

OPERATIONS MANUAL BANK POLICIES (BP)

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

PROGRAM LENDING

A. Introduction

1. A program loan is provided by ADB to assist a developing member country (DMC) in developing a sector (or subsector, sectors) as a whole and improving the performance of a sector through appropriate policy and institutional improvements over the medium to long term. Program loans are relatively quick disbursing to cover the immediate adjustment costs arising from policy reforms. ADB makes program loans only to DMC governments.
2. Program lending may be either from ADB's ordinary capital resources (OCR) or the Asian Development Fund (ADF); for financing from ADF, policies regarding ADF lending to DMCs¹ apply.
3. A broad-based sector reform and development plan that will enhance sector efficiency and performance, comprising in particular policy changes and institutional enhancement, is the basis for program lending. Such a sector plan, consistent with ADB's strategy for the DMC and with the DMC's own development strategy and plans, is set forth in a policy statement by the DMC government concerned in the form of a letter addressed to the President of ADB (the development policy letter [DPL]); the program outlined in the DPL is the focus of ADB's support.

B. Definitions

4. The term "sector" in the context of program lending is to be understood in the broad sense of the word. In addition to the traditional concept of a sector, it may include subsectors of more limited scope, or relate to broad cross-sectoral themes of a macroeconomic nature.
5. The general characteristics of policy-based program loans and guarantees are (i) that they are not linked to specific project activities but to the implementation of policy reform and are relatively quick-disbursing to cover the immediate adjustment costs arising from policy reforms; and (ii) that they have sector-wide and economy-wide impact.
6. A negative import list, or negative list for short, specifies ineligible imports excluded from financing under the loan, either by item or by specification of the Standard International Trade Classification. All items not listed on the negative list may be financed under the loan. In contrast, a positive import list, or positive list for short, specifies eligible imports for financing under the loan.

¹ See OM Section D2 (Lending and Relending Policies [ADF]).

OPERATIONS MANUAL BANK POLICIES (BP)

C. The Policy

7. Program lending supports sectoral and intersectoral development programs in a DMC, and involves adjustments to policies and investment plans, and capacity building of institutions. The program addresses underlying constraints that are sectorwide or intersectoral, or have a bearing on linkages between sectors and the macroeconomy.

8. Program loans, as well as sector development programs (SDPs),² must be targeted at sectors in which the government is firmly committed to reform, but in which significant economic, financial, or social costs are associated with the reform program and are likely to hinder its smooth and timely implementation without the additional support and inducement provided by a program loan. Strong government ownership of the reform program is essential. Program lending should also be limited to areas where ADB has or can readily acquire the requisite experience to provide well-founded advice on the formulation and implementation of reform programs.

9. Experience of a DMC in implementing policy conditionalities attached to project and sector loans in the same sector, and implementation experience with past program loans, are important factors for planning further program lending. This should cover not only the status of second tranche release of ongoing program loans in the DMC, but also postevaluation results of completed program and project/sector loans. Where serious problems were experienced with other program loans in the same DMC, processing of further program loans or SDPs need to be particularly well justified, and will be contingent on substantial front-loading of the relevant conditionalities.

D. Scope of the Policy

10. ADB has three program lending products, all policy-based, each catering to a different situation in a DMC. The standard program loan is used in normal situations where relatively short-term incidences of adjustment costs are expected in a particular sector, the time horizon of the program is short to medium term, no formal linkages to other programs are envisaged, and disbursements are relatively quick (about 3 years). The second program lending product, the program cluster approach (PCA), is an extension of the standard program loan modality. It differs, however, in that it addresses policy and institutional reforms over a longer time frame (4–7 years). The PCA comprises alternative ways of "packaging" policy in chronologically sequenced packaging (over time), vertical packaging (across levels of government), and horizontal packaging (intersectoral); and disbursements are moderately fast (4–7 years). The third program lending product, the special program loan (SPL), is used for emergency lending to a DMC in times of crisis and is characterized by its short-term time horizon, large size, quick disbursement (up to 3 years), nonstandard lending terms, and focus on actions to reduce the severity of the crisis.³ The standard and PCA program loans form part of the

² See OM Section D5 (Sector Development Programs).

³ Exceptional assistance under an SPL would typically be provided in a crisis situation where a large International Monetary Fund-led international rescue package is being mounted in one or more of ADB's

OPERATIONS MANUAL BANK POLICIES (BP)

assistance package contained in a country partnership strategy (CPS), CPS midterm progress review, or indicative rolling country operations business plan for a DMC; however, because a crisis is often hard to anticipate, an SPL is not planned in advance. An SPL, however, can lead to subsequent planned standard and/or PCA programs during the recovery phase following a crisis. Advisory TA may also be attached to all program loan products to study major policy issues and to strengthen key sector institutions.

11. Standard and PCA program loans, as well as, where applicable, SPLs, are based on comprehensive sector analyses that identify structural constraints to sector development, and on policy dialogue with the government to determine the means to address these constraints. The program resulting from the sector studies and policy dialogue must have the full commitment of the government, be consistent with ADB's CPS for the DMC concerned (in the case of the standard and PCA products), coincide with the DMC's own development plans and priorities, and be closely coordinated with other major development agencies.

1. Standard Program Loan

12. The standard program lending product is normally used to improve the policy environment for enhanced sector efficiency and for increased returns on investment. Macroeconomic and sectoral reforms seek to improve the efficiency and amount of investment in a sector by enhancing resource mobilization through increasing cost recovery, reducing or eliminating subsidies, and rationalizing interest rates; improving allocation of resources by lowering barriers; and promoting efficient resource use by increasing competition and involvement of the private sector. Where policy adjustments are required in a particular sector over an extended period of time, a succession of standard program loans may be considered to sustain the process.

2. Program Cluster Approach

13. The PCA is an extension of standard program lending, designed to provide more effective and flexible ways of translating complex policy objectives into implementable policy actions. The PCA recognizes imperfections in information and its availability, and allows for flexibility to cater to this in designing policy packages. The logical linkages between the packages are captured in a program cluster concept paper.

14. The first type of PCA, the chronologically sequenced packaging of policy reforms, allows for phasing in reforms over an adequate period of time in a coherent yet flexible framework and enables (i) the capacity to deliver policy reform to be matched with the intended policy change; (ii) changes to be made in non-traditional areas of policy where solutions are not obvious; (iii) reframing of solutions to policy issues in response to

DMCs to help restore stability. The second dimension that would justify ADB intervention is when the crisis has significant structural dimensions and is likely to have significant negative social impact.

OPERATIONS MANUAL BANK POLICIES (BP)

changes in the external environment; and (iv) incentives to be balanced sequentially throughout the program cycle to sustain commitment and ownership to change.

15. The chronologically sequenced packaging is characterized by (i) a coherent reform strategy with discrete subprograms linked as a cluster; (ii) linking the decision to proceed with a successive subprogram to satisfactory performance under the current subprogram; and (iii) the provision of flexibility, which enables experience and changes in the external environment to be incorporated in downstream subprograms.

16. The second type of PCA, the vertical packaging of policy reform, is a variant of the chronologically sequenced package. It is based on the understanding that the implementation of certain types of policy objectives will involve several levels of government and that follow-through will be required at each level over an adequate timeframe. Vertical packaging of policy reforms allows for concurrent implementation of logically linked subprograms across several levels of government and provides the means of managing the complexity and dynamics of multilevel policy change. Concurrent implementation in this type of PCA should be structured to avoid a top-down approach in implementing policy change, and ensures that constraint at a particular level of government does not impede implementation of the other subprograms of reform while the constraint is addressed at source. Each of the subprograms should be designed to link the policy instruments, actions, and institutional arrangements at a particular level of government. While implementation of some of the subprograms may occur concurrently, others may be implemented subsequently based on the experience gained with the initial subprograms.

17. The third type of PCA, the horizontal packaging of policy reforms, is another variant of chronologically sequenced packaging, involving cross-sectoral policy goals. In horizontal packaging, policy change would be undertaken simultaneously and followed through in a number of sectors to achieve a common goal. This approach may be used to address thematic policy change where solutions to problems are multifaceted and have substantive policy and investment requirements that are mutually reinforcing.

3. Special Program Loan

18. Extraordinary crisis situations, principally as a feature of globalized capital markets, can reoccur and be unexpected. Large reversals of capital flows and marked unexpected swings in relative prices require very sizable resources to restore stability. A protracted recovery phase is likely to ensue after stability has been restored, during which period the structural weaknesses that precipitated the crisis are addressed.

19. Typically, these crises are likely to affect DMCs at a more advanced stage of development: those that are OCR eligible or those that have graduated. The special characteristics of crisis-related lending, particularly its unanticipated character and exceptional scale, and the associated credit risk require adequate risk-bearing capacity to back up such lending. The SPL is used to address crisis situations by providing large-

OPERATIONS MANUAL BANK POLICIES (BP)

scale lending as part of an international rescue effort, usually including the International Monetary Fund (IMF) and the World Bank. To avail of assistance under an SPL, a DMC must be OCR eligible.⁴ Countries that have graduated out of regular ADB assistance are eligible for SPLs.

4. Identification

20. Identification of program loans is made in the context of ADB's CPS for the DMC concerned to achieve medium- to long-term objectives in a particular sector or across sectors. SPLs can be identified only when a crisis arises. The decision to initiate preparation of program loans requires comprehensive assessment of sector or cross-sectoral issues and their analyses. Full commitment by the government to institute a reform program is a prerequisite for a program loan, as are the ability and political will to implement the needed reforms. In addition, the reform program must merit ADB support on account of its scope and strength, and the program lending must facilitate and accelerate implementation of the reform program by helping to defray financial, economic, or social costs that the reform entails.

5. Sector Analysis

21. Comprehensive sector or intersectoral studies are a prerequisite for considering standard and PCA program lending.⁵ In addition to policy issues, the sector or intersectoral studies are to address social and environmental issues, the relative roles of the public and private sectors, and institutional development needs. Technical assistance (TA) may be processed with the program loan to study unresolved policy issues or to strengthen the capacity of key sector institutions.

22. An assessment must be carried out of the impact of the proposed sector reforms on the poor and other vulnerable groups. Where a reform program entails adverse short-term impacts on the poor or other vulnerable groups, the program loan must seek to include mitigating or offsetting measures to the extent feasible. When applicable, counterpart funds generated by the foreign currency disbursed under the loan may be used for this purpose.

6. Macroeconomic Linkage and Aid Coordination

23. A program loans must take into account the linkage between it and the macroeconomic conditions in the DMC. General macroeconomic conditions and the direction of macroeconomic policies must be deemed satisfactory before a program loan can be considered. Also, the effects of untied capital inflows on the money supply and exchange rate must be considered. ADB is to systematically consult and closely

⁴ SPLs are not proposed for ADF-only borrowers.

⁵ This does not mean that a formal sector study must necessarily be carried out by ADB. Where the necessary information is already available, for example through ongoing sector work by ADB or studies carried out by other institutions, these may serve as a foundation for program loan formulation.

OPERATIONS MANUAL BANK POLICIES (BP)

coordinate with the IMF, the World Bank, and, where applicable, other multilateral development banks, and major bilateral funding agencies in formulating and implementing program loans. Aid coordination must in particular address the interface of the ADB-supported program with macroeconomic aspects, including the adequacy of the macroeconomic framework for successful implementation of the program, and the potential impact of the latter on the above-mentioned macroeconomic variables.

7. State- or Provincial-Level Program or Subprogram Loans

24. Program and subprogram loans at the state or provincial levels may be considered selectively in DMCs where sufficient policy autonomy exists at these levels of government, and where there are no legal or administrative impediments to such loans. The ability of these levels of government to address all relevant sector issues, and the full concurrence of the national government and the state or provincial level government, are required for this approach.

8. Tranching

25. A program loan is divided into tranches if major elements of the sector policy reforms are to be introduced after the loan agreement becomes effective. Tranching enables ADB to monitor and expedite phased program implementation. The program period and number of tranches are determined case by case. Untranching loans may be considered if the most important reforms can be implemented prior to effectiveness.

26. Considerable importance in program lending is attached to the proper timing and sequencing of reforms. Tranching conditionalities must be formulated with a view to optimizing the sequencing of reform steps, as well as minimizing short-term costs of adjustment.

27. Comprehensive and far-reaching reform is normally required in a program loan. However, in view of the dislocations often caused by drastic policy changes and the sometimes adverse short-term impact of reform on specific groups, ADB can, where justified, support an incremental pace of reform. This may be accomplished through a succession of program loans in a sector, or through the adoption of a longer time frame together with multiple tranching.

9. Loan Amount

28. Key factors to consider in determining the amount of a program loan are ADB's overall annual lending program and the lending program to the DMC, sectoral and cross-sectoral investment needs, availability of alternative sources of financing, the strength and adjustment costs of the policy reform program, and the relative importance of the sector or sectors.

OPERATIONS MANUAL BANK POLICIES (BP)

10. Loan Terms

29. Standard program loans and subprogram loans under the PCA from OCR have a 15-year maturity including a 3-year grace period. ADB's London interbank offered rate (LIBOR)-based loan lending terms⁶ apply. The terms for standard program loans and subprogram loans under the PCA from ADF are 24 years maturity including an 8-year grace period, a 1.0% annual interest charge during the grace period, and a 1.5% annual interest charge during the amortization period, and equal amortization. In the case of an SPL, the maturity period is 5 years including a grace period of 3 years. The floor for SPL charges is set at 400 basis points above LIBOR, and the spread is fixed for the life of the loan.⁷ In addition, such other charges as are applicable to regular OCR loans also apply to SPLs.

11. Ceilings

30. There are no individual country ceilings for program lending. Total annual program lending for standard program loans, PCA loans, the policy-based component of SDP loans, and policy-based guarantees is not to exceed 20% of total public sector lending on a 3-year moving average basis under normal circumstances.⁸ Similar lending from ADF is subject to a ceiling of 22.5% of total ADF lending. SPLs are exempted from counting towards the ceiling on regular program lending.

12. Technical Assistance

31. The TAs attached to policy components of a program loan must be carefully targeted to meet key capacity-building needs in the sector and/or address major policy issues having a bearing on future strategy decisions. The number and design of attached TAs must be geared to the absorptive capacity of the executing agencies involved. Close supervision of TA execution by ADB, and incorporation of TA findings in ongoing policy dialogue, are an essential part of program loan administration.

13. Counterpart Funds

32. Program lending must include a broad review of budgetary allocations to and within the sector, with a view to ensuring that essential expenditures are met. Where shortfalls in the allocation of development or operating expenditures to the sector are identified, the program loan must seek to correct these, to the extent feasible, by obtaining matching expenditure commitments from the borrowing government in exchange for the counterpart funds generated. Such matching expenditure commitments may, where applicable, take the form of policy covenants, and may be documented in

⁶ See OM Section D1 (Lending and Relending Policies [OCR]).

⁷ The floor would be adjusted from time to time as necessary to take into account ADB's overall risk-bearing capacity and market conditions. Consequently, the spread could vary from one SPL to another.

⁸ The 1999 paper (R210-99) specifically stated that the first such 3-year period following the adoption of the ceiling covering the year 2000–2002.

OPERATIONS MANUAL BANK POLICIES (BP)

the loan agreement and indicated in the policy matrix. In all cases, agreement on the appropriate use of the additional budgetary resources generated by the program loan must be reached during loan negotiations, and specified as counterpart funds and explained in the report and recommendation of the President.

14. Procurement and Disbursement

33. The approach to procurement and disbursement under program lending is different from that under project loans. There is considerable flexibility in the use of program loan proceeds to meet a DMC's development needs. The loan proceeds may be utilized to finance economywide import requirements on the basis of a negative import list, or, where necessary and appropriate, sector-specific import requirements on the basis of a positive import list.

34. Where the foreign exchange provided by ADB is used for procurement by public sector entities rather than private, commercial importers, ADB must review the standard public sector procurement procedures used in the DMC with regard to their economy and efficiency. Where exchange controls are in effect, ADB will review the general foreign exchange allocation mechanism in the DMC with regard to its efficiency and transparency; where these cannot be guaranteed, remedial steps should be adopted as an integral part of program design. Also, ADB must always ensure that program loan proceeds are used for procurement in and from member countries and that the standard exclusion negative list applies in the case of economy-wide imports.

35. With respect to retroactive financing, considering program loans are generally designed to provide budgetary or balance-of-payments support for the implementation of policy reforms, the disbursement schedule should as far as possible be referenced to the incurrence of the relevant costs. Retroactive financing will, therefore, generally not be necessary or appropriate, since the reform programs to be supported will normally be forward looking. Where, however, reforms were introduced prior to program loan approval as a condition for Board consideration, and the associated costs have thus already been incurred, or where costs are likely to be incurred shortly after Board approval, retroactive financing could be permitted selectively to help defray the relevant costs.

**OPERATIONS MANUAL
BANK POLICIES (BP)**

- Basis:** This OM section is based on:
- ADB. 1999. Doc. R210-99, Corrigendum 1, *Review of ADB's Program Lending Policies*, 2 December. Manila.
- ADB. 1998. Doc. R50-98, *Simplification of Disbursement Procedures and Related Requirements for Program Loans*, 23 March. Manila.
- ADB. 1996. Doc. R143-96, *Review of Bank's Program-Lending Policies*, 3 July. Manila.
- This OM section is to be read with OM Section D4/OP.
- Compliance:** This OM section is subject to compliance review.
- For inquiries:** Questions may be directed to the Director, Strategy, Policy, and Interagency Relations Division, Strategy and Policy Department.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

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

PROGRAM LENDING

A. Introduction

1. Although the objectives of program lending are different from project or sector lending, operational procedures for processing program loans are generally the same,¹ except that the emphasis is on understanding the existing policy framework in the sector (or sectors) and on assessing the need and scope for reform and development. Sector work on the relevant policy and institutional issues generally precedes formulation and appraisal of a program loan.

B. Application of the Policy

1. Identification

2. A program loan² supports a government program for sector reform and development. The decision to start preparing a program loan must be made in the context of ADB's strategy for the developing member country (DMC) concerned, with a view to achieving certain medium- to long-term sector, multi-sector or sub-sector objectives. The initiating department must be convinced that the DMC authorities are willing and able to institute an acceptable reform program and to maintain close and continuous policy dialogue with ADB. This also includes an assessment that the program proposed merits ADB support on account of its scope and strength, and that program lending by ADB will facilitate and accelerate program implementation by helping defray the financial, economic, or social costs that the reforms entail. The decision to initiate preparation of a program loan also requires careful assessment of available sector analysis and the demand on ADB staff for sector work and policy dialogue.

2. Development Policy Letter

3. During program loan processing,³ ADB will need to determine whether the existing and envisaged policy framework and institutional development plan form an appropriate basis for ADB support. This also includes an assessment of public investment plans in the sector, and of the envisaged distribution of roles between the public and private sectors. Hence, a major objective in program loan processing is to reach an understanding with the government on the medium- and long-term development framework in the sector and on the schedule of policy steps to be undertaken during the program period which will be formalized as the government's

¹ See OM Section D11 (Processing Loan Proposals).

² Unless it specifically includes a special program loan (SPL), a program loan in this section generally refers to a standard program loan or a subprogram loan under the Program Cluster Approach (PCA).

³ Comprising identification, fact-finding, and appraisal.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

policy statement in the form of a letter (the development policy letter [DPL]) from an appropriate government official to the President of ADB. The DPL is a key document throughout program loan processing. The letter must spell out in appropriate detail medium- to long-term sector objectives, the measures already taken and those to be taken to achieve them, and various indicators to be used in monitoring program implementation and sector performance.

4. The focus of the program loan process is to reach an understanding with the government and to develop and review the draft DPL with the government. In the early stages of processing, an initial draft of the DPL is produced and discussed with the authorities for reference purposes only, that would also be subject to subsequent Management approval at various stages of the program loan process. The draft DPL is included in full in the successive stages of the draft report and recommendation of the President (RRP). The RRP also includes a policy matrix, i.e., a table setting out the overall objectives of the program, measures already taken, specific actions to be taken under the program, their timing, and further actions needed over the medium term. The DPL remains a draft until an understanding is reached on its finalization between ADB and the DMC authorities.⁴ However, agreement must have been reached regarding the essential features of the DPL prior to loan negotiations. The signed DPL is an integral part of the documentation sent to the Board when seeking its approval of the program loan.

3. Program Cluster Concept Paper

5. For program cluster approach (PCA) loans, the program cluster concept paper is a key design element. The broad objectives and scope of the various subprograms in the program cluster will be set forth in the program cluster concept paper, with particular attention paid to articulating the logical linkage among the subprograms. The program cluster concept paper covers (i) initial conditions and issues to be addressed under the program cluster, (ii) the desired end state, (iii) the logical linkage among the issues, (iv) the rationale for adopting the PCA, (v) an outline of the intended objectives and scope of each subprogram, (vi) an approximate cost estimate of the cluster, and (vii) an indicative implementation time frame of the cluster. The program cluster concept paper forms the basis for a memorandum of understanding with the borrower on the broad design and the implementation approach of the program cluster.⁵ The first subprogram in the PCA loan is presented to the Board of Directors for approval along with the program cluster concept paper, which indicates the total amount that ADB is willing to provide over the program cluster period. The completion period for actions in policy matrixes of the standard program loans, as designed, is around 3 years. The program cluster period could range for a longer period of 4–7 years. The program cluster should emanate from the country partnership strategy and should be grounded in a sector study. As in standard program loans, each subprogram will include a policy matrix. The multiyear program cluster concept paper will include a logical framework that will serve as a route

⁴ The mission must inform the government accordingly.

⁵ A PCA program loan also has a DPL. The DPL reflects the understanding reached in this memorandum.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

map to reach the target/outcome. All subprograms in a cluster operation will be placed within an indicative rolling schedule that would be reviewed and amended as needed. Subject to satisfactory performance on the subprogram and after consultation with the DMC, further subprograms are presented for Board approval. Disbursements are made against each subprogram's policy matrix.

6. Performance monitoring at each stage of implementing the program cluster is of critical importance for ADB to (i) determine whether to proceed with the next subprogram and (ii) incorporate the lessons learned into the design of subsequent subprograms. Performance indicators should comprise three main categories: (i) policy indicators that monitor the policy and institutional actions, (ii) ownership and capacity indicators, and (iii) outcome indicators. Some policy indicators will be unique to a subprogram, others could be common to two or more subprograms. Ownership and capacity indicators, although difficult to develop *ex ante*, are particularly important for the PCA. Identifying such indicators at the outset and tracking them will help in the design of later subprograms and in the evaluation of the impact of the program cluster as a whole. Ownership indicators will normally be common across all the subprograms whereas capacity indicators could be distinct or overlapping. Outcome indicators will be based on the desired end state and should be specified in the overall program cluster framework. The contribution of individual subprograms to the desired outcomes should also be kept under review.

4. Fact-Finding

7. Preparation of a program loan involves detailed sector analysis by ADB; reviewing with the government its plans and needs for policy and institutional change; firming up details on specific policy measures to be taken; evaluating—and if necessary modifying—the sectoral investment program⁶ and institutional support provided; coordinating with the International Monetary Fund, the World Bank, and important bilateral agencies; and determining the criteria for measuring progress in program implementation and sector performance. Continuous dialogue between ADB and key policy makers in the DMC is essential to assess the degree of the government's commitment to concrete policy actions and to determine when the program loan is ready to be appraised.

8. The RRP for program loans are required to address the following issues: (i) diagnostics—assessing the extent to which a particular policy distortion leads to a particular policy problem; (ii) the policy matrix—selecting policy actions for inclusion in the matrix based on the extent to which they address problems identified in the diagnostics; (iii) linkage with sector strategy—ensuring that the program formulation is consistent with the government's plan for the sector and ADB's own sector strategy; (iv) tranching—apportioning policy actions into tranches to ensure proper sequencing and implementation of required policy actions; (v) policy-focused institution building—

⁶ Especially with regard to the adequacy of capital and recurrent spending and the appropriate split between public and private sector activities.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

providing complementary assistance to enhance policy delivery capacity; (vi) adjustment costs—identifying, to the extent possible, the costs of policy changes; and (vii) performance indicators—specifying monitorable indicators that can subsequently be used to assess the development impact of the program. Program loan designs are complex exercises in economic and institutional reform. Their successful implementation depends not only on the technical design but also the manner in which the political economy of the reforms is factored into the design.

5. Appraisal

9. During appraisal, it is important that an understanding is reached on detailed program objectives and content, conditions of loan effectiveness, tranching and conditionalities for tranche release, use of counterpart funds, procurement and disbursement, how key elements of the program will be monitored, and all other issues listed in the draft RRP and the minutes of the management review meeting (MRM). Depending on the complexity of issues dealt with during appraisal and the sensitivities involved, more than one appraisal mission may sometimes be required for a program loan.

6. Second Management Review Meeting

10. The second MRM is required for all program loans.

7. Legal Documents

11. As the government's DPL is the basis on which a program loan is granted, the letter must be referred to in the loan agreement and must serve as the basis for any major conditions for effectiveness and conditionalities for tranche release which are reflected in the policy matrix attached to the DPL. The interpretation of DPL related covenants or tranche release conditionalities and their compliance question must be considered in the context of the program framework laid out in the DPL. The loan agreement will also contain appropriate arrangements for procurement and disbursement.

8. Negotiations

12. ADB and the government must agree on the essential features of the DPL prior to loan negotiations. Although the final wording of the DPL may still change during negotiations, these changes should be relatively minor and be cleared quickly with the negotiators' capital. A final agreed version of the DPL and of the policy matrix is normally confirmed on the last day of negotiations, which is normally the date of the DPL. The final step of the negotiation process is furnishing to the President the DPL, duly signed by an appropriate government official.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

9. Loan Agreement Signing and Effectiveness

13. Following Board approval of a program loan, standard rules and regulations for loan agreement signing and effectiveness must be followed, and in addition, staff should generally endeavor to arrange for signing almost immediately after Board approval. Conditions for effectiveness will thus generally be kept to a minimum, with all substantial program-related matters having been resolved as a precondition for Board consideration. This also means making advance arrangements with the borrower to have a draft legal opinion furnished to ADB at the time of negotiations or as soon as possible thereafter so that the final legal opinion may be ready as soon as the loan agreement is signed.

10. Release of Tranches⁷

14. In cases where there is tranching, the release of the second and any subsequent tranches will be conditional on the introduction of the agreed upon program elements. Before the release of the second or subsequent tranche, a progress review should be undertaken. If conditionalities for a tranche release have been met, tranche release is authorized by the President, after a progress report reviewing and assessing program implementation and compliance with conditionalities has been circulated for the Board's information. Board members may request a discussion of the report if they wish. The tranche release will be effected not less than 10 working days after the progress report has been distributed to the Board.

15. If a tranche release is proposed even though compliance with conditionalities has been incomplete, Board approval will be sought through a progress report on a no-objection basis. The progress report will be similar to that under para. 14, but will also explain the factors justifying the proposed release despite the incomplete compliance. Board approval will be sought for an appropriate waiver of or amendment to the relevant loan covenant. The advice of the Office of the General Counsel should be sought in cases of doubt whether particular loan covenants require waiver or amendment.

11. Procurement and Disbursement

16. There is considerable flexibility in the use of program loan (including special program loan) proceeds to meet a DMC's developmental needs. The loan proceeds may be utilized to finance economy-wide import requirements on the basis of a negative import list, or sector-specific import requirements on the basis of a positive import list. Normally, negative import lists will be appropriate, although positive lists may also be

⁷ Release of the first tranche or its equivalent under the untranching loans whose conditionalities have not been met within 6 months of Board approval of the loan will require a progress report. In this case, the progress report should be prepared following the same procedure as that for release of the second and any subsequent tranche releases presented in paras.14-15. If the conditionalities for the release of the first tranche or its equivalent under the untranching loans are met within 6 months of Board approval, then a progress report will not be required.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

applied, for example when foreign exchange is scarce and ADB wishes to ensure that sector import requirements are met.

17. The proceeds of a program loan for which there is only a negative list of ineligible items may be disbursed without supporting import documentation, if during each year in which the proceeds of the program loan are expected to be disbursed, the value of the DMC's total imports minus (x) imports from non-member countries, (y) ineligible imports, and (z) disbursements made under other official development assistance, is greater than the amounts expected to be disbursed during such year. The borrower will be required to submit with each withdrawal request a certification confirming the borrower's compliance with the above formula in respect of the period covered by the withdrawal request. Otherwise, import documentation under existing procedures will still be required.

18. Documentation in respect of specific imports will continue to be required for program loans for which a positive list of eligible items is utilized.

19. ADB's international competitive bidding procedures will no longer be required for contracts financed under program loans. For goods commonly traded in international commodity markets (e.g., petroleum products and fertilizers), normal commercial procedures appropriate to the trade are regarded as acceptable for ADB financing. Financing of specific commodities may be limited to an agreed upon maximum percentage (say 60% of the total loan amount). The specific procurement procedures proposed for each program loan are based on ADB's assessment of the procedures in the borrowing DMC and are set out in the loan documentation. The borrower and, where appropriate, concerned agencies are required to keep accurate records of the accounts under the program loan.

20. Disbursement under program loans normally takes the form of reimbursement to the central bank of the DMC acting as a depository. The central bank is generally responsible for administering program loans⁸ in close consultation with the government and sector-specific entities responsible for implementing the sector program. Where appropriate, the central bank may disburse the loan through commercial banks or development finance institutions or both.

⁸ Occasionally, this role can be played by the ministry of finance.

**OPERATIONS MANUAL
OPERATIONAL PROCEDURES (OP)**

- Basis:** This OM section is based on OM Section D4/BP and the documents cited therein.
- Compliance:** This OM section is subject to compliance review
- For inquiries:** Questions may be directed to the Director, Strategy, Policy, and Interagency Relations Division, Strategy and Policy Department.