the prepayment could be reinvested and ADB's funding cost for the prepaid amount. In the event of prepayment of fixed-rate loans or floating-rate loans that involve interest rate conversions and the corresponding hedge transactions have to be terminated, the borrowers will be charged the unwinding costs of the hedge transactions, if any. No prepayment charges will apply for floating-rate loans funded under the pool-based approach if prepayments occur on an interest payment date.</p> <p>Borrowers may cancel all or part of the undisbursed balance before the loan account is closed. However, for back-to-back funding arrangements, the borrower will need to pay a cancellation charge calculated as the present value of ADB's costs of carrying the canceled funds if ADB had agreed with the borrower to pre-fund the local currency requirement under the loan. No cancellation charge applies to loans funded under the pool-based funding approach.</p>
Currency Substitution	<p>If access to the loan currency is constrained, ADB will retain the right to replace the currency of the loan by a substitute currency until ADB's access to the loan currency is restored.</p>



Term Sheet

Local Currency Loan Project for Nonsovereign Loans

Features	Loan Terms
Currencies	Loans will be offered in selected local currencies if local market conditions provide suitable opportunities.
Maturity	Loans will be based on project needs for the grace period and final maturity, and subject to suitable funding opportunities available in the local market.
Floating Lending Rate	Loans will initially have a floating rate until borrowers request for fixing. As floating-rate loans, the lending rate will consist of a cost base rate plus an effective contractual spread. The cost base rate for floating-rate loans will be based on a suitable local floating rate market benchmark, adjusted by the Asian Development Bank (ADB)'s funding spread over/below the benchmark. The effective contractual spread will be set at the time of loan signing and will be fixed for the life of the loan. The effective contractual spread will depend on the assessment of the credit and project risks of the loan.
Fixed Lending Rate	Rate fixing will be available at the request of the borrower and is subject to appropriate hedging transactions available to ADB. At the time of fixing, the cost base will be the fixed-rate funding cost of ADB for the relevant maturity payable by ADB under the relevant hedge swap transaction.
Lending Rate Reset Dates	For floating-rate loans, the lending rates will be reset according to the specific terms of the loan agreement.
Loan Conversion Options	The floating rate on the whole or part of the disbursed balance may be converted into a fixed rate, or vice versa, for the whole or part of the loan's residual maturity, if ADB is able to transact the appropriate hedging transactions in the local market. Conversions will be executed at the prevailing market rates.
Commitment Charge	Negotiated with the borrower.
Front-End Fee	Negotiated with the borrower.



Features	Loan Terms
Transaction Fees	No fee for the first series of interest rate conversions undertaken by the borrower. All subsequent interest rate swaps will be charged a transaction fee of 0.0625% of the transacted amount.
Prepayments and Cancellations	For floating-rate loans, borrowers may prepay any outstanding amounts on the interest payment due date of the loan, by notifying ADB in writing according to the relevant prepayment notice period stated in the loan agreement. However, a prepayment charge will be applied based on the difference, if any, between the rate at which the proceeds from the prepayment could be reinvested and ADB's funding cost for the prepaid amount. In the event of repayment of fixed-rate loans or floating-rate loans that involve interest rate conversions and the corresponding hedge transactions have to be terminated, the borrowers will be charged the unwinding costs of the hedge transactions, if any. No prepayment charges will apply for floating-rate loans funded under the pool-based approach if prepayment occurs on an interest payment date. Borrowers may cancel all or part of the undisbursed balance at any time. However, for back-to-back funding arrangements, the borrower will need to pay a cancellation charge calculated as the present value of ADB's costs of carrying the canceled funds if ADB had agreed with the borrower to pre-fund the local currency requirement under the loan. No cancellation charge applies to loans funded under the pool-based funding approach.
Currency Substitution	If access to the loan currency is constrained, ADB will retain the right to replace the currency of the loan by a substitute currency until ADB's access to the loan currency is restored.



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For more information on ADB's projects and policies, visit www.adb.org.

Detailed information is available online at www.adb.org/About/financial-resources.asp.

About the ADB Financial Products

This brochure introduces ADB's financial products, including the LIBOR-based Loan, the Local Currency Loan, and Debt Management Products. It also explains each product's main features and provides an overview of the basic terms and conditions to assist borrowers in making informed decisions.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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