

ADB'S PRIVATE SECTOR OPERATIONS

Catalyzing Private Investments Across Asia and the Pacific

Asian Development Bank

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THE ASIAN DEVELOPMENT BANK

The Asian Development Bank (ADB) is a multilateral development finance institution. Established in 1966, it is owned by 59 member governments—43 of which are from the Asian and Pacific region. Its headquarter is in Manila, Philippines. ADB is rated triple-A by Moody's and Standard & Poor's.

Private enterprise plays an important role in the economic development of many of ADB's developing member countries (DMCs). The DMCs are increasingly adopting policies to create an environment more conducive to the commercial operations of private enterprise.

In response to the growing emphasis on private enterprise in its DMCs, ADB offers a variety of direct assistance to the private sector. Specifically, ADB's role is to help private enterprises undertake financially viable projects with significant economic and social merit, and therefore a positive development impact. Through its involvement, ADB helps make more private projects happen, thus promoting the efficient use of resources, accelerating economic development, reducing poverty, and raising the standards of business.

MOBILIZING PRIVATE CAPITAL

The demand for private capital has increased considerably in the region, influenced by the financing needs of large infrastructure development programs as well as the capitalization needs of financial institutions. While official development aid continues to be an important element in the development strategies of ADB and its DMCs, it is inadequate to meet their growing capital requirements. Attracting private capital has become a strategic objective of many DMC governments.

ADB is in a unique position to assist in mobilizing international private capital for its DMCs. It has considerable regional experience accumulated over decades and, through policy dialogue with member governments, has

assisted in formulating policies designed to encourage private initiatives. However, structural reforms alone are not enough to attract long-term investors. The presence of a multilateral bank investing alongside private partners also helps by providing comfort to the private investors. Innovative financial solutions involving a mixture of private and official funding sources may be needed for commercial lenders and equity investors to manage the risks associated with investing in developing countries. ADB has been directly supporting private sector projects through its nonsovereign window since 1983.

Currently, private sector operations are carried out by ADB's Private Sector Operations Department (PSOD), to provide focus for the catalytic role of ADB in mobilizing private capital for DMCs. PSOD has helped ADB respond to new opportunities and challenges created by the increasing role of the private sector in economic development, actively promoted by DMC governments.

ASSISTANCE TO PRIVATE ENTERPRISES

ADB directly supports private enterprises, private equity funds, and financial institutions. Its traditional modes of financing are equity investments and hard currency loans. Equity may include preferred stock, convertible loans, and other forms of mezzanine financing. Loans may be cofinanced by commercial banks and other financial institutions. ADB has three credit enhancement products to facilitate such cofinancing: Complementary Financing Scheme, Partial Credit Guarantee, and Political Risk Guarantee (see pages 11-14). ADB is also accustomed to working closely with export credit agencies (ECAs) and other official sources of parallel financing. More recently, ADB has explored various ways to more effectively mobilize local currency debt financing on terms suitable for financing long-term projects, thus reducing the risk for projects which are dependent on domestic sources of revenue.

ADB private sector operations focus primarily on two areas: financial sector and infrastructure. Financial sector or capital markets projects assist private financial intermediaries in diverse sectors including banking, leasing, venture capital financing, merchant banking, microcredit, small

and medium enterprises (SMEs), private equity funds, mutual funds, insurance, securitization, credit enhancement, and credit rating. Infrastructure includes telecommunications, power and energy, water supply and sanitation, ports, airports, and toll roads. Projects may involve various forms of risk-sharing and ownership arrangements including build-own-operate (BOO) and build-operate-transfer (BOT) structures. Infrastructure also includes social sectors such as health care, education, and services to government agencies. ADB is increasing its support for human capital development since such investments are frequently the most effective way of breaking the cycle of intergenerational poverty. By supporting efforts to improve policy and institutional arrangements, ADB will help ensure that the poor have access to essential social services. ADB does not focus on private industrial or agribusiness projects, but may consider them if they have links to core capital markets or infrastructure sectors and have special economic merit. Appendix 1 gives examples of ADB-financed private sector projects.

ELIGIBILITY FOR ADB ASSISTANCE

To be eligible for ADB assistance, the proposed investment should be in the private sector of a DMC and owned by local or foreign private sector entities. An enterprise owned jointly by private interests and the government of the DMC may be eligible for ADB assistance, provided the majority of its equity is privately owned and it is controlled by private investors.

When selecting projects to support, ADB favors those with strong, long-term economic benefits within its financial sector and infrastructure focus. This would include projects that cost-effectively supply basic needs and services for a wide segment of the population, projects that encourage technology and know-how transfer to DMCs, projects that expand the role of the private sector or improve the quality of private sector participation, and projects that play a key role in improving financial sector intermediation. Priority is given to improving the environment for private sector development. This favors projects that constitute an important step toward more effective privatization, for example by pioneering new contractual structures and promoting better risk sharing. Infrastructure

projects that are part of a well conceived privatization strategy are clearly favored. ADB also favors projects that promote a better financial environment for the private sector by providing new sources of debt and equity financing and building institutions that promote more stable and liquid capital markets. Asian economies exhibit great diversity of circumstances and needs. Accordingly, ADB's detailed strategy varies by country, depending on each country's size, stage of development, and specific economic profile. Priority is given to sectors in which the country has a comparative advantage, and sectors and companies starved of capital due to market imperfections and relatively high levels of perceived risk. Developing more integrated methods to encourage, support and finance SMEs is a priority in many DMCs. Small infrastructure projects may be more feasible and appropriate than larger ones, in certain countries. With new developments in private sector microfinance, ADB's reach is being extended to even smaller companies and the financial institutions that serve them.

When evaluating projects, ADB ensures that the cost of the project is reasonable and the sharing of risks and rewards between stakeholders is fair for both the country and the sponsors. For projects where private sponsors are granted an exclusive concession or license to operate facilities or supply specific services, ADB prioritizes projects awarded on a competitive and transparent basis, with a framework for regulating tariffs based on sound economic principles.

ADVANTAGES OF WORKING WITH ADB

Financial Intermediaries and Capital Market Institutions

ADB supports financial sector projects because this is key to the economic development of its DMCs, and capital markets projects have a significant catalytic impact in channeling foreign and domestic capital to productive sectors of the economy. Equally, sponsors of financial sector projects consider working with ADB because they can significantly benefit from the presence of a multilateral bank such as ADB. They approach ADB with their projects for a number of different reasons, including the following.

- ADB has been operating in the region for 35 years and has a 18-year record of private financial sector operations.

- As an established, multilateral development finance institution with a reputation for objectivity, ADB support for a project is a stamp of approval valued both by governments and other private sponsors or investors.
- As part of its policy dialogue with DMC governments, ADB is actively engaged in financial sector reform and can assist in promoting a more favorable environment and removing barriers preventing a sound project from moving forward.
- ADB maintains long-term relationships with institutional investors, banks, export credit agencies, and other official institutions and can help bring sponsors and investors together, in support of a proposed project.
- ADB has experience in helping structure and supervise financial sector projects, and can provide useful insights on project design based on lessons learned from past experience.
- ADB continues to contribute in developing best practices in the financial sector, particularly in the areas of corporate governance and risk management of banks and investment funds.
- Many sponsors find that ADB's goals as a development bank fit well with their own long-term objectives and contribute to a successful and more profitable project and a productive long-term relationship with ADB. Such developmental goals include
 - building stronger local financial institutions
 - transferring management know-how to DMCs and training local staff
 - improving corporate governance
 - increasing local capital market efficiency, liquidity, and scope
 - improving compliance with laws and regulations, and
 - supporting environmentally sound projects.

As a development bank, ADB has the objective of adding value to projects and not merely substituting for private capital in projects, which the private sector could do equally well or better on its own. ADB therefore looks for projects that maximize its catalytic role and leverage of capital. ADB also looks for projects that it believes fit well with the policy reforms it is recommending, and the level of market sophistication and degree of state intervention in the relevant country.

ADB can participate in offshore, country, and regional funds and domestic mutual funds. Private equity funds are currently emphasized over funds that invest in listed securities, but both can be considered. ADB assesses the fund's investment focus and the fund's catalytic or developmental role, and requires that the fund be managed according to best governance, environment, social, and risk management practices. ADB can assist in designing suitable fund structures.

Supporting SMEs is a priority for ADB. These enterprises represent the future of the private sector in many countries and yet their development is often constrained by a shortage of capital and other impediments. Investment funds are an important way for ADB to help support enterprises that are too small for direct investment. Increasingly, it has been recognized that funding alone is not the full answer. It should be accompanied by advice and assistance in managing the enterprise. Such advice is often supplied by fund managers that take an active role in supervising their investments and improving corporate governance. In selective cases, complementary advisory units, funded separately through grants, may provide additional support and develop deal flow for the fund.

Infrastructure Projects

The wide-ranging benefits that the private sector can derive from expanded and improved infrastructure facilities and the catalytic role for ADB justify the priority ADB accords to financing infrastructure projects. The private sector has traditionally been most active in telecommunications and power generation, the sectors with shorter payback periods most conducive to privatization. For this reason, the focus of ADB's operations is shifting more towards projects in water supply, waste treatment, toll roads, ports, airports, and light rail systems that are harder to finance using purely commercial sources. Also, ADB is beginning to consider social sector infrastructure, for example hospitals and schools, which until recently have seen little private sector involvement. ADB has significant experience in these sectors and can bring to bear the expertise of its sector and country specialists.

ADB assists in analyzing the feasibility out and developing the structure of infrastructure projects and provides financial support to qualified projects through equity investments, loans, and credit

enhancement products including guarantees. ADB provides loan maturities tailored to the needs of the project up to a maximum of about 15 years. When blended with medium-term commercial financing, ADB loans can result in a better-balanced financial structure that meets the long-term funding requirements of infrastructure projects. ADB is also considering developing ways to assist in mobilizing local currency financing for infrastructure projects, on suitable terms, to better manage the foreign exchange exposure of projects dependent on local currency revenues. This may involve an ADB guarantee of a local currency loan or bond issue.

When appraising projects, ADB pays particular attention to the process of selecting the developers and suppliers, and to the environmental and social aspects, particularly poverty reduction. ADB's preference is for projects and sponsors that are selected through a fair and transparent competitive bidding process—often the best way to ensure that the terms of the project are reasonable for all the stakeholders. ADB will consider negotiated transactions that have not been subject to competitive bidding if the circumstances of the project justify this approach, but additional due diligence may be required to approve the project cost and structure. ADB will only participate in a project if the regulatory framework for the project is sufficient, and there is proper provision for recommending and approving tariff adjustments.

EXTENT OF ADB ASSISTANCE

ADB's total support for a project for its own account, including loan, equity investment, partial credit guarantee, and underwriting commitment is limited by policy to 25 percent of the total cost of the project or US\$75 million, whichever is lower. ADB also provides political risk guarantee, coverage without the host government's counter-guarantee, of up to 50 percent of the total project cost or US\$150 million, whichever is less. ADB participation is intended to catalyze financing from local or foreign sources, not to compete with these sources. ADB's policy is to limit equity investments to less than 25 percent of the total share capital. Also, ADB cannot be the largest single investor in an enterprise. If needed, ADB may assist in mobilizing additional debt from commercial banks and other

financial institutions. This may be through parallel financing, separate from the ADB package, or through cofinancing, in which ADB acts as lender of record and the commercial banks take participations in the ADB loan, or through the use of guarantees.

APPRAISAL CRITERIA

ADB will undertake a comprehensive appraisal of the applicant enterprise and the project for which assistance is sought. In addition to evaluating the technical feasibility, market prospects, financial and economic viability, commitment to best practices of corporate governance, and environmental soundness of the project, ADB attaches considerable importance to the integrity, experience, success record, financial resources, and competence of the project sponsors and management. ADB does not support projects whose financial viability is dependent on tariff or nontariff protection and/or government subsidy.

LOAN TERMS

The interest rate and other terms of ADB nonsovereign loans vary depending on the needs and risks of the project concerned (Appendix 2). Interest rates are in line with market rates prevailing in the relevant country and sector, and factor in the country risk and project risk. Typically, ADB provides floating rate loans at a spread above the London interbank offered rate or Euro interbank rate, depending on the currency. Fixed rate loans are also available at the fixed rate swap equivalent of floating rate loans. The final maturity and the amortization schedule are chosen depending on the project's cash flow profile. Typically, loans have level amortization with a grace period of two to three years. ADB also charges fees. Typically, on floating rate loans there is a once-only front-end fee of about 1.0–1.5 percent of the loan amount, and a commitment fee of about 0.5–0.75 percent per year on the undisbursed balance. Depending on the circumstances, ADB may also charge an appraisal fee to cover its up-front costs associated with due diligence. ADB is reimbursed by the sponsors for out-of-pocket

expenses such as those for travel, and external advisory services (i.e., legal counsel, technical consultants, insurance advisors, etc.).

SECURITY

ADB loans must be secured. The nature and extent of the security is determined on a case-by-case basis. It usually entails a charge on the borrower's assets, including concession and operating agreements, and may take the form of a guarantee by a financial institution, project sponsors, or third parties.

PROCUREMENT

ADB funding can only be used to finance procurement of goods and services from ADB's member countries (Appendix 3). ADB encourages international competitive bidding for the procurement of goods and services. However, ADB will permit flexibility to expedite procurement and allow the enterprise latitude in the choice of plant, machinery, and services, provided that procurement procedures have been applied in a transparent manner with due regard to suitability and price considerations.

ACCOUNTING AND AUDITING ARRANGEMENTS

Accounts and financial statements of the enterprise must be audited at least annually by an independent auditor acceptable to ADB. The audited financial statements must be submitted to ADB together with the auditor's reports to management, directors, and shareholders. ADB encourages project entities to adopt best practices for audit committees, and adhere to internationally accepted accounting principles, designed to ensure adequate financial control during project implementation and operation.

CORPORATE GOVERNANCE

ADB encourages borrowers and investees to adopt and implement corporate governance practices consistent with international best practice, for example the standards issued by the Organisation for Economic Co-operation and Development (OECD). Naturally, such standards must be tailored to the country and project in question.

ENVIRONMENTAL CONSIDERATIONS

ADB-assisted projects are required to comply with the prevailing environmental regulations of the country as well as applicable ADB guidelines and to submit, when necessary, an environmental impact assessment report. Should a project have a significant environmental impact, a summary of the environmental impact assessment report must be circulated to ADB's Board of Directors 120 days before the Board considers the project. The report will describe, among others, the environmental mitigation measures required to address any significant environmental impact. The report should also be made available to affected groups and nongovernment organizations, where applicable.

ROLE OF ADB IN SUPERVISING INVESTMENTS

ADB will not seek a controlling interest in an investee company, and will not assume any management responsibilities. ADB does, however, reserve the right to appoint its nominee to the company's board of directors and will exercise its voting rights as a shareholder. ADB will maintain regular contact with company management and will require periodic reports on the progress of capital projects, operating performance, financial condition of the enterprise, and economic value added.

RISK PRINCIPLES FOR INVESTMENT FUNDS

ADB requires its investee funds to adopt best practices in risk management. A list of "Risk Principles for Investment Funds" is given in Appendix 4.

SALE OF ADB EQUITY INVESTMENT

ADB intends to divest its shareholdings at a fair market price once the objective of its investment is considered achieved. To facilitate divestment, ADB may require eventual listing of the shares of the investee enterprises on one or more stock exchanges or enter into a suitable buy-back agreement with the project sponsors. In general, ADB will prefer to sell its shares to nationals of the host country to broaden local ownership and further develop local capital markets. When disposing of its shares, ADB will, as far as practicable, consult with major investment partners and give due consideration to their views but will be entitled to dispose of its investments at its sole discretion.

COMMERCIAL COFINANCING

ADB may mobilize additional resources, in the form of commercial cofinancing, for the projects in which it participates. It should be noted that *direct* ADB participation in a project (e.g., a loan or equity investment from ADB's resources) is a precondition for ADB-supported commercial cofinancing.

ADB mobilizes commercial cofinancing by means of the following modalities:

- *Uncovered Parallel loans*, typically sourced from international or domestic financial institutions or bilateral agencies;
- *Complementary Financing Scheme* (CFS) loans, in which ADB is the "lender of record" on behalf of commercial cofinanciers;

- *Partial Credit Guarantees*, which provide comprehensive cover for a designated portion of the commercial debt provided by cofinanciers;
- *Political Risk Guarantees*, which cover specified sovereign risks; and
- *Export Credit Agency* cofinancing.

The salient features of each of the above modalities, as applied to ADB-assisted private sector projects, are summarized below.

COMPLEMENTARY FINANCING SCHEME

CFS loans, in which ADB acts as "lender of record" and provides loan administration services, are funded by commercial lenders, such as banks and insurance companies. CFS loans are available for private sector projects in which ADB is a direct participant. Although CFS loans do not provide cofinanciers with recourse to ADB for debt service, such loans do enjoy the same privileges and immunities given to ADB direct loans, including exemption from withholding taxes and from restrictions on remittance of principal and interest. In addition, CFS loans share in ADB's *preferred creditor status*, and thus enjoy enhanced cover against sovereign risk.

Commercial cofinanciers of ADB-assisted projects have access to ADB's project appraisal and loan documentation, thus facilitating their credit analysis and due diligence. In most cases, bank regulatory authorities in the cofinancier's home country reduce the provisioning requirements on lender of record loans. Taken together, these benefits allow ADB to mobilize CFS cofinancing on better terms than would otherwise be possible.

CFS Documentation Requirements. For CFS cofinancing, a single loan agreement covering both ADB's main loan and the complementary (CFS) loan may be used. This is in line with the principle that all senior lenders to a project, including cofinanciers, are in the same position and should receive debt service on a *pari passu* basis. Cofinanciers of a CFS loan are allowed to accelerate the loan, if it is in default due to nonpayment of principal or interest. ADB reserves the right to accelerate its direct loan,

based on an optional cross-default clause that is a standard feature of ADB CFS loan documents.

CFS Fees. ADB incurs a cost for arranging and administering CFS loans and therefore charges fees for arrangement and administration as summarized below.

Arrangement Fee (payable on arrangement)	75–100 basis point on the amount of the CFS loan (minimum of US\$20,000)
Administration Fee	US\$5,000 per participating CFS lender per annum, with a maximum fee of US\$20,000 per annum

GUARANTEES

ADB guarantees for private sector projects are credit enhancements designed to cover those risks that the private sector cannot easily absorb or manage on its own. Mitigating these risks can make a crucial difference in mobilizing debt funding for private sector projects. Guarantees have been used successfully to mobilize commercial cofinancing for infrastructure projects and financial institution development projects.

ADB offers two guarantee products, both of which are designed to mitigate risk exposure of commercial lenders. The first is the Partial Credit Guarantee, which provides *comprehensive* cover for both commercial and political risks. The second product, the Political Risk Guarantee, covers *sovereign* (or political) risks—leaving commercial risks with the private sector sponsors or lenders. The key features of these products are summarized below.

Partial Credit Guarantees (PCGs) are designed to cover that portion of the debt service that falls due beyond the normal tenure of loans available from commercial lenders. They are generally used for projects that need long-term funds to be financially viable. PCGs cover all events of nonpayment of the guaranteed obligation. In that sense, PCGs are comprehensive guarantees of principal and/or interest for those maturities that cannot be obtained from commercial lenders without credit enhance-

ment. PCG cover is particularly useful for projects in DMCs with restricted access to the financial markets, but which are considered fundamentally creditworthy and sound by ADB.

With lessons learned from the Asian financial crisis, host governments, project sponsors, and cofinanciers are placing increased emphasis on matching the currency of project revenue and debt service cash flows. To address this concern, ADB PCGs can be designed to cover *local currency debt*, including domestic bond issues or long-term loans from local financial institutions.

Political Risk Guarantees (PRGs) are designed to facilitate commercial cofinancing by covering specifically defined sovereign or political risks, which may include any combination of the following:

- *breach of contract* refers to losses arising from a host government's breach or repudiation of a contract with an insured project (for a power project, such a breach may result from failure by a government-owned entity to make payments in accordance with the power purchase agreement between the independent power producer and the user or distributor);
- *expropriation and nationalization*;
- *currency inconvertibility and nontransfer*; and
- *political violence*.

Guarantee Fees. Pricing of PCGs and PRGs for private sector transactions is market determined. Depending on administrative considerations and prevailing commercial practice, guarantee fees can be charged either to the borrower or to the lender.

EXPORT CREDIT AGENCY COFINANCING

In the wake of the Asian financial crisis, financing for private sector projects has become more expensive, shorter in term, or simply not available. While the aforementioned ADB credit enhancement products—(*CFS, PCG and PRG*)—provide valuable “cover” to commercial cofinanciers, support from ECAs can provide an additional and significant source of cover to such cofinanciers.

Export credit is usually provided by means of (i) commercial bank loans that are *insured* or *guaranteed* by ECAs or (ii) *direct loans* from ECAs. Export credit is often part of an export credit package put together by a structured trade or project finance unit of a commercial bank. The mandate of most ECAs is to fill a "gap" and cover the risks that the commercial market will not.

To tap this very important source of cover, and to assist borrowers in obtaining affordable and realistically priced commercial cofinancing, ADB is implementing an *ECA Collaboration Strategy*. The key features of the strategy that apply to private sector transactions include

- intensified communication and coordination with ECAs; and
- a willingness on ADB's part to act as *coordinator* between the project sponsor or arranging bank, and the various ECAs and international financial institutions (IFIs) participating in a transaction.

APPLYING FOR ADB ASSISTANCE

To enable ADB to promptly assess a project for its assistance, the sponsor will submit an application including the following information (Appendix 5):

- a description of the project;
- a backgrounder on the sponsors, including their financial and managerial background;
- project cost estimates, including foreign exchange requirements;
- implementation plan, including status of government approvals;
- market prospects, including proposed marketing or off-take arrangements;
- financing plan, indicating the type and amount of ADB assistance requested;
- corporate governance system; and
- disclosure and analysis of key risks.

After this information is assessed, ADB will convey its preliminary views to the applicant and may ask for additional details and documents necessary for further processing. ADB will observe confidentiality in its dealings with private sector projects.

It should be noted that ADB may not be able to assist all projects even when a project meets the criteria outlined in this brochure due to (i) staff or other resource limitations, (ii) need for industry and country risk diversification, or (iii) simple differences of opinion on the quality of the project and/or of its sponsors.

PROCESSING PROCEDURES

Processing of a project by ADB includes the following major steps: (i) concept clearance, (ii) fact-finding, (iii) appraisal, (iv) negotiations, (v) consideration by ADB's Board of Directors, and (vi) financial closing.

Concept Clearance

As a first step, there is an initial screening of the sponsors' request for assistance. If the information provided to ADB indicates that the project (i) is prima facie technically, economically, socially, and financially viable; (ii) needs ADB to play a catalytic role in developing and financing the project; and (iii) supports ADB's strategy in the country or region where the project is to be located, a concept clearance paper is prepared and submitted to ADB's Management for approval. At this point, the sponsors must provide an agreement to pay ADB's out-of-pocket expenses for processing the project.

Fact-Finding

Shortly after concept clearance, a project team (the Mission) will visit the project site, offices of the sponsors, and other locations, if necessary. The Mission will meet the sponsors, government agencies concerned, and local and international financial agencies to review the feasibility and environmental impact studies, including any resettlement of project-affected persons, and the overall viability of the project. Project costs and the project financing and implementation plans will also be reviewed. In addition, the need for cofinancing under ADB's CFS will be critically assessed and alternatives examined.

An important item on the critical path of processing for projects that appears to have a significant environmental and/or social impact, is the

submission of a summary of the environmental impact assessment (including resettlement aspects) report to ADB's Board of Directors. It is compulsory that this summary report, prepared in accordance with ADB's guidelines, be circulated at least 120 days before the project can be considered by the Board.

For large and complex projects, the Mission will coordinate with the sponsors and other senior lenders about appointing an independent counsel and engineering and other technical advisers needed to represent the lenders on a collective basis. In the case of smaller projects, a lower level of outside assistance will be required but in all cases the sponsors will be required to pay for these services.

Appraisal

Next, the Mission undertakes appraisal of the project. Appraisal includes an in-depth examination of the project and its sponsors and the issues identified at the fact-finding stage.

Negotiations and Board Consideration

After negotiations of the terms and conditions of ADB's investment, the internal documentation for the project is finalized and circulated to ADB's Board of Directors for consideration. Once Board approval is given, the project can proceed to financial closing and then the ADB loan and/or equity investment can be disbursed subject to compliance with the conditions agreed upon.

ILLUSTRATIVE PRIVATE SECTOR PROJECTS OF ADB

Capital Markets

Liberty New World China Enterprises Investments, L.P.

ADB approved in 2000 an equity investment of up to US\$25 million in the Liberty New World China Enterprises Investments Limited Partnership, a fund to help spur the growth of SMEs in the People's Republic of China (PRC).

The fund combines the PRC investment expertise of New World Group and the international fund management expertise of Newport Private Equity Asia, an affiliate of Liberty Mutual Group. In addition to the capital contribution to the fund, ADB helped structure the project to ensure best corporate governance and management practices in the fund itself as well as in its investee companies.

The fund raised \$75 million at the time of its initial closing. With an arrangement of New World Investments Ltd. making equal amounts of investment with the fund in a joint venture investment company, a total amount of \$150 million is committed to the joint venture company to make investments in PRC.

Since the launching in December 2000, the fund has invested in seven projects. The fund's investment strategy is to (i) invest in companies who have strong growth potential but lack financial strength, (ii) add value through strengthened financial discipline as well as employment of modern marketing and management techniques, and (iii) expand and replicate successful investment and business strategies into other regions in PRC.

The Lombard Asian Private Investment Company Limited (1996)

In November 1996, ADB approved its participation in a regional equity investment fund, the Lombard Asian Private Investment Company Limited (LAPIC) by means of (i) a US\$25 million investment in LAPIC and (ii) a US\$1 million investment in a related fund management company. It was structured as a closed-end direct investment fund with a 10-year life from the date of final closing, with a possibility of a two-year extension. LAPIC has raised a total equity capital of US\$252 million from the California Public Employees Retirement System (CalPERS) through Lombard Pacific Partners (LPP). Its eligible investments are equity, or equity-linked securities such as convertible bonds, issued by companies undertaking (i) industrial projects, including mainly industries and services that are infrastructure related and those enhancing efficiency as a result of economic liberalization policies such as privatization; and (ii) financial services companies, such as commercial banks, leasing companies, rating agencies, and insurance companies in ADB's DMCs.

Infrastructure Projects

North Luzon Expressway Rehabilitation and Expansion (2000)

The North Luzon Expressway is one of the Philippines' main road arteries. Presently a narrow, congested and poorly maintained expressway, its upgrading will spur development of central and northern Luzon—the Philippines' biggest island, help decentralize economic activities from Metro Manila, and support the government thrust to develop the national road network with private sector participation.

The total cost to upgrade 84 kilometers of the expressway was estimated at US\$377 million, for which ADB's funding support would consist of a loan of US\$45 million from its own resources and a complementary loan of US\$25 million funded by international commercial banks. ADB acted as the lead coordinating bank in structuring the debt package for the Project. Other key lenders include Export Finance and Insurance Corporation of Australia, International Finance Corporation, and seven international commercial banks.

Structured as a public–private partnership, the Project is being undertaken by the Manila North Tollways Corporation (MNTC) on a rehabilitate-operate-transfer basis. MNTC is a limited liability company jointly owned by the First Philippine Infrastructure Development Corporation, a major private infrastructure development firm; Egis Projects, a unit of the largest French tollway operator; and Philippine National Construction Corporation, a government controlled company that held the original franchise for constructing and operating of the expressway. At the end of the concession period in 2030, the expressway will be transferred to the Government without cost.

Meghnaghat Power Project (2000)

The Meghnaghat Power Project is the first power-generating plant to be financed by the private sector in Bangladesh. This BOT Project is expected provide cheaper electricity for the people and more reliable power supply to agriculture and industry. To be built on the northern bank of the Meghna River, 20 kilometers from the capital city of Dhaka, the Project will consist of a 450-MW gas-fired combined-cycle power plant, the largest in the

country. Sponsorship of the project was won in an international competitive bidding by AES Corporation, a leading independent power producer based in the United States.

The Project is part of the least-cost power expansion program and will provide additional base-load capacity to mitigate the present and projected power shortages. ADB has played a lead role in developing the Project: through a series of technical assistance packages, ADB supported the preparation of the project feasibility study and detailed engineering design, as well as the planning and conduct of the whole bidding process.

The total project cost was estimated at US\$300 million. To help finance this, ADB arranged a debt financing package consisting of a US\$50 million loan from ADB's own resources, a US\$70 million loan from a syndicate of commercial banks against an ADB political risk guarantee, and another US\$20 million loan funded by the same syndicate of commercial banks under ADB's CFS. In the spirit of public-private partnership, ADB also committed to provide a public sector loan to finance the transmission lines of the Project.

Chengdu Water Project (1999)

The Chengdu Water Project was designed to provide bulk supply of treated water to the capital city of Sichuan Province in the People's Republic of China (PRC) under an 18-year BOT contract. Chengdu is the second largest city in the southwestern part of the country and one of the cities classified by the PRC Government as having serious water shortages. The Project involves the construction of a water treatment plant with a capacity of 400,000 cubic meters per day, two water intakes, and a 27-kilometer transmission pipeline to the city. The project sponsor is a consortium of Vivendi from France and Marubeni Corporation from Japan.

The Project was developed with the assistance of ADB. As the first BOT water supply project in the PRC, it would serve as a model for similar projects in other parts of the PRC. Through technical assistance support to the Chengdu Municipal Government, ADB helped ensure that the basic elements of transparent bidding were observed, that the lowest feasible tariff was obtained, and that the project fundamentals, such as tariff

increases to enable cost recovery, were in place. The Project demonstrated that the BOT structure could be used at the municipal level and funded externally without any central government guarantee.

ADB was instrumental in structuring the finance for the Project, estimated to cost US\$106.5 million. Besides its own direct loan of US\$26.5 million, ADB helped secure debt funding commitments from seven commercial banks under ADB's CFS (US\$21.5 million) and under a guarantee facility from the European Investment Bank (US\$26.5 million).

Following approval by ADB and financial closing, the Project won three awards for excellence in project finance in 1999 from three internationally recognized financial publications. The London-based *Project Finance International* cited the Project as the "Infrastructure Deal of the Year," while both Hong Kong-based *Financial Intelligence Agency* and the *International Financial Law Review* voted it as the "Project Finance Deal of the Year." The awards were given in recognition of the Project's innovative and superior financing structure that allowed the international lenders to take long-term municipal risk in PRC for the first time.

GrameenPhone (1998)

The Project represents a joint venture between a well-established Norwegian telephone operator and a telecommunications company controlled by Grameen Bank of Bangladesh. It involves constructing and operating a nationwide cellular telephone network using GSM technical standard. The backbone of the proposed system is the state-of-the-art 1,800 kilometers fibre-optic transmission system that is leased from the Bangladesh Railways. The network covers almost the entire country and provides the most cost-effective solution to building up a nationwide network covering cities/towns as well as rural areas. The key innovative aspect of the Project is the inclusion of village pay telephones (VPPs), based on the proven and successful experience of Grameen Bank. This allows many villagers to have access to telephone services for the first time, providing a sound business opportunity, particularly for women entrepreneurs.

The development impact of the GrameenPhone Project has been well documented. Researchers from the University of Bonn did an analysis of

the development impact of VPPs. They found that out of the 3,000 operational VPPs, each served 1,500–2,000 people, giving about half a million people access to telephone services for the first time. A sample of 50 phone owners spread over 50 villages surrounding Dhaka metropolitan city indicated that 15 percent of the users are poor, accounting for 25 percent of phone calls made through VPPs. Thirty-five percent of the total phone calls sampled were for family and personal purposes, and ten percent were directed for seeking solutions related to health. The proportion is higher for poor people, where most of their calls are directed at obtaining market information and emergency health services. A significant impact cited by the study relates to the use of VPPs to increase transparency and consequently real income, via productivity increase and fair pricing of commodities supplied by villagers. Women were also more empowered due to phone ownership. The study concludes that "telephones in rural areas trickle tremendous socioeconomic benefits to the villagers, and more so to the poor ones."

The total cost of the Project was US\$167 million. ADB's support approved in 1998, consisted of a US\$16.7 million loan and a US\$1.6 million equity commitment, and was an important component of a financing package from a group of four multilateral and bilateral funding agencies.

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Latest developments on ADB's Private Sector Operations are available at
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APPENDIXES

Appendix 1

EXAMPLES OF ADB-FINANCED PRIVATE SECTOR PROJECTS

Bangladesh	Power-Generating Plant Rural Mobile Telephone Network
Bhutan	Joint Venture Commercial Bank
China, People's Republic of	Commercial Bank Venture Capital Fund Power-Generating Plants Bulk Treated Water Supply
India	Venture Capital Company Power-Generating Plant Credit Rating Agency Mutual Fund
Indonesia	Leasing Company Development Bank Securities Company
Malaysia	Credit Rating Agency
Nepal	Hydropower Plant
Pakistan	Leasing Company Export Guarantee Agency Mutual Fund Port Complex
Philippines	Development Banks Venture Capital Companies Mutual Fund Expressway Rehabilitation and Expansion Power-Generating Projects Water and Sewerage Concession Airport Terminal
Samoa	Venture Capital Fund
Sri Lanka	Insurance Company Power-Generating Plant Venture Capital Company Development Banks Container Port Terminal
Thailand	Mutual Fund Credit Rating Agency Expressway
Viet Nam	Leasing Company Water Treatment Plant Tertiary Education Hospital and Healthcare
Regional	Equity Funds Venture Capital Funds Bond Insurance Company

Appendix 2
PRIVATE SECTOR LOAN TERMS

LIBOR BASED LOAN PRODUCT	
CURRENCIES	<ul style="list-style-type: none"> Euros, US dollars or Japanese Yen
LENDING RATE	<ul style="list-style-type: none"> All LIBOR – based loans will initially have a floating rate until borrower requests for a fixed rate. The lending rate will consist of a base rate plus a fixed spread. <i>Cost Base Rate:</i> 6-month London Interbank offered rate (LIBOR) for the US dollar and Japanese Yen and 6-month euro interbank offered rate (EURIBOR) for the euro. At any time during the life of the loan, the borrower may request ADB to implement a series of interest rate fixing either by period or by amount. <i>Fixed Spread:</i> To be determined on a case to case basis based on assessment of credit and project risks and set approximately one month prior to loan signing.
COMMITMENT FEE	<ul style="list-style-type: none"> 0.5–0.75% per annum on progressive amount of undisbursed loan balance.
FRONT-END FEE	<ul style="list-style-type: none"> 1.0–1.5% flat of the loan amount
MATURITY	<ul style="list-style-type: none"> As may be determined based on project needs and could comprise of a grace period and a repayment period with final maturity.
LOAN CONVERSION OPTIONS	<p>Following conversion options would be available subject to ADB conversion procedures as may be applicable at the time of conversion.</p> <p>a) Currency Conversion:</p> <p><i>Undisbursed Amounts:</i> The whole or part of the undisbursed balance of the loan may be converted into the three offered currencies.</p> <p><i>Disbursed Amounts:</i> The whole or part of the disbursed balance may be converted into the three offered currencies for the whole or part of the loan’s residual life. Maximum maturity will depend on market conditions, currently 10 years. Conversions will be executed at the then prevailing market rates.</p> <p>b) Interest Rate Conversion: The floating lending rate on the whole or part of the disbursed balance may be converted into a fixed-rate or vice versa for whole or part of the loan’s residual maturity. Conversions will be executed at the prevailing market rates. Borrower may exercise these options any time during the life of the loan subject to a minimum amount of the higher of \$ 3 million or 10% of the loan amount. In the case of floating-to-fixed rate conversion maximum maturity is 10 years, although longer maturities may be available on a case by case basis.</p> <p>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 whole or part of the residual maturity.</p>

Appendix 2

PRIVATE SECTOR LOAN TERMS (cont'd.)

TRANSACTION FEES	<ul style="list-style-type: none"> • <i>Currency Conversion:</i> 0.125% of the transacted amount for the disbursed loan amounts and 0.0625% of the transacted amount for the undisbursed loan amounts. • <i>Interest Rate Conversion:</i> No fee for first series of conversion from floating rate to a fixed rate for up to full amount and maturity of the loan. 0.0625% of the transacted amount on the subsequent interest rate swaps. • <i>Interest Rate Caps and Collars:</i> 0.0625% of the transacted amount.
PREPAYMENT	<ul style="list-style-type: none"> • All or part of the disbursed and outstanding loans may be prepaid. Floating rate loans could be prepaid on an interest payment due date without a prepayment premium. Prepayment of floating rate loans on a date other than the interest payment due date will attract payment of a 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 prepaid amount. Prepayment of fixed rate loans or floating rate loans that involve conversion and a corresponding hedge requiring termination will attract payment of hedge unwinding costs, if any.
CANCELLATION	Borrower may cancel all or a part of the undisbursed balance at any time.
REPAYMENT	<ul style="list-style-type: none"> • Equal principal or annuity repayments.
LENDING RATE RESET/PAYMENT DATES	<ul style="list-style-type: none"> • Lending rate for floating rate loans will be reset every six months on an interest payment date. • Interest payment are due either on the 1st or 15th day of a calendar month and semiannually thereafter.

Appendix 3

ADB's MEMBER COUNTRIES

Afghanistan	Mongolia
Australia	Myanmar
Austria	Nauru
Azerbaijan	Nepal
Bangladesh	Netherlands
Belgium	New Zealand
Bhutan	Norway
Cambodia	Pakistan
Canada	Papua New Guinea
China, People's Republic of	Philippines
Cook Islands	Samoa
Denmark	Singapore
Fiji Islands	Solomon Islands
Finland	Spain
France	Sri Lanka
Germany	Sweden
Hong Kong, China	Switzerland
India	Taipei, China
Indonesia	Tajikistan
Italy	Thailand
Japan	Tonga
Kazakhstan	Turkey
Kiribati	Turkmenistan
Korea, Republic of	Tuvalu
Kyrgyz Republic	United Kingdom
Lao People's Democratic Republic	United States of America
Malaysia	Uzbekistan
Maldives	Vanuatu
Marshall Islands	Viet Nam
Micronesia, Federated States of	

Appendix 4

RISK PRINCIPLES FOR INVESTMENT FUNDS

The following list of principles forms the basis for ADB's approach to the processing and administration of investment funds.

- Sound, Effective, and Documented Governance Systems at Fund and Portfolio Company Level
- Effective Board of Directors and Investment Committee
 - Independent
 - Accountable
 - Compliance with international standards for corporate decision making
- Transparent, Consistent, and Documented Guidelines for Managing Conflicts of Interest
 - Effectively communicated
 - Published list of disclosure requirements
- Transparent and Documented Guidelines for Fair Dealing in All Fund Business Activities
 - Commitment to adhere to internationally accepted code of ethics and conduct
- Defined and Acknowledged Fiduciary Responsibilities
- Independent Internal Audit Function
- Documented Guidelines for Fund Termination Set at Inception
- Effective Management Arrangements
 - Objective, documented, transparent and competitive management selection process
 - Set guidelines for terminating fund management
 - Emphasis on personal selection, roles, responsibility, and relevant expertise

- Compensation policies and incentive schemes, which encourage behavior that is consistent with the fund's objectives and shareholder value
- Defined and Documented Operations Policies and Procedures
 - Effectively communicated
 - Periodically and systematically monitored and updated
- Defined and Documented Investment Guidelines
 - Clear, consistent, detailing the degree of management discretion
 - Set at fund inception and modifiable only with unanimous consent of all shareholders
 - Defined and documented exit strategy for portfolio investments
- Effective and Documented Investment Due Diligence Process
 - Structured, consistently applied and documented
- Transparent and Documented Performance Target
 - Effectively communicated and monitored
 - Consistent use of benchmarks
- Transparent and Documented Portfolio Performance Measurement and Monitoring
 - Consistent use of internationally accepted valuation and performance measurement methods
 - Risk-adjusted performance measures
 - Mark-to-market valuation of investments, whenever possible
- Effective and Documented Risk Management Function
 - Set limits for credit, market, and settlement risks
 - Independent monitoring of fund operations and external events
 - Periodic evaluation of independence and overall effectiveness of fund's control and risk management infrastructure

Appendix 4

RISK PRINCIPLES FOR INVESTMENT FUNDS *(cont'd.)*

- Compliance Function Independent of Investment Process
- Effective Management Information System
 - Effective monitoring of business performance
 - Enabling informed decision making
 - Consistent application of internationally accepted accounting standards
- Effective Treasury Function Independent of Investment, Trading, and Credits
- Corporate and Regulatory Reporting
 - Documented disclosure policies
 - Compliance with regulatory reporting requirements
- Communications with Investors
 - Complete, accurate and timely provisions of information that enables evaluation of performance
 - Decision-making "friendly"

APPLICATION INFORMATION REQUIREMENTS

The application for assistance should be accompanied by, as much as possible, the information listed below.

The Proposal

The role ADB is expected to play in the transaction, including equity, debt, and cofinancing arrangement.

Introduction

General information on the Sponsor, how the Sponsor was selected to undertake the Project, description of the project including implementation and operation philosophy, level of support for the project from the various levels of government, lending institutions and investors, and perceived difficulty to implement without ADB support. A feasibility study establishing the technical, financial, economic, and environmental viability of the project, prepared by a reputable consultant.

A Brief History of the Sponsor

Background of the Sponsor, including experience in project development in the home country and overseas, particularly in developing countries, the financial history including audited financial statements for the last three years, financial plans and projections, copies of any recent filings with securities commissions for issuance of debt and equity, and the ownership structure of the Sponsor.

The Project

Ownership and Management

Proposed structure of the ownership and management of the project, including legal, tax, and other advantages of such a structure, responsibilities and accountability of the proposed management and cost and incentive structure for any contractual arrangements with any separate management company.

Appendix 5

APPLICATION INFORMATION REQUIREMENTS *(cont'd.)**Project Description*

Project description, including location, major components, sources and quality of inputs for operation, and level of technology.

Implementation Arrangements

Implementation and contractual arrangements, including the construction and supervision methodology and a bar chart showing major scheduled achievements and completion for each of the major components of the project. Draft construction contracts and sources of possible cost increases and delays and sponsor support arrangements for such eventualities. Detailed description of liquidated damage provisions and performance bond requirements.

Project Operation

Operational arrangements for the project, including contractual agreements, availability and training of operational staff, expected efficiency levels of operation, and incentive and penalties for performance, maintenance plans, and reporting systems.

The Market

Market and marketing arrangements, including draft off-take concession and/or purchase agreements, creditworthiness of customer(s), current and projected markets (preferably from independent studies), price sensitivity, and market risks.

Environmental Aspects

A site-specific environmental impact assessment report, highlighting environmental impacts and mitigating measures, prepared by an acceptable consulting firm in accordance with ADB's guidelines.

Cost Estimates

Project cost estimates broken down by (i) major cost category; and (ii) local and foreign currency cost, setting out taxes and duties, development expenses, working capital requirements, and interest during construction.

Financing Plan

A summary of the proposed financing plan and security package including (i) source, amount, currency, and terms of the debt and equity investments; (ii) the source of finance for contingencies and cost overruns; (iii) description of escrow and retention arrangements; and (iv) information on the terms, security requirements, and status of the financing commitments of other lenders. The proposed arrangements for disposal of ADB's equity stake and dividend policy and proposed restrictions on their payment.

Expected Operational and Financial Performance

Financial projections for the project covering the period from financial closing through final maturity of the proposed ADB financing, including balance sheet, profit and loss, and cash flow statements, and detailed assumptions used to prepare the projections. These data should be included in the financial model so that sensitivities for changed assumptions can be readily calculated.

Financial and Economic Evaluation

A calculation of the economic and financial rates of return as well as return on the equity investment. These data also should be included in the financial model so that sensitivities for changed assumptions can be readily calculated.

Appendix 5

APPLICATION INFORMATION REQUIREMENTS *(cont'd.)***Others***Risk Analysis*

An analysis of the risks in implementing and operating the project with the accompanying mitigating measures showing which party will bear the risk and/or pay for the mitigating measures. This should be accompanied by a list of proposed insurance coverages for both implementation and operation of the project.

Financial Model

The information submission should be accompanied by a copy of the project's financial model. This should be an integrated model that can provide for sensitivity analysis of critical elements of the project. It should be provided in hard copy and on a 3.5 inch floppy disk.

Permitting and Licensing

A list of all permits and clearances required for implementing and operating the project, the issuing authority, and the date of issue or expected issue.