

OPERATIONS MANUAL BANK POLICIES (BP)

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

LOAN COVENANTS

A. Introduction

1. The *Agreement Establishing the Asian Development Bank* (the Charter) provides the following:

- (i) ADB will promote investment in the Asian and Pacific region of public and private capital for development purposes (Article 2[i]);
- (ii) ADB will take necessary measures to ensure that any loan made, guaranteed, or participated in by ADB is used only for the purposes for which it was granted and with due attention to considerations of economy and efficiency (Article 14[xi]); and
- (iii) ADB will be guided by sound banking principles in its operations (Article 14[xiv]).

2. The Charter also provides that the contract for direct loans made or participated in or loans guaranteed by ADB will establish the terms and conditions for the loan or the guarantee concerned (Article 15.1).

3. Thus, ADB's legal agreements stipulate loan covenants that are considered necessary to ensure efficient implementation of, and full realization of benefit from, projects financed by ADB. These covenants include development covenants that deal with the objectives and implementation of an ADB-financed project, taking into account ADB's role as a development financing institution and its objective to contribute to the economic growth of the region. These covenants include covenants entered into by ADB in its equity investments.

4. During project implementation, including review, midterm review, and project completion missions, ADB departments concerned review the status of compliance with loan covenants in the legal agreements entered into by ADB with the borrowers/guarantors/executing agencies of ADB-financed projects.

B. Definition

5. As used in this OM section, the term "legal agreements" refers to all or any of the project-related legal documents, including the loan agreement, guarantee agreement, and project agreement.

C. The Policy

6. Loan covenants are primarily the obligations to be performed by the borrowers/guarantors/executing agencies of ADB-financed projects. ADB is under an obligation to monitor and follow up these obligations contained in loan covenants. ADB's

general approach on noncompliance with loan covenants is to seek corrective measures in order to attain the original development objectives of the ADB-financed project. ADB's legal remedies on noncompliance with loan covenants include suspension, cancellation, or acceleration of maturity, which are available under the loan agreement and the loan regulations made applicable thereto. Resorting to legal remedies in the event of noncompliance is not automatic or mandatory. Before resorting to such measures, ADB uses available means to rectify the situation satisfactory to all parties to the legal agreements, including initiating dialogue with the parties concerned such as the borrower, guarantor, or executing agency to explore ways to achieve covenant compliance.

D. Scope of the Policy

7. ADB's legal agreements have covenants that specify actions important for efficient project implementation and for the realization of the expected objectives and benefits. There are two categories of covenants in the legal agreements: general and special.

8. General covenants are those standard assurances and undertakings that ADB obtains from all borrowers, guarantors, and executing agencies in respect of ADB-financed projects, regardless of the special features of a particular project. General covenants include obligations to repay the loan and to maintain project records and accounts. Special covenants are those assurances and undertakings that ADB considers necessary or desirable to obtain from the borrower, guarantor, and executing agency for each specific project, considering the special features of the individual project.

9. Special covenants may include matters such as institutional and staffing arrangements for project execution; acquisition of required land; allocation or provision of water, fuel or power resources; distribution and marketing arrangements or supporting services; conduct of surveys and studies; institutional development and training; review of tariffs, rates, charges and prices; sector or regional policy matters; operational and management matters; and cofinancing arrangements and other financial measures.

10. Both general and special covenants provide a basis for ADB to monitor project implementation and performance. On general covenants, the formulation is based primarily on the loan regulations made applicable to the loan. In formulating special covenants, they should indicate, where possible, the date by which compliance is expected of various items therein, on the basis of a realistic assessment of project-specific requirements.

11. Covenants will be compatible with the socioeconomic conditions of developing member countries, and local laws, regulations, and administrative procedures, except where ADB and the borrower/guarantor/executing agency agree to have appropriate changes in the existing local laws, regulations, or administrative procedures. Covenants must also satisfy ADB's sectoral/subsectoral policy requirements.

Basis: This OM section is based on:

ADB. 1987. Doc. IN.300-87, *Study of Compliance with Special Loan Covenants*, 28 December. Manila.

This OM section is to be read with OM Section J4/OP.

For other background information and references, see:

ADB. 2001. *Ordinary Operations Loan Regulations (Applicable to LIBOR-Based Loans Made from ADB's Ordinary Capital Resources)*, 1 July. Manila.

ADB. 1986. *Ordinary Operations Loan Regulations (Applicable to Loans Made by the Bank from Its Ordinary Capital Resources)*, 1 July. Manila.

ADB. 1982. *Special Operations Loan Regulations (Applicable to Loans Made by the Bank from Its Special Funds Resources)*, 7 December. Manila.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the General Counsel, Office of the General Counsel.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

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

LOAN COVENANTS

The operational procedures for this OM section are contained in Project Administration Instructions, Chapter 5 (Project Administration Actions) and Chapter 6 (Internal Procedures and Reports), as well as the documents cited therein.

- Basis:** This OM section is based on OM Section J4/BP and the documents cited therein.
- Compliance:** This OM section is subject to compliance review.
- For inquiries:** Questions may be directed to the General Counsel, Office of the General Counsel.