

OPERATIONS MANUAL BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

LENDING AND GRANT POLICIES (Asian Development Fund)

A. Introduction

1. Article 9 of the *Agreement Establishing the Asian Development Bank* (the Charter) states that the operations of the Asian Development Bank (ADB) consist of ordinary operations and special operations. The former are financed from ordinary capital resources (OCR) and the latter from Special Funds resources. Articles 19 and 20 of the Charter provide for the establishment and utilization of Special Funds resources.

B. Definition

2. The Asian Development Fund (ADF), established in 1974, is a Special Fund under the Charter for carrying out concessional lending¹ and grant² operations. ADF is subject to the Regulations of the Asian Development Fund (ADF Regulations), as amended from time to time.³

C. The Policy

1. Eligible Recipients

3. ADB provides loans and grants from ADF to developing member countries (DMCs). Access to the concessional terms of ADF assistance are based on country considerations, and the benefits of concessionality are intended to accrue to the DMCs. Country eligibility is determined in accordance with ADB's graduation policy,⁴ but ADF donors may choose to limit a DMC's access to ADF resources regardless of eligibility. The actual allocation of ADF resources and eligibility for grants are determined in accordance with ADB's policy on performance-based allocation for ADF resources and the ADF grant framework.⁵

4. The Charter and ADF Regulations also allow ADB to provide loan or grant financing from ADF to (i) an agency, instrumentality, or political subdivision of a DMC; (ii) an entity or enterprise operating in the territory of a DMC; or (iii) an international or regional agency or entity concerned with the economic development of the region.

¹ ADB. 2006. *Special Operations Loan Regulations*. Manila (1 January).

² ADB. 2005. *Special Operations Grant Regulations: Applicable to Grants Made by ADB from Its Special Funds Resources*. Manila (7 February).

³ ADB. 2006. *Regulations of the Asian Development Fund*. Manila (1 January). See Resolutions No. 62 (28 April 1973), No. 67 (20 November 1973), and No. 68 (20 November 1973) of the Board of Governors.

⁴ See OM Section A1 (Classification and Graduation of Developing Member Countries).

⁵ See OM Section A3 (Performance-Based Allocation of Asian Development Fund Resources).

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2. Expenditures Financed

5. ADF loans and grants finance the foreign exchange costs and local expenditures of projects, subject to the rules on cost sharing and eligibility of expenditures.⁶

3. Terms of Lending

6. Investment loans financed from ADF resources have a fixed-term, 32-year maturity including a grace period of 8 years, a 1.0% interest charge during the grace period and 1.5% during the amortization period, and equal amortization. Program loans from ADF resources have a fixed-term, 24-year maturity including a grace period of 8 years, a 1.0% interest charge during the grace period and 1.5% during the amortization period, and equal amortization.

7. The terms of loans committed from ADF resources may be adjusted to reflect changes in a country's economic circumstances. Accordingly, if (i) the per capita gross national product of the country has remained above the ADF eligibility threshold for 5 consecutive years, and (ii) the country has achieved the capacity to repay debt on OCR terms, ADB may modify the terms of repayment of the loan by increasing by 100% the amount of each maturity due thereafter until the principal amount of the loan has been fully repaid. In lieu of such an increase in maturity amounts, ADB may, at the request of the borrower, charge a higher interest rate on the loan amount disbursed and outstanding balance, provided that the resulting grant element is the same as it would be under the above-stated increase of maturity amounts. No adjustment of terms may be considered during the grace period. Where, after such an adjustment in terms, a country's economic conditions deteriorate, ADB has the flexibility to allow the country to revert to its original repayment schedule and interest charges.

4. Prepayment of Loan

8. A borrower can repay all or part of a loan in advance of the maturity specified in the Loan Agreement by giving notice to ADB 45 days in advance and upon payment of all accrued interest charges. ADB can reduce or waive the 45-day notice. There is no premium on prepayment of ADF loans. On the date of prepayment of a portion of a loan, no portion of the loan is to mature after the portion to be prepaid.

5. Procurement

9. Loan and grant proceeds from ADF are to be used for procurement, only in the territories of contributors to ADF and of DMCs of ADB, of goods, works, and services supplied from and produced in such territories.⁷

⁶ See OM Section H3 (Cost Sharing and Eligibility of Expenditures for ADB Financing).

⁷ See OM Section J3 (Procurement).

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6. Relending Terms

10. Relending becomes necessary when the proceeds of an ADF loan or grant are loaned to a beneficiary that is not the direct borrower or grantee of the ADF financing. The terms of relending depend on the nature of the beneficiary, while maintaining the principle that the benefits of the concessionality of ADF assistance should accrue to the DMC. ADB may allow relending on the same terms as those of the ADF loan, if the beneficiary is a government agency or instrumentality entrusted with implementing special social and economic policies of the government. If the beneficiary is a commercially operated public corporation, relending is generally to be on terms harder than those of the ADF financing, using the terms of lending from ADB's ordinary capital resources as the minimum acceptable relending terms. If the beneficiary is a private entity, the cost of external capital and the prevailing borrowing terms in the local market as reflected in the interest rate structure of the DMC concerned are the major factors in determining the relending terms. In all these cases, the proceeds of the ADF loan or grant may be provided to the beneficiaries on terms more concessional than those determined on the above basis, or in the form of equity capital, in circumstances to be specifically justified. The justification depends on the special economic or social nature of the project and the need to strengthen the financial position of the beneficiary. For ADF loans, an additional factor in the determination of relending terms is whether the foreign exchange risk is borne by the borrower or the beneficiary. In cases where such risk is borne by the borrower, a reasonable fee, included in the relending spread, may be charged by the borrower under the relending terms.⁸

Basis: This OM section is based on:

ADB. 2006. *Special Operations Loan Regulations*. Manila (1 January).

ADB. 2005. *Special Operations Grant Regulations: Applicable to Grants Made by ADB from Its Special Funds Resources*. Manila (7 February).

ADB. 2005. Doc. R359-05. *Proposed Revisions to the Regulations of the Asian Development Fund and the Special Operations Loan Regulations*. Manila (5 December).

ADB. 1998. Doc. R205-98. *Review of the Loan Terms for the Asian Development Fund*. Manila (23 November).

⁸ See OM Section H7 (Foreign Exchange Risk).

**OPERATIONS MANUAL
BANK POLICIES (BP)**

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Performance-Based Allocation Focal Point, Strategy and Policy Department.

**OPERATIONS MANUAL
OPERATIONAL PROCEDURES (OP)**

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**LENDING AND GRANT POLICIES
(Asian Development Fund)**

This OM section does not contain operational procedures.