

A photograph of a woman in a red jacket and blue headscarf holding a child's hand. In the background, a child in a red hoodie is visible. The image is overlaid with the title text.

Management's Discussion and Analysis

The Asian Development Bank (ADB) is an international development financial institution whose vision is to make Asia and the Pacific region free of poverty. ADB was established in 1966 through the Agreement Establishing the Asian Development Bank (the Charter), ratified by 31 countries to promote the social and economic development of the region and reduce poverty.

As of 31 December 2007, ADB had 67 members, 48 of which are in the region. ADB provides various forms of financial assistance to its developing member countries. The main instruments are loans, technical assistance, grants, guarantees, and equity investments. These instruments are financed through ordinary capital resources (OCR), Special Funds, and various trust funds. OCR and Special Funds are used to finance operations that are solely under ADB administration. Trust funds are externally funded and are administered by ADB on behalf of donors. The Charter requires that funds from each resource be kept separate from the others.

ADB also provides policy dialogues and advisory services and mobilizes financial resources through its cofinancing operations tapping official, commercial, and export credit sources to maximize the development impact of its assistance. Cofinancing for ADB projects can be in the form of external loans, grants for technical assistance and components of loan projects, and credit enhancement products such as guarantees and syndications.

ORDINARY CAPITAL RESOURCES

Funding for OCR operations comes from three distinct sources: funds borrowed from private placements and capital markets, paid-in capital provided by shareholders, and accumulated retained income (reserves). The financial strength of OCR is largely based on the support of shareholders and on financial policies and practices. Shareholder support is reflected in the form of capital backing from members and in the record of borrowing members in meeting their debt service obligations.

Borrowed funds, together with equity, are used to fund OCR lending and investment activities as well as other general operations. Loans are generally made to developing member countries that have attained a higher level of economic development and to private and other nonsovereign borrowers. Sovereign loans are priced on a cost pass-through basis in which the cost of funding the loans plus a lending spread is passed through to the borrowers. Nonsovereign loans are priced based on market practice.

In addition to direct lending, ADB also provides guarantees to assist governments of developing member countries and nonsovereign borrowers in securing commercial funds for ADB-assisted projects. ADB experienced a strong and growing demand for guarantees as credit enhancement products.

Basis of Financial Reporting

Statutory Reporting. Table 1 presents selected financial data for 2007. ADB prepares its financial statements in accordance with accounting principles generally accepted in the United States (US). ADB complies with

Financial Accounting Standards (FAS) 133, Accounting for Derivative Instruments and Hedging Activities, and its related amendments (collectively referred to as FAS 133), including FAS 155 (Accounting for Certain Hybrid Financial Instruments, an amendment to FAS 133 and 140). FAS 133 allows hedge accounting only if certain qualifying criteria are met. An assessment of those criteria indicated that most of ADB's derivative transactions are highly effective in hedging the underlying transactions and are appropriate for reducing funding costs. However, applying FAS 133 hedge criteria will not entirely reflect ADB's risk management and hedging strategies. Compliance with hedge accounting will impose undue constraints on future borrowings, loans, and hedge programs and will likely detract ADB's efforts to effectively and efficiently minimize the funding costs for its borrowing member countries. Accordingly, ADB elects not to adopt hedge accounting and reports all derivative instruments on the balance sheet at fair value while recognizing changes in the fair value of derivative instruments for the year as part of net income.

Supplemental Reporting. ADB manages its balance sheet by selectively using derivatives to minimize the interest rate and currency risks associated with its financial assets and liabilities. Derivative instruments are used to enhance asset/liability management of individual positions and overall portfolios, and to reduce borrowing costs. Certain financial instruments (including all derivatives, structured borrowings, and certain investments) are recorded at their fair value while loans, the majority of borrowings, and certain investments are recorded at carrying book value.

ADB uses derivatives to convert fixed rate borrowings into floating rate borrowings. These borrowing-related derivatives are considered to be equivalent to fixed rate assets; in general, the value of the derivatives decline (loss) when market interest rate increases and vice versa. These derivatives would generally economically offset the contractual obligations resulting from the debts. However, as most of these bonds are accounted for at their carrying book value, the reported values are not affected by interest rate movements. Because of the different methods used to account for the bonds and their associated derivatives, the application of FAS 133 creates volatility in the reported earnings. In addition, applying FAS 133 does not fully reflect the overall economic value of ADB's financial positions.

The adoption of FAS 155 on 1 January 2006 to a degree alleviates the volatility in the reported earnings as only certain financial instruments can be fair valued. FAS 155 allows fair value measurement for hybrid financial instruments that contain embedded features that would otherwise be required to be treated as separate derivative instruments (bifurcated) in the

TABLE 2 Condensed Current Value Balance Sheets as at 31 December 2007 and 31 December 2006
(\$ thousand)

	31 December 2007				31 December 2006	
	Statutory Basis	Reversal of FAS 133	Pre-FAS 133 Basis	Current Value Adjustments	Current Value Basis	Current Value Basis
Due from banks	\$ 108,821	\$ –	\$ 108,821	\$ –	\$ 108,821	\$ 205,418
Investments and accrued income	13,440,728	–	13,440,728	–	13,440,728	12,891,140
Securities transferred under securities lending arrangement	5,041,387	–	5,041,387	–	5,041,387	1,922,901
Securities purchased under resale arrangement	427,132	–	427,132	–	427,132	432,963
Loans outstanding and accrued interest	30,576,306	(538)	30,575,768	858,515	31,434,283	27,176,109
Provision for loan losses and unamortized net loan origination costs	27,087	–	27,087	–	27,087	(14,324)
Equity investment	808,157	–	808,157	–	808,157	655,819
Receivable from members	174,805	–	174,805	(69,778)	105,027	108,822
Receivable from swaps						
Borrowings	17,968,867	923,370	18,892,237	(923,370)	17,968,867	12,986,831
Others	512,089	27,410	539,499	(27,410)	512,089	655,151
Other assets	463,793	–	463,793	–	463,793	480,870
TOTAL	\$ 69,549,172	\$ 950,242	\$ 70,499,414	\$ (162,043)	\$ 70,337,371	\$ 57,501,700
Borrowings and accrued interest	\$ 31,959,300	\$ 617,924	\$ 32,577,224	\$ (553,555)	\$ 32,023,669	\$ 27,972,473
Payable for swaps						
Borrowings	16,936,964	274,601	17,211,565	(274,601)	16,936,964	12,502,403
Others	583,320	14,255	597,575	(14,255)	583,320	655,461
Payable under securities lending arrangement	5,092,316	–	5,092,316	–	5,092,316	1,954,409
Accounts payable and other liabilities	722,402	–	722,402	–	722,402	683,814
Total Liabilities	55,294,302	906,780	56,201,082	(842,411)	55,358,671	43,768,560
Paid-in capital	3,842,293	–	3,842,293	–	3,842,293	3,652,800
Net notional maintenance of value receivable	(661,197)	–	(661,197)	–	(661,197)	(672,899)
Ordinary reserve	9,245,332	(2,500)	9,242,832	399,622	9,642,454	9,555,260
Special reserve	202,847	–	202,847	–	202,847	197,799
Loan loss reserve	182,100	–	182,100	–	182,100	130,100
Surplus	616,300	–	616,300	–	616,300	330,117
Cumulative revaluation adjustments account	(110,959)	110,959	–	–	–	–
Net income ^a – 31 December 2007	760,174	(53,814)	706,360	447,543	1,153,903	–
Net income ^a – 31 December 2006	–	–	–	–	–	539,963
Accumulated other comprehensive income	177,980	(11,183)	166,797	(166,797)	–	–
Total Equity	14,254,870	43,462	14,298,332	680,368	14,978,700	13,733,140
TOTAL	\$ 69,549,172	\$ 950,242	\$ 70,499,414	\$ (162,043)	\$ 70,337,371	\$ 57,501,700

– = 0, () = negative, \$ = US dollar.

a Net income after appropriation of guarantee fees to Special Reserve.

reported financial statements under FAS 133. As of 31 December 2007, ADB holds a small portion of hybrid financial instruments in its borrowing portfolio.

Because of the continued inconsistent accounting treatment as described above, ADB has decided to continue issuing two non-US GAAP supplemental

financial reports to better reflect its financial positions and risk management: current value and pre-FAS 133. Applications of consistent approaches on these statements allow better analysis for management information and decision making.

TABLE 3 Condensed Current Value Income Statements for the Years Ended 31 December 2007 and 31 December 2006
(\$ thousand)

	31 December 2007				31 December 2006	
	Statutory Basis	Reversal of FAS 133 Effects	Pre-FAS 133 Basis	Current Value Adjustments	Current Value Basis	Current Value Basis
REVENUE						
From loans	\$ 1,442,338	\$ –	\$ 1,442,338	\$ –	\$ 1,442,338	\$ 1,210,071
From investments	683,212	–	683,212	–	683,212	564,495
From guarantees	5,049	–	5,049	–	5,049	4,169
From other sources – net	77,732	–	77,732	–	77,732	60,204
Total Revenue	2,208,331	–	2,208,331	–	2,208,331	1,838,939
EXPENSES						
Borrowings and related expenses	1,389,778	–	1,389,778	–	1,389,778	1,116,326
Administrative expenses	127,327	–	127,327	–	127,327	127,669
Technical assistance to member countries	(683)	–	(683)	–	(683)	(1,220)
Provision for losses	(579)	–	(579)	579	–	–
Other expenses	3,998	–	3,998	–	3,998	3,767
Total Expenses	1,519,841	–	1,519,841	579	1,520,420	1,246,542
Net realized gains	22,905	–	22,905	–	22,905	80,614
Net unrealized gains	53,828	(53,814) ^a	14	–	14	8
Current value adjustments ^b	–	–	–	447,543	447,543	(161,402)
Provision for losses	–	–	–	579	579	32,515
NET INCOME	\$ 765,223	\$ (53,814)	\$ 711,409	\$ 447,543	\$ 1,158,952	\$ 544,132

– = 0, () = negative, \$ = US dollar.

a FAS 133 adjustments are reversed as the current value adjustments incorporate the effect of net unrealized gains/losses on derivatives.

b Current value adjustments include the effect of FAS 133 adjustments.

TABLE 4 Summary of Current Value Adjustments
(\$ thousand)

	Balance Sheet Effects as of 31 December 2007					Income Statement Effects Year to Date	
	Loans After Swaps	Investments	Borrowings After Swaps	Other Assets	Less Prior Year Effects ^a	31 December 2007	31 December 2006
Total Current Value Adjustments on Balance Sheet	\$ 824,682	\$ 20,678	\$ (95,214)	\$ (69,778)	\$ (532,290)	\$ 148,078	\$ (295,567)
Unrealized Gains on Investments ^b						232,792 ^c	170,487
Accumulated Translation Adjustments						126,844 ^d	40,298
Pension and Post Retirement Benefit Liability Adjustments						(60,171) ^c	(76,620)
Total Current Value Adjustments						\$ 447,543	\$ (161,402)

– = 0, () = negative, \$ = US dollar.

a Prior Year Effects include cumulative current value adjustments on all financial instruments made in the prior years.

b Relates to unrealized gains/losses of investments and equity investments classified as available for sale.

c These are included in other comprehensive income under the statutory basis forming part of current value adjustments for current value reporting.

d Relates to the accumulated translation adjustments for the period and net current translation effects from FAS 133 reversals.

Discussion and Analysis on Current Value

Table 2 presents estimates of the economic value of OCR's financial assets and liabilities taking into consideration changes in interest rates, exchange rates, and credit risks. Current value reflects the exit price

for financial instruments with liquid markets and is the estimated fair value. For financial instruments with no market quotations, current value is estimated by discounting the expected cash flows by applying the appropriate market data. The current value results may differ from the actual net realizable value in the

event of liquidation. The reversal of the effects of FAS 133 removes its impact, as these effects are part of current value adjustments (Tables 3 and 4).

Current Value Balance Sheet

Loans and Related Swaps. Most loans are made to or guaranteed by ADB members. ADB does not sell its loans believing that there is no market for them. The current value of loans incorporates management's best estimate of expected cash flows including interest. Estimated cash flows from principal repayments and interest are discounted by the applicable market yield curves for ADB's funding cost plus lending spread.

The current value also includes an appropriate credit risk assessment. To recognize the risk inherent in these and other potential overdue payments, the loan value is adjusted through loan loss provisioning. ADB has never suffered a loss on sovereign loans except opportunity losses resulting from the difference between payments for interest and charges not in accordance with the loan's contractual terms.

The positive adjustment of \$0.8 billion indicates that the average interest rates on loans on an after-swap basis are higher than ADB would currently originate on similar loans.

Investments and Related Swaps. Under both the statutory and current value bases, investment securities and related derivatives are reported at fair values based on market quotations when available. Otherwise, the current value is calculated using market-based valuation models incorporating observable market data. The net positive adjustment of \$20.7 million resulted from unrealized gains on asset swaps due to increasing interest rates in certain markets.

Equity Investments. Under both statutory and current value bases, equity investments are reported at fair value when market values are readily determinable; by applying equity method for investments in limited partnership and certain limited liability companies, or for investments where ADB has the ability to exercise significant influence; or at cost less permanent impairment, if any, which represents a fair approximation of the current value.

Receivable from Members. These consist of promissory notes which may be restricted by member countries. The current value is based on the cash flow of the projected encashment of the promissory notes discounted using appropriate interest rates.

Borrowings after Swaps. The current value of these liabilities includes the fair value of the borrowings and associated financial derivative instruments, and is cal-

culated using market-based valuation models incorporating observable market data.

The \$95.2 million unfavorable current value adjustment is due to the fact that the average cost of the borrowings on an after-swap basis is higher than the market rate at which ADB can currently obtain new funding.

Current Value Income Statement

For 2007, current value net income is \$1,158.9 million compared with pre-FAS 133 net income of \$711.4 million and statutory reported net income of \$765.2 million (Table 3).

Current Value Adjustments. The total current value adjustment of \$447.5 million (\$161.4 million in 2006) represents the change in the current value of all ADB financial instruments during the year. The adjustment reflects changes in interest rates, currency exchange rates, and credit risks. This comprised a net favorable adjustment of \$148.1 million from the change in the valuation of all outstanding financial instruments, \$126.8 million from translation adjustments, \$160.7 million and \$72.1 million from unrealized gains on investments, and equity investments, respectively, offset by \$60.2 million additional pension and postretirement benefit liability (Table 4).

Impact of Changes in Interest Rates. The net increase in the current value adjustments on the balance sheet during 2007 was \$148.1 million. It was a result of a decrease in unrealized losses in the borrowing portfolio of \$52.5 million, increase in unrealized gains for loans of \$103.7 million, offset by unfavorable results for investment and other asset swaps of \$3.2 million and \$4.9 million, respectively.

Impact of Changes in Exchange Rates. Translation adjustments, reported under the statutory basis as part of "accumulated other comprehensive income," are presented as current value adjustments. The general weakening of the US dollar against most of the major currencies in 2007 resulted in a positive translation adjustment of \$126.8 million compared to \$40.3 million in 2006.

Operating Activities

In pursuing its objectives, ADB provides financial assistance through loans, technical assistance, guarantees, and equity investments to its developing member countries to help them meet their development needs. These assistance can be provided to sovereign and nonsovereign entities. ADB also actively promotes cofinancing of its development projects and programs

to complement its own assistance with funds from both official and commercial sources including export credit agencies.

Loans. Until 30 June 2001, ADB's three windows for loans from OCR were the pool-based multicurrency loan, the pool-based single-currency loan in US dollars, and the market-based loan. With the introduction of LIBOR-based loan on 1 July 2001, the pool-based multi-currency loan and market-based loan are no longer offered, and on 1 July 2002, the pool-based single-currency loan in US dollars was retired. Effective January 2004, the pool-based multi-currency loans were transformed into pool-based single-currency loans in Japanese yen. The LIBOR-based loan is a timely response to borrowers demand for loan products that suit project needs and effectively manage their external debt. LIBOR-based loan products give borrowers a high degree of flexibility in managing interest rate and exchange rate risks and at the same time provide low intermediation risk to ADB. Since November 2002, ADB has been offering local currency loans to nonsovereign borrowers and expanded this to the sovereign borrowers in August 2005.

Loan Approvals, Disbursements, Repayments, and Prepayments. In 2007, the Board of Directors approved 38 sovereign and 22 nonsovereign loans totaling \$7.3 billion and \$0.9 billion, respectively, compared with 2006 approvals of 26 sovereign and 9 nonsovereign loans totaling \$5.5 billion and \$0.6 billion, respectively. Disbursements in 2007 totaled \$5.2 billion (\$4.7 billion for sovereign loans and \$0.5 billion for nonsovereign loans) representing an increase of 18.0% from the \$4.4 billion disbursements in 2006. Regular principal repayments for the year were \$1.4 billion (\$1.3 billion in 2006) while prepayments amounted to \$0.1 billion (\$0.5 billion in 2006). In 2007, six loans were fully prepaid. As of 31 December 2007, the total loans outstanding after provision for losses and net unamortized loan origination cost amounted to \$30.3 billion, of which \$29.0 billion is for sovereign loans and \$1.3 billion is for nonsovereign loans.

In 2005, ADB established the multitranches financing facility (MFF), a debt financing facility that allows ADB to deliver financial resources for a specific program or investment in a series of separate financing tranches over a fixed period. Financing tranches may be provided as loans, guarantees, equity, or any combination of these instruments based on periodic financing requests submitted by the borrower. In 2007, seven MFFs totaling \$4.0 billion (eight MFFs totaling \$3.8 billion in 2006), were approved under OCR. Periodic financing requests under MFFs amounting to \$2.0 billion were approved in 2007 (\$931.0 million in 2006).

Starting September 2005, ADB provided lending without sovereign guarantee to entities that can be considered public sector borrowers but are structurally separate from the sovereign or central government. Such entities include state-owned enterprises, government agencies, municipalities, and local government units. In 2007, three loans to state-owned enterprises without sovereign guarantee totaling \$105.0 million were approved (two loans totaling \$150.0 million in 2006).

Status of Loans. One sovereign loan and four nonsovereign loans with total principal outstanding balance of \$2.3 million (\$6.1 million - 2006) and \$16.5 million (\$29.7 million - 2006) respectively, were in non-accrual status. In total they represented 0.1% of the total OCR loans outstanding. The \$13.2 million decline in nonsovereign loans is mainly attributed to the sale of two nonsovereign loans which were in non-accrual status.

Loan Charges. LIBOR-based loans carry a floating lending rate that consists of 6-month LIBOR and an effective contractual spread fixed over the life of the loan. The lending rate is reset every 6 months on each interest reset date and can be converted to fixed rate at borrower's request. The lending rates for pool-based single-currency loans are based on the previous semester's average cost of borrowings. Interest rates for market-based loans are either fixed or floating. The floating rates are determined based on 6-month LIBOR with reset dates of either 15 March and 15 September or 15 June and 15 December. Effective 2000, all sovereign loans without specific provisions in the loan agreements were charged with lending spread of 60 basis points over the base lending rate. In 2004, 20 basis points of the lending spread were waived on sovereign loans outstanding from 1 July 2004 to 30 June 2005 for borrowers that did not have loans in arrears. Subsequently, the policy was extended to cover the period up to June 2008. In December 2007, the Board of Directors revised the lending rates for all sovereign LIBOR-based loans negotiated on or after 1 October 2007 by reducing the effective contractual spread to 20 basis points over the base lending rate and eliminating the waiver mechanism for such loans.

ADB's variable lending rates for pool-based single-currency loans in US dollars and in Japanese yen are shown in Table 5.

For nonsovereign loans, the lending spread is determined based on market practices, which is intended to cover ADB's risk exposure to specific borrowers and projects.

ADB also charges a front-end fee of 1.0% on sovereign loans and 0.5–1.0% on nonsovereign loans to cover the administrative costs incurred in loan origination.

TABLE 5 Lending Rates^a
(% per annum)

	2007	2006	PSCLs
1 January	1.31	1.49	Japanese yen
	5.91	5.94	US dollar
1 July	1.69	1.46	Japanese yen
	6.34	5.86	US dollar

% = percent, PSCL = Pool-based single currency loan.

a Lending rates are set on 1 January and 1 July every year and are valid for 6 months and are represented net of 20 basis points lending spread waiver.

In 2004, the Board of Governors approved the waiver of the entire front-end fee on all new sovereign loans approved from 1 January 2004 to 30 June 2005. Subsequently, the policy was extended to cover the period up to June 2008. In December 2007, the Board of Directors approved the elimination of front-end fees for sovereign LIBOR-based loans negotiated on or after 1 October 2007.

ADB applied a progressive commitment fee of 75 basis points on undisbursed loan balances for sovereign project loans and a flat commitment fee of 75 basis points for sovereign program loans. In October 2006, as part of the enhancement of ADB's loan and debt management products, all sovereign project loans negotiated after 1 January 2007 carried a flat commitment fee of 35 basis points on the full amount of undisbursed loan balances. In April 2007, the Board also approved the waiver of 10 basis points of the commitment charge on the undisbursed balances of sovereign project loans negotiated after 1 January 2007 and 50 basis points of the commitment charge on the undisbursed balances of sovereign program loans. The waiver is applicable to all interest periods starting from 1 January 2007 up to and including 30 June 2008. In December 2007, the Board of Directors approved the reduction of the commitment charge from 75 basis points for sovereign program loans and 35 basis points for sovereign project loans to 15 basis points for both sovereign program and project loans negotiated on or after 1 October 2007, and eliminated the waiver mechanism for such loans. For nonsovereign loans, ADB charges a commitment fee of about 50–75 basis points on the full amount of undisbursed loan balances.

Rebates and surcharges are standard features of sovereign LIBOR-based loans. To maintain the principle of cost pass-through pricing, ADB returns the

TABLE 6 Rebate Rates
(% per annum)

	US dollar	Japanese yen
1 January 2007	0.30	0.36
1 July 2007	0.31	0.45

% = percent.

actual sub-LIBOR funding cost margin to its LIBOR-based loans sovereign borrowers through rebates. A surcharge could arise if ADB's funding cost exceeds the 6-month LIBOR, which is a remote possibility unless ADB experiences serious credit deterioration. Rebate or surcharge rates are set on 1 January and 1 July every year and are based on the actual average funding cost margin for the preceding 6-month period. Effective 1 July 2007, rebates or surcharges are passed on to the borrowers by incorporating them into the interest rate for the succeeding interest period, rather than retroactively. Based on rebate rates, ADB returned an actual sub-LIBOR funding cost margin of \$38.1 million to its LIBOR-based loan sovereign borrowers in 2007.

Official Cofinancing for Loans. In 2007, \$3.6 million from the OPEC Fund for International Development was mobilized in loan cofinancing with partial administration by ADB for a loan project of \$60.0 million.

Technical Assistance. From 1967 to 1991, technical assistance (TA) expenses were charged to OCR and other technical assistance funding resources—the Technical Assistance Special Fund, the Japan Special Fund, and trust/grant funds. From 1992 to 2000, no TA expenses were charged to OCR. In 2001, the Board of Directors approved the financing of high-priority TA programs out of OCR current income within a rolling 4-year financing framework. The amount of financing required varies between years and is subject to the approval of the Board of Directors. In 2003, the Board reverted to the practice of allocating OCR net income to the Technical Assistance Special Fund and of financing technical assistance activities through it and other various funding resources.

Guarantees. ADB provides guarantees¹ as credit enhancements for eligible projects to cover risks that the project and its commercial cofinancing partners cannot easily absorb or manage on its own. Reducing these risks can make a significant difference in

¹ ADB offers two types of guarantee products—political risk and partial credit—designed to facilitate cofinancing by mitigating risk exposure of commercial lenders and capital market investors. A political risk guarantee covers against specifically defined political risks. A partial credit guarantee provides comprehensive cover (of commercial and political risks) for a specific portion of the debt service provided by cofinanciers. These guarantees are provided only for projects in which ADB participates.

mobilizing debt funding for projects. ADB has used its guarantee instruments successfully for infrastructure projects, financial institutions, capital markets, and trade finance. These instruments generally are not recognized in the balance sheet and have off-balance sheet risks. For guarantees issued and modified after 31 December 2002 in accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others,” ADB recognized at the inception of a guarantee the noncontingent aspect of its obligations. ADB’s total exposure on signed and effective loan guarantees is disclosed in Note F of OCR Financial Statements. In 2007, ADB provided \$376.0 million for four guarantee operations.

Syndications. Syndications enable ADB to mobilize cofinancing by transferring some or all of the risks associated with its loans and guarantees to other financing partners.² Syndications thus decrease and diversify the risk profile of ADB’s financing portfolio. Syndications may be on a funded or unfunded basis and may be arranged on an individual, portfolio, or any other basis consistent with industry practices. In 2007, \$425.0 million for syndications through B-loans³ was provided for two projects.

Equity Investments. In accordance with ADB’s Charter which mandates that its nonsovereign operations promote the investment of private capital in the region for development, ADB provides assistance in the form of equity investments, in addition to loans without government guarantees, and other financing schemes. The Charter allows the use of OCR for equity investments in private enterprises up to 10% of its unimpaired paid-in capital together with reserves and surplus, exclusive of special reserves. The total equity investment portfolio for OCR for both outstanding and undisbursed approved facilities amounted to \$1,152.2 million at year-end of 2007. This represented about 78.0% of the ceiling defined by the Charter.

As of 31 December 2007, the total exposure of non-sovereign operations in equity investments amounted to about \$1.1 billion.

In 2007, 5 equity investments totaling \$79.8 million were approved compared with 13⁴ equity investments totaling \$250.5 million⁴ in 2006. In the same year, ADB disbursed a total of \$115.6 million in equity investments, 11.0% decrease from \$129.9 million

disbursed in 2006, and received a total amount of \$112.2 million from capital distributions and divestments, whether in full or in part, in 30 projects. The divestments were carried out in a manner consistent with good business practices, after ADB’s development role in its investments have been fulfilled, and without destabilizing the companies concerned.

Capital and Resources

Capital. Total shareholders’ equity on a statutory basis increased from \$13.1 billion as of 31 December 2006 to \$14.3 billion as of 31 December 2007. This was due primarily to net income for the year of \$765.2 million; net increase in other comprehensive income of \$260.1 million (unrealized gain on investments and equity investments of \$232.8 million, favorable translation adjustments of \$86.6 million, amortization of FAS 133 adjustment of \$0.9 million, offset by additional pension/post retirement benefit obligation of \$60.2 million); the net effect of change in special drawing rights value on capital and reserves of \$159.3 million; and additional capital subscription received of \$7.4 million. These were offset by allocations to the Asian Development Fund (ADF) and the Regional Cooperation and Integration Fund, of \$40.0 million each.

In February 2007, Georgia became ADB’s 67th member, subscribing 12,081 shares. This brought the total authorized and subscribed capital to 3,546,311 shares valued at \$55,977.8 million as of 31 December 2007. Of the subscribed capital, \$3,937.1 million was paid-in and \$52,040.7 million was callable. Callable capital can be called only if required to meet ADB’s obligations incurred on borrowings or guarantees under OCR. No call has ever been made on ADB’s callable capital.

To ensure it has adequate risk-bearing capacity, ADB reviews its income outlook annually. Based on that review, the Board of Directors allocates a portion of the previous year’s net income to reserves to ensure that the level is commensurate with the income planning framework. In addition, to the extent feasible, it allocates part of the net income to support development activities in its developing member countries. In May 2007, the Board of Governors approved that the 2006 net income of \$565.9 million together with \$138.5 million transferred from the cumulative revaluation adjustments account be allocated to loan loss reserve for \$52.0 million, Surplus and Ordinary reserves for

2 Depending on whether ADB retains risk or not, there may or may not be a contingent liability to ADB.

3 A B-loan is a tranche of a direct loan nominally advanced by ADB, subject to eligible financial institutions’ taking funded risk participations within such a tranche and without recourse to ADB. It complements an A-loan funded by ADB.

4 Net of subsequent cancellations.

\$286.2 million each, and to ADF and Regional Cooperation and Integration Fund for \$40.0 million each.

In February 2004, the Board of Directors reviewed ADB's lending and borrowing limitations and approved the following policies: gross outstanding borrowings are limited to no more than the sum of callable capital from nonborrowing members, paid-in capital, and reserves (including surplus), subject to the Charter limit of 100% of callable capital; and outstanding loan commitments measured by the sum of outstanding disbursed and undisbursed loans, equity investments, and guarantees⁵, are limited to no more than the sum of the subscribed capital and reserves (including surplus but excluding special reserve).

In April 2007, the Board of Directors reviewed the resource position of OCR. The review followed a medium-term capital management approach within the approved financial framework, for assessing the adequacy of current and prospective lending and borrowing headrooms. The review concluded that ADB's capital position is sufficient to support projected lending operations through 2009. As of 31 December 2007, headrooms for lending and borrowings were \$15.4 billion and \$14.4 billion, respectively (compared with \$18.3 billion and \$15.9 billion, in 2006).

Borrowings. ADB's primary borrowing objective is to ensure availability of funds at the lowest possible cost for its operations. Thus in this respect ADB seeks to diversify its funding sources across markets, instruments, and maturities. To achieve the objective, ADB continued in 2007 a strategy of issuing liquid benchmark bonds to maintain its strong presence in key currency bond markets, and raising funds through cost-efficient, opportunistic and private placement transactions to minimize borrowing costs. In addition, ADB continued to pursue its objective of contributing to the development of regional bond markets and of providing local currency financing for ADB's projects through local currency bond issues. All proceeds from new funding transactions are invested until they are required for ADB's ordinary operations, including loan disbursements and refinancing of maturing funding obligations.

2007 Funding Operations. In 2007, ADB completed 94 borrowing transactions raising about \$8.9⁶ billion in long- and medium-term funds compared with \$5.4 billion in 2006. The new borrowings were raised in 13 currencies: Australian dollar, Canadian dollar, Euro, Hong Kong dollar, Japanese yen, Kazakhstan tenge, Malaysian ringgit, Philippine peso, Pound sterling, Singapore dol-

TABLE 7 Borrowings
(\$ million)

	2007	2006
Long Term		
Total Principal Amount	8,854.3	5,397.2
Average Maturity to First Call (years)	5.2	5.9
Average Final Maturity (years)	9.4	6.7
Number of Transactions		
Public Offerings	10	8
Private Placements	84	43
Number of Currencies (before swaps)		
Public Offerings	8	5
Private Placements	9	10
Short Term^a		
Total Principal Amount ^b	3,139.1	1,642.8
Number of Transactions	24	23
Number of Currencies	3	3

\$ = US dollar.

a All euro-commercial papers.

b At year-end, the outstanding principal amount was nil in 2007 and \$179 million in 2006.

TABLE 8 Local Currency Bond Issues

Market	Principal Amount (million)	Coupon Rate (%)	Maturity (years)
Hong Kong, China	HK\$ 1,500	4.00	5
Singapore	S\$ 250	3.27	5
Malaysia	MYR 500	4.00	10
Philippines	PHP 5,000	5.23	5

% = percent, HK\$ = Hong Kong dollar, S\$ = Singapore dollar, MYR = Malaysian ringgit, PHP = Philippine peso.

lar, South African rand, Turkish lira, and US dollar. After swaps, \$8.4 billion or 95.0% of the 2007 borrowings were in US dollar, \$0.4 billion or 4.5% were in Japanese yen and the remaining \$0.05 billion or 0.5% were in Kazakhstan tenge. The average maturity of 2007 borrowings was 5.2 years compared with 5.9 years in 2006. Of the total 2007 borrowings, \$4.0 billion was raised through 10 public offerings, and 84 private placements amounting to \$4.8 billion. In addition, ADB raised \$3.1 billion in short-term funds under its Euro commercial paper program to enhance its presence in the market and to meet temporary cash needs. Table 7 shows details of 2007 borrowings compared to borrowings in 2006.

5 ADB's financial policies require that political risk guarantee be charged against lending limitations at the nominal value of the guaranteed obligation, plus interest that will be accrued for the succeeding interest period and partial credit guarantee at the present value of the guaranteed obligation.

6 Total amount does not tally to the breakdown due to rounding of the principal amount.

FIGURE 1 Effect on Currency Composition

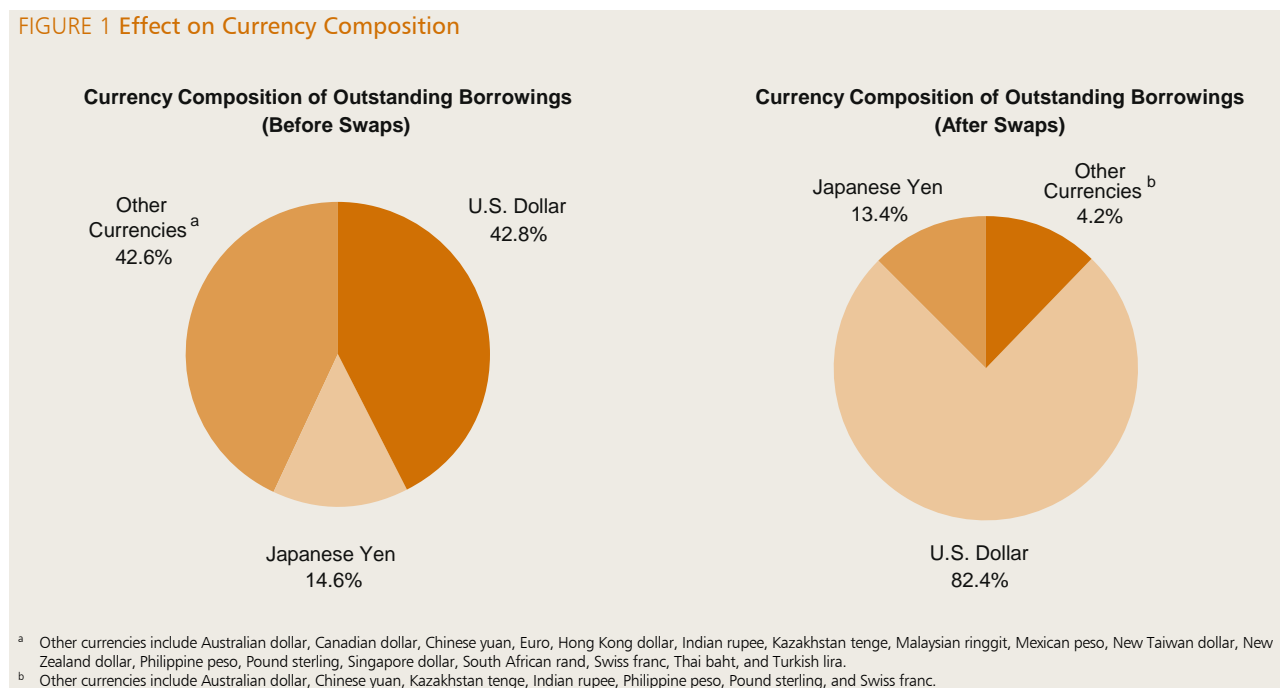
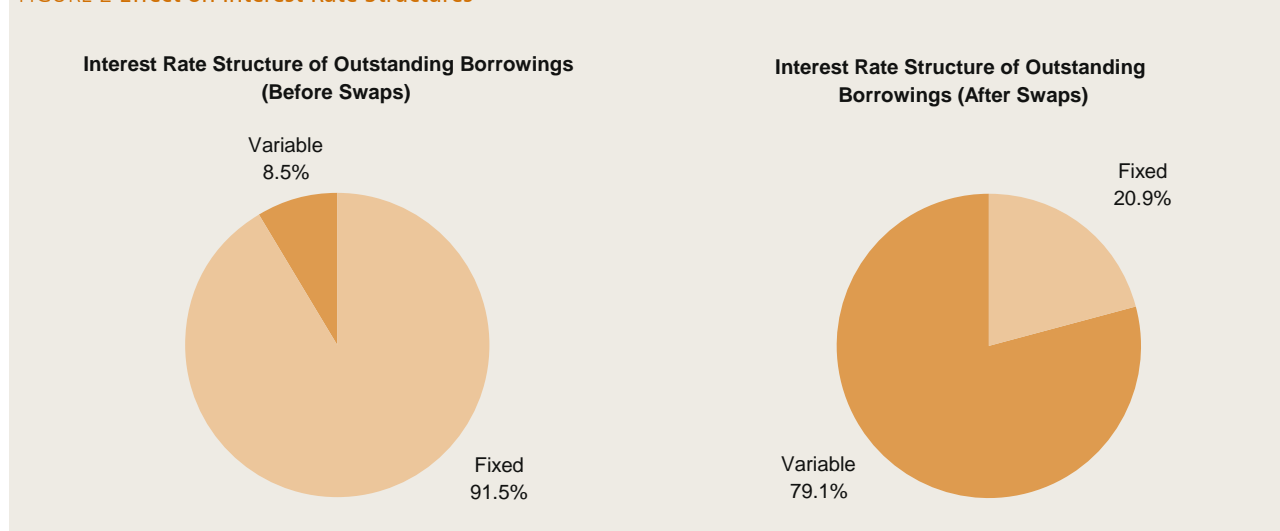


FIGURE 2 Effect on Interest Rate Structures



Local Currency Bond Issues. ADB's local currency bond issuances in 2007 are shown in Table 8. During the first quarter, ADB originated three local currency bond issues denominated in Hong Kong dollar, Singapore dollar, and Malaysian ringgit. The Hong Kong dollar note issue has a principal amount of HK\$1.5 billion (\$192.3 million equivalent), a coupon of 4.0% per annum and a 5-year maturity. The Singapore dollar issue has a principal amount of S\$250.0 million (\$162.5 million equivalent), a coupon of 3.3% per annum and a maturity of 5 years. Both were issued under the Asian Currency Note Programme. In February 2007, ADB returned to the bond market of Malaysia and launched its second note issue under

the 15-year MYR3.8 billion Medium Term Note Program. The issue has a principal amount of MYR500 million (\$142.9 million equivalent), a coupon of 4.0% per annum and a maturity of 10 years. Additionally, in May, ADB returned to the Philippine bond market and launched its second Philippine peso-denominated bond issue. It had a principal amount of PHP5 billion (\$108.0 million), a maturity of about 5 years, and carried a fixed rate of 5.2% per annum.

Use of Derivatives. ADB undertakes currency and interest rate swaps to raise, on a fully hedged basis, currencies needed for operations in a cost efficient way while maintaining its borrowing presence in major cap-

ital markets. Figures 1 and 2 show the effects of swaps on the interest rate structure and currency composition of ADB's outstanding borrowings as of 31 December 2007. Interest rate swaps are also used for asset/liability management purposes to match the liabilities to the interest rate characteristics of loans.

Liquidity Portfolio

The liquidity portfolio helps ensure the uninterrupted availability of funds to meet loan disbursements, debt servicing, and other cash requirements. It also contributes to ADB's earning base. ADB's Investment Authority governs liquid asset investments. Its primary objective is to maintain the security and liquidity of funds invested. Subject to these two parameters, ADB seeks to maximize the total return on its investments. In compliance with its Charter, ADB does not convert currencies for investment; investments are made in the same currencies in which they are received. At present, liquid investments are held in 21 currencies.

Liquid assets are held in government and government-related debt instruments, time deposits, and other unconditional obligations of banks and financial institutions, and, to a limited extent, in corporate bonds, mortgage-backed securities, and asset-backed securities of high credit quality. They are held in four sub-portfolios—prudential liquidity, operational cash, cash cushion, and discretionary liquidity—all of which have different risk profiles and performance benchmarks. The year-end balance of the portfolios in 2007 and 2006, including receivables for securities repurchased under resale arrangements, and excluding securities transferred under securities lending arrangements and pending sales and purchases, is presented in Table 9.

The prudential liquidity portfolio is invested to ensure that the primary objective of a liquidity buffer is met. Cash inflows and outflows are minimized to maximize the total return relative to a defined level

of risk. The portfolio is funded largely by equity, and performance is measured against external benchmarks with an average duration of about 2 years. ADB revised the liquidity policy in October 2006 to bring up to date its financial and risk management policies and practices in line with ADB's business activities and initiatives and to harmonize its liquidity policy with other multilateral development banks. Under the new policy, the duration for the prudential liquidity portfolio can be extended up to 4 years for the portfolio funded by equity. The remaining part of the prudential liquidity portfolio is funded by debt and is invested to maximize the spread earned between borrowing cost and investment income on high-quality investments.

The operational cash portfolio is designed to meet net cash requirements over a 1-month horizon. It is funded by equity and invested in short-term, highly liquid money market instruments. The portfolio performance is measured against short-term external benchmarks.

The cash cushion portfolio holds the proceeds of ADB's borrowing transactions pending disbursement. It is invested in short-term instruments, and the performance is measured against short-term external benchmarks.

The discretionary liquidity portfolio is used to support medium-term funding needs and is funded by debt to provide flexibility in executing the funding program over the medium-term to permit borrowing ahead of cash flow needs and bolster ADB's access to short-term funding through continuous presence in the market.

Contractual Obligations

In the normal course of business, ADB enters into various contractual obligations that may require future cash payments. Table 11 summarizes ADB's significant contractual cash obligations at 31 December 2007 and 2006. Long-term debt includes direct medium- and long-term borrowings excluding swaps but does not include any adjustment for unamortized premiums, discounts, or effects of applying FAS 133. Other long-

TABLE 9 Year-End Balance of Liquidity Portfolio^a
(\$ million)

	2007	2006
Prudential Liquidity Portfolio	9,209.3	7,763.9
Operational Cash Portfolio	395.1	587.2
Cash Cushion Portfolio	778.8	953.9
Discretionary Liquidity Portfolio	2,550.5	3,830.6
Other Portfolio	645.7	–
Total	13,579.4	13,135.6

– = 0, \$ = US dollar.

a The composition liquidity portfolio may shift from 1 year to another as part of ongoing liquidity management.

TABLE 10 Return on Liquidity Portfolio
(%)

	Annualized Financial Return	
	2007	2006
Prudential Liquidity Portfolio	5.84	4.25
Operational Cash Portfolio	3.95	3.82
Cash Cushion Portfolio	4.67	4.21
Discretionary Liquidity Portfolio ^a	0.28	0.30
Other Portfolio	3.64	–

– = 0, % = percent.

a Spread over funding cost at 31 December.

TABLE 11 Contractual Cash Obligations
(\$ million)

	2007	2006
Long-Term Debt	32,187.2	27,602.5
Undisbursed Loan Commitments	19,011.3	16,768.2
Undisbursed Equity Investment Commitments	344.0	391.6
Guarantee Commitments	1,460.6	1,293.7
Other Long-Term Liabilities	450.6	373.4
Total	53,453.7	46,429.4

\$ = US dollar.

term liabilities correspond to accrued liabilities, including pension and postretirement medical benefits.

Financial Risk Management

In its development banking operations, ADB faces various credit, market (interest rate and foreign exchange), liquidity, and operational risks. Sovereign loans and guarantees to its developing member countries constitute the large majority of ADB's portfolio. ADB has adopted an integrated risk management framework designed to ensure that credit and other risks are appropriately identified, measured, monitored, and managed. In November 2005, ADB established the Risk Management Unit, which is independent of the business units and mandated to manage credit risk of the sovereign and nonsovereign loan and guarantee portfolios as well as market- and treasury-related risks. The unit has been implementing risk management tools and methodologies under the said framework.

Asset and Liability Management. The objectives of asset and liability management for ADB is to safeguard ADB's net worth and overall capital adequacy, promote steady growth in ADB's risk bearing capacity, and define sound financial policies to undertake acceptable levels of financial risks in order to provide resources for developmental lending purposes at the lowest and most stable funding cost to the borrowers along with the most reasonable lending terms, while safeguarding ADB's financial strength. The asset and liability management safeguards net worth from foreign exchange rate risks, protects net interest margin from fluctuation in interest rates, and provides sufficient liquidity to meet ADB's operations. ADB also adheres to cost pass-through pricing policy for the loans to sovereign borrowers, and allocates the most cost efficient borrowings to fund the loans. The asset and liability management objectives and practices were clarified and formalized in 2006 through the Board-approved comprehensive asset and liability management policy framework. The framework has formalized the guiding principles

for managing the financial assets and liabilities of the OCR and provided the governing framework to guide all asset and liability management-related financial policies, including liquidity, investments, equity management, and capital adequacy.

Capital Adequacy. ADB's capital adequacy framework adopts the equity-to-loan ratio as the key measure of ADB's available capital. The available capital should be adequate to absorb any unexpected losses from its loan and guarantee portfolios. ADB utilizes an internally developed credit risk model to estimate the unexpected loss in its loan and guarantee portfolios. In addition to that, the available capital should be able to absorb loss of loan income due to a major and protracted nonaccrual shock in the loan and guarantee portfolios while matching growth in the portfolios. Under the present policy, ADB ensures that the equity-to-loan ratio is maintained above a fixed target of 35.0%.

In determining equity-to-loan ratio, ADB's equity capital is defined as the sum of usable paid-in capital, ordinary reserve, special reserve, and surplus. At 31 December 2007, equity-to-loan ratio was 44.7% under the pre-FAS 133 basis (47.7% on 31 December 2006). The higher-than-target equity-to-loan ratio represents a strong equity capital position relative to the credit risk assumed in its loan and guarantee portfolios indicating that both net income and equity capital are adequate to sustain significant credit event.

Under its capital adequacy framework, ADB utilizes the loan loss reserve to absorb expected losses from its loan and guarantee portfolios. Hence, both expected and unexpected losses for its loans and guarantees are addressed through adequate loan loss reserve and equity-to-loan ratio. On the other hand, loan loss provisions are made against impaired loans and recognized in the net income.

Country Credit Risks. The capital adequacy framework also links the adequacy of net income and equity capital to the country credit risk of the sovereign loan and guarantee portfolios. A credit risk model is used to estimate expected and unexpected losses in these portfolios, incorporating borrower's default probability, loss given default, projected exposure, and default correlations. In addition, ADB stress-tests net income projections to ensure that net income is adequate to absorb the loss of loan income due to credit shocks and to support sufficient growth. To assess the creditworthiness of its developing member countries independently, ADB adopted an internal country credit risk rating system.

Credit Risk of Nonsovereign Operations. Aside from providing loans and guarantees to its developing member countries, ADB provides loans and guarantees to

nonsovereign entities. These entities include private sector firms, state-owned enterprises, and local governments. ADB could also make equity investments in private sector firms and state-owned enterprises. ADB's nonsovereign investments are usually not backed by government guarantees and are exposed to commercial and political risks. Currently, the nonsovereign investment portfolio is subject to an overall limit of \$5 billion. Managing and monitoring the risk are important aspects in the project cycle. ADB evaluates not only the development impact of a project but also analyzes its credit strength; financial, commercial, and technical viability; and good corporate governance. Each nonsovereign project undergoes an in-depth credit analysis and appraisal prior to approval with emphasis being given to the project's financial sustainability and ability to repay its debt. The nonsovereign operations are subject to Board-approved prudential limits in respect of exposures to a single as well as group of entities, industry sectors, and countries.

The current private sector strategy focuses on the infrastructure and financial market sectors. Nevertheless, ADB remains responsive to the changing needs of developing member countries and private investment opportunities in other sectors. The objective is to build a diversified nonsovereign portfolio in terms of both countries and sectors, while managing concentration risks by establishing appropriate limits for countries, industries, and groups of related companies.

The total amount of ADB assistance to a single project, including equity investments, loans, and guarantees, must not exceed 25% of the total project cost or \$250 million, whichever is lower. This limit ensures that exposure to a single project or obligor on net basis is limited at any time to a maximum of 5% of the targeted portfolio size of the nonsovereign portfolio.

ADB streamlined approval of private sector investment recovery operations. They generally involve negotiations for financial restructuring, foreclosure, or other remedies, including liquidation. Restructuring is undertaken only when it is expected to improve ADB's prospects for recovery. If the financial condition of the entity has deteriorated beyond recovery, ADB may have to proceed with liquidation or other legally permissible forms of recovery.

Issuer and Counterparty Credit Risks. Treasury-related transactions also give rise to credit risk, or the risk of loss if an issuer or counterparty does not honor its financial obligations to ADB.

To control issuer and counterparty credit risk, ADB has established stringent eligibility criteria that impose minimum credit ratings provided by at least two reputable international credit rating agencies on its investments, and require that such investments be

placed with approved issuers or counterparties that meet required credit criteria. Furthermore, ADB has set single-issuer limits to its corporate investments, maximum credit exposure to its depository banks, and other limits for controlling exposure to varied asset classes.

To mitigate counterparty credit risk arising from derivative transactions, ADB has strict counterparty eligibility criteria. In general, ADB will undertake swap transactions with counterparts that have met the required minimum counterparty credit rating, executed an International Swaps and Derivatives Association Master Agreement, and signed a credit support annex. Under the credit support annex arrangements, derivatives' positions of ADB are marked-to-market daily, while collateral calls, transfers, and adjustments with counterparties are made in coordination with an external collateral manager. ADB also sets exposure limits on individual swap counterparties based on their credit ratings and equity, and daily monitors current and potential counterparty exposure against the limits.

Market Risks. ADB manages the market risk of its liquid asset investments by adopting investment policy guidelines which allow for investments only in government and government-related debt instruments, time deposits, and other unconditional obligations of banks and financial institutions, and to a limited extent in corporate bonds, mortgage-backed securities, and asset-backed securities of high credit quality. The principal source of investment risk arises from income volatility due to interest rate movements. ADB monitors and manages interest rate risks by employing various quantitative methods. All positions are marked-to-market, and risk-sensitive measures, including potential exposure, are calculated and compared to internally established risk limits. On the other hand, ADB mitigates the market risks associated with its loan portfolio by employing derivatives to closely match the characteristics of such loans with those of borrowings.

ADB manages its currency risk to ensure that exchange risk sensitivity is mitigated to minimize volatility in the equity-to-loan ratio as the measure of equity capital adequacy and risk-bearing capacity. This can be achieved by matching the currency of its liabilities and investments with the currency of its loans and equity, thus, ensuring that fluctuations in exchange rates would have similar effects on both, and periodically aligning the currency composition of its balance sheet. ADB measures such foreign exchange translation risk in its liquidity investment portfolio by setting an aggregate value-at-risk limit at 7% as maximum tolerance for bearing both the interest and foreign exchange translation risks.

ADB manages its market risks by employing market standard risk parameters and assumptions in the valua-

tion and risk analysis of its treasury activities, enhanced performance measurements and attribution methodologies and systems for its investment portfolios, supplementary risk management tools such as stress testing and scenario analysis, and a computer system that values both plain vanilla as well as highly structured borrowings and their related swap transactions.

ADB engages external asset managers to invest in mortgage-backed securities and asset-backed securities with minimum ratings of AAA and in corporate bonds with minimum rating of A, totaling \$1.3 billion. ADB determined, through its due diligence and review, that \$117.0 million of these asset-backed securities invested in tranches of securitized home equity loans could be considered as sub-prime related holdings. ADB's assessment indicated that the current sub-prime credit crisis had minimal impact to the overall portfolio value through this particular investment. On an aggregate basis, ADB's investments have increased in value due to the declining US dollar yield and flight to quality. ADB utilizes a custodian to provide the valuation of the externally managed investments and appropriate diligence revealed that the custodian adopted market acceptable practice by obtaining valuation from various independent pricing service providers including broker's quotation.

Liquidity Risks. The objective of ADB's liquidity policy is to ensure the availability of sufficient cash flows to meet all financial and operational commitments despite uncertain conditions in the capital markets. The policy establishes minimum levels of liquidity to maintain expected operation, even if access to capital markets is temporarily denied. ADB's liquidity requirements are primarily determined by expected lending volumes and disbursements, redemption of current borrowings, repayments and prepayments of loans, and cash from net income. The policy defines ADB's annual net cash requirement to meet large contractual obligations for loan disbursements and debt redemption.

In addition, ADB can raise discretionary liquidity, funded entirely by borrowings, to provide flexibility in the funding and debt redemption schedule over time. The transition to the new liquidity policy, which may result in a higher level of prudential minimum liquidity level, will be managed carefully to avoid an unnecessary surge in borrowing needs or negative implications on the financial ratios. Levels of liquidity and net cash requirement are monitored on an ongoing basis and reviewed by the Board of Directors quarterly.

Operational Risks. Operational risk represents the potential for loss resulting from inadequate or failed internal processes or systems, human factors, or exter-

nal events including business disruptions and system failure, transaction processing failures, and failure in execution of legal, fiduciary, and agency responsibilities. ADB is exposed to many types of operational risks, which are mitigated by maintaining a sound system of internal controls and processes. In addition, ADB has a rigorous process for approving transactions that requires reviews and authorization by all relevant parties to ensure that all transactions are properly approved, documented, monitored, and controlled. ADB has put in place a strategy to strengthen the business continuity plan to reduce the impact of disruption affecting business processes.

Summary of Financial Performance

Net Income. Net income before net unrealized gains was \$711.4 million, compared with \$705.5 million in 2006. The slight increase of \$5.9 million (0.8%) was predominantly due to the following:

- \$236.7 million increase in net loan income, mostly associated with increase in interest income and other loan charges resulting from higher interest rates and average outstanding loan portfolio (\$28.1 billion - 2007; \$24.3 billion - 2006);
- \$107.3 million increase in investment income resulting mainly from increase in average investment portfolio (\$14.4 billion - 2007; \$13.4 billion - 2006), due to higher liquidity requirement to meet projected loan disbursements, as well as relatively higher interest rates in most invested currencies (for the US dollar, there is a time lag for interest to adjust, thus on average, US dollar rate of return is comparatively higher in 2007);
- \$0.3 million decrease in net administrative expenses, associated with \$5.6 million increase in deferred loan origination costs related to new loans and guarantees, offset by \$3.8 million decrease in expenses charged to ADF, caused by lesser operational activities for ADF compared to OCR; and \$1.5 million increase in overall administrative expenses of ADB;
- \$282.5 million increase in borrowings and related expenses, including \$9.0 million increase in realized losses on purchase/redemption of bonds, due to the increase in the borrowing portfolio and higher interest rates;
- \$25.5 million net increase in provision for loan losses mainly attributed to the release of provisions in 2006 resulting from the change in provisioning methodology for nonsovereign operations;
- \$17.9 million decrease in income from equity investments resulting mainly from \$35.3 mil-

lion decrease in net realized gains on disposal of equity investments, offset by \$15.5 million increase in proportionate gains on equity investments accounted for under equity method; and \$2.0 million increase in dividend income for the year.

Net Unrealized Gains and Losses on Derivatives, as required by FAS 133 and 155. ADB posted net unrealized gains on derivatives, which are used for hedging transactions, of \$57.5 million, compared to net unrealized losses of \$138.5 million in 2006, due primarily to significant downward shift of the US dollar yield curve at 2007 year-end, especially in the short to medium term, and the strengthening of most major currencies against the US dollar, compared to last year. The effect of declining interest rates coupled with continued weakening of the US dollar during the period had a net effect of increasing the borrowing related derivatives value, i.e., swaps. The impact was largely felt on the nonstructured debts and their related derivatives, as the asset portion of the swaps are designed to behave as long-term fixed assets denominated in the hedged-borrowings original currencies. The liability portion of the swaps would behave similar to long-term US dollar LIBOR-based liabilities. Because of the asymmetrical accounting treatment between the nonstructured debts and their swaps, the net unrealized gains on the swaps were not offset by the increase in the value of the nonstructured debts, which are not fair valued but recorded at their carrying book value. A fair valuation of the nonstructured debts would have offset some of the unrealized gains on the swaps. In addition, the declining interest rate environment would have increased the value of the debts, mainly fixed rate US dollar bonds, which do not have any derivatives transactions attached to them.

The appreciation of certain currencies against the US dollar in 2007 specifically the Japanese yen also affected the structured debt (hybrid instruments) portfolios to a certain extent. The increase in value of the underlying debts outweighed the increase in the value of the embedded derivatives, which are highly sensitive to the expected foreign exchange rates movements. On an after-swap basis, the change in fair value of the structured debts led to an unrealized loss of \$5.3 million for the year ended 31 December 2007, as required by FAS 155. The unrealized losses were due mainly to movements of foreign exchanges and interest rates. As the hybrid instruments are fully hedged, however, the swaps would economically offset any foreign exchange and interest rate risks of the instruments (*Note M of OCR Financial Statements*).

Critical Accounting Policies and Estimates

Significant accounting policies are contained in Note B of OCR's financial statements. As disclosed in the financial statements, Management estimates the fair value of financial instruments. Estimates by their nature are based on judgment and available information; therefore, actual results may differ and might have a material impact on the financial statements.

Fair Value of Financial Instruments. Under statutory reporting, ADB carries its financial instruments and derivatives, as defined by FAS 133 and its related amendments, including FAS 155, on a fair value basis. These financial instruments include embedded derivatives that are valued and accounted for in the balance sheet as a whole. Fair values are usually based on quoted market prices. If market prices are not readily available, fair values are usually determined using market-based pricing models incorporating readily observable market data and require judgment and estimates.

The pricing models used for determining fair values of ADB's financial instruments are based on discounted expected cash flows using observable market data. ADB reviews the pricing models to assess the appropriateness of assumptions to reasonably reflect the valuation of the financial instruments. In addition, the fair values derived from the models are subject to ongoing internal and external verification and review. The models use market-sourced inputs such as interest rates, exchange rates, and option volatilities. Selection of these inputs may involve some judgment and may impact net income. ADB believes that the estimates of fair values are reasonable given existing controls and processes.

In September 2006 and February 2007, the Financial Accounting Standards Board (FASB) issued FAS 157, Fair Value Measurements, and FAS 159, Fair Value Option for Financial Assets and Financial Liabilities, respectively. FAS 157 emphasizes the definition and methods for measuring fair value, and expands disclosure requirements for financial reporting purposes, while FAS 159 expands the scope of financial instruments that may be carried at fair value. These are discussed in more detail in Note B of OCR's financial statements. These statements will be effective for financial statements to be issued after 31 December 2007.

Provision for Loan Losses. Provision against loan losses for impaired loans reflects management's judgment and estimate of the present value of expected future cash flows discounted at the loan's effective

interest rate. ADB considers a loan impaired when, based on current information and events, it is probable that ADB will be unable to collect all the amounts due according to the loan's contractual terms.

In 2006, the Board approved the revision of the loan loss provisioning methodology for ADB's nonsovereign operations to a risk-based model. The assessment applies the concept of expected loss to establish loss provision and loss reserve, similar to the concept applied to ADB's sovereign operations approved in 2004. The provisioning estimate is performed by the Risk Management Unit on a quarterly basis.

In the revised methodology, ADB uses an internal risk rating system to estimate the probability of default based on its past loan loss experience and various tools available in the market. Loans that are considered impaired based on the probability of default are provisioned through the income statement. Those that are not impaired will be provisioned through the establishment of a loss reserve in the equity section as an allocation of net income subject to the approval of the Board of Governors.

At 31 December 2007, provision for loan losses was \$15.0 million (\$28.3 million - 2006), the reduction resulting mainly from the sale of two nonsovereign loans which were previously provisioned.

SPECIAL FUNDS

ADB is authorized by its Charter to establish and administer special funds. These are the Asian Development Fund (ADF), Technical Assistance Special Fund, Japan Special Fund, ADB Institute Special Fund, the Asian Tsunami Fund, the Pakistan Earthquake Fund, and the Regional Cooperation and Integration Fund. Financial statements for each fund are prepared in accordance with generally accepted accounting principles except for ADF's which are special purpose financial statements prepared in accordance with ADF Regulations.

Asian Development Fund

The ADF is ADB's concessional financing window for developing member countries with low per capita gross national product and limited debt repayment capacity. It is the only multilateral source of concessional assistance dedicated exclusively to reducing poverty and to improving the quality of life in Asia and the Pacific. Thirty-one donor members (regional and nonregional) have contributed to the fund. Cofinancing with bilateral and multilateral development partners complement ADB's ADF resources.

TABLE 12 ADF Commitment Authority^a
31 December 2007 and 2006
(\$ million)

	2007	2006
Carryover from ADF VIII ^b	126.9	120.9
ADF IX Contributions ^c	2,144.4	1,292.9
ADF VIII Contributions	164.6	157.8
OCR Net Income Transfer	120.0	80.0
Loans Savings and Cancellation	890.8	316.5
Expanded Advance Commitment Authority	2,979.7	1,893.2
Provision for Disbursement Risk ^d	(157.9)	(120.1)
Total ADF IX Commitment Authority	6,268.5	3,741.4
Loans and Grants Committed	(5,833.1)	(3,240.3)
ADF Commitment Authority Available for Future Commitments	435.4	501.1

(-) = negative, \$ = US dollar.

a The schedule reflects cumulative commitment authority for ADF IX.

b The US dollar equivalent of SDR 80.39 million at each year-end exchange rates.

c Contributions received to finance forgone interest of grants are excluded as they have been incorporated as cash inflows in the computation of Expanded Advance Commitment Authority.

d Applies to contribution and net income transfer received prior to the adoption of the new ADF Financial Framework in December 2007.

Note: Totals may not add due to rounding.

Contributed Resources. During the eighth replenishment of the ADF (ADF IX), donors recommended a replenishment of \$7.0 billion, consisting of \$3.3 billion in new contributions from donors and \$3.7 billion from internal resources based on the exchange rate specified in the Resolution of the Board of Governors. ADF IX, which covers the 4-year period from 2005 to 2008, became effective in April 2005 after instruments of contribution deposited with ADB for unqualified contribution exceeded 50% of all pledged contributions. As of 31 December 2007, 28 donors have submitted their Instruments of Contribution to ADF IX totaling \$3.5 billion including Ireland's contribution of \$34.0 million. Total deposited installment payments amounting to \$2.5 billion include \$2.1 billion for ADF operations, \$0.2 billion for Technical Assistance Special Fund, and \$0.1 billion for financing forgone interest of grants. The remaining unpaid contributions under ADF VIII as of 31 December 2007 amounted to \$171.9⁷ million. (*For details of amounts released for operational commitment in 2007, see the column labeled "Addition" in Statistical Annex 23*).

In May 2007, the Board of Governors approved the transfer of \$40.0 million to ADF as part of OCR's net income allocation (\$40.0 million — 2006). In addition, a total of \$890.8 million from loan savings and cancellations have been included in the commitment authority.

7 US dollar equivalent at 31 December 2007 exchange rates.

This resulted from management's continuous assessment of opportunities for freeing committed resources through cancellations of unused loan balances. During 2007, promissory notes totaling \$882.0 million have been encashed, \$53.2 million of which was transferred to the Technical Assistance Special Fund.

Financial Framework. In December 2007, the Board of Directors approved a new ADF financial framework which aims to enhance the long-term financial capacity of ADF and improve prudential financial management practices. The new framework establishes tranching of liquidity to improve the liquidity management and prudential minimum liquidity level ADF should maintain. The new framework allows ADF to have a higher and more stable commitment authority for future replenishments and ensure that liquidity is managed in a transparent and efficient manner.

Currency Management. Effective 1 January 2006, the new currency management framework for ADF, which was approved by the Board of Directors in October 2005, was implemented. Under this new framework, the practice of managing ADF resources in as many as 15 currencies was discontinued, and an approach based on special drawing rights (SDR) basket of currencies was introduced. ADF donor contributions and loan reflows received in currencies that do not constitute SDR are immediately converted into one of SDR currencies to maintain SDR-based liquidity portfolio. In addition, the borrower's obligations for new ADF loans are now determined in SDR.

Loan Conversion. In July 2007, as an application of the Board-approved new currency management framework, ADB offered a full-fledged special drawing rights (SDR) approach to ADF legacy loans by providing ADF borrowers the option to convert their existing liability (i.e., disbursed and outstanding loan balance) in various currencies into SDR, while the undisbursed portions will be treated as new loans. The conversion will shorten the time horizon to achieve the full benefits, reduce exchange rate volatility associated with legacy ADF loans, and provide a consistent debt portfolio management framework across peer multilateral banks and all ADF loans. The conversion was made available beginning 1 January 2008.

Revised Framework for Grants and Hard-Term Facility. In September 2007, the Board of Directors approved the revised ADF grant framework which limits grants eligibility to ADF-only countries and introduced a

new hard-term ADF lending facility. The facility will have a fixed interest rate of 150 basis points below the weighted average of the 10-year fixed swap rates of the special drawing rights component currencies plus the OCR lending spread, or the current ADF rate, whichever is higher. Other terms are similar to those of regular ADF loans. In general, blend countries with per capita income not exceeding the International Development Association operational cutoff for more than 2 consecutive years and an active ordinary capital resources lending program are eligible to borrow from this new facility. The interest rate will be reset every January through a Board information paper. The rate will apply to all hard-term loans approved that year and will be fixed for the life of the loan. For hard-term ADF loans approved in 2007, the interest rate was set at 3.85%. No loans were approved under this new facility in 2007.

Loan Approvals, Disbursements, and Repayments. In 2007, 36 ADF loans totaling \$1.9 billion were approved compared with 45 loans totaling \$1.3 billion in 2006. Disbursements during 2007 totaled \$1.6 billion, an increase of 20.9% from \$1.3 billion in 2006. At the end of the year, cumulative disbursements from ADF resources were \$25.1 billion. Loan repayments during the year amounted to \$586.4 million. At year-end, outstanding ADF loans amounted to \$24.0 billion.

Status of Loans. At the end of the year, 28 sovereign loans to Myanmar (\$488.9 million) were in non-accrual status representing about 2.0% of the total outstanding ADF loans.

Investment Portfolio Position. The ADF investment portfolio⁸ amounted to \$7.0 billion at 31 December 2007 compared with \$6.4 billion in 2006. About 88.0% of the portfolio was invested in bank deposits and 12.0% was invested in fixed income securities. The annualized rate of return on ADF investments in 2007 and 2006 was 4.7% and 4.0%, respectively. At the end of 2007, ADF investments were denominated in six currencies, 98.3% of which were in special drawing rights currencies—US dollar (USD), Japanese yen (JPY), euro (EUR), and pound sterling (GBP).

Grants. With the introduction of grant financing in ADF IX, 24 grants (16 – 2006) were approved in 2007 totaling \$519.3 million (\$274.9 million – 2006), while 17 grants (22 – 2006) totaling \$377.8 million (\$346.5 million – 2006) became effective.

8 Includes securities purchased under resale arrangement.

Cofinancing for Loans and Grants. In 2007, \$82.0 million was mobilized in official loan cofinancing for four loan projects totaling \$186.1 million and \$34.9 million for three grant projects totaling \$92.4 million.

Heavily Indebted Poor Countries (HIPC) Debt Relief. ADF donors requested ADB's participation in the HIPC debt relief. In line with this, Management proposed to the Board of Directors the "Policy for Providing Heavily Indebted Poor Countries (HIPC) Relief from Asian Development Fund Debt and Proposed Debt Relief to Afghanistan" which will be considered in March 2008. In this paper Management recommends to the Board of Directors the submission of a resolution to the Board of Governors for ADB to participate in the HIPC debt relief, and to provide Afghanistan with debt relief upon the adoption of the resolution by the Board of Governors.

The HIPC Initiative was launched in 1996 by the International Development Association and International Monetary Fund (IMF) to reduce the excessive debt burden faced by the world's poorest countries. A "sunset clause" was stipulated to prevent the HIPC debt relief from becoming a permanent facility, minimize moral hazard and encourage early adoption of reform programs. This has been extended several times with the latest "sunset clause" being end-2006 with a "ring-fence" of its application to countries satisfying the income and indebtedness criteria using end-2004 data. Thus far, Afghanistan is the only ADF borrower that has qualified for HIPC debt relief. The estimated principal amount of Afghanistan's ADF debt to be forgiven is \$81.5 million.⁹ While other ADF borrowers have met the HIPC indebtedness criteria, it is not possible to currently estimate whether these countries will qualify for HIPC debt relief.

Under the policy, upon approval of debt relief for a country by the Board of Directors, the principal component of the estimated debt relief costs will be recorded as a reduction of the disbursed and outstanding loans on a provisional basis and charged against ADF income. The IDA and IMF Boards will decide when a country has satisfied the conditions for reaching the completion point. Upon reaching the completion point the debt relief will become irrevocable. The accumulated provision for HIPC debt relief will be reduced when debt relief is provided on the loan service payment date.

Technical Assistance Special Fund

Review of Activities. With the effectivity of ADF IX and the third regularized replenishment of Technical Assistance Special Fund, contributions of \$212.6 million from 27 donors have been committed and \$148.7

**TABLE 13 Technical Assistance Special Fund
Cumulative Resources**
(\$ million)

	2007	2006
Regularized Replenishment		
Contributions	425.7	425.7
Allocations from OCR Net Income	683.0	683.0
Direct Voluntary Contributions	88.8	88.8
Income from Investment and Other Sources	167.3	152.9
Transfers from the TASF to the ADF	(3.5)	(3.5)
Total	1,361.3	1,346.9

() = negative, \$ = US dollar.
ADF = Asian Development Fund, OCR = Ordinary Capital Resources, TASF = Technical Assistance Special Fund.

million have been received. In addition, India made a wholly untied direct voluntary contribution amounting to Rs2.25 million (\$50,000 equivalent). At the end of 2007, total Technical Assistance Special Fund resources amounted to \$1,361.3 million, of which \$1,168.2 million was committed (Statistical Annex 24).

Operations and Resource Position. Technical assistance (TA) commitments (approved and effective) declined from \$91.8 million in 2006 to \$77.5 million in 2007 for 107 TA projects that were made effective during the year, net of \$11.9 million (\$9.4 million – 2006) write back of undisbursed commitments for completed and cancelled TA projects. Income from investments increased from \$11.8 million in 2006 to \$14.2 million in 2007 because of higher yields in some capital markets. In addition, foreign exchange gains also increased by \$28.3 million, from \$7.4 million in 2006 to \$35.7 million in 2007, due to the appreciation of most currencies against the US dollar. The uncommitted balance available for future commitments decreased from \$220.5 million in 2006 to \$193.1 million in 2007. Technical Assistance Special Fund financed 41.6% of all TA activities approved in 2007.

At the end of the year, Technical Assistance Special Fund investments stood at \$295.1 million, up by 7.1% from 2006. Other assets—due from banks and contributors, advances to consultants, and others—totalled \$81.8 million.

Japan Special Fund

Review of Activities. The technical assistance (TA) grants financed by Japan Special Fund continued to support ADB operations aimed at reducing poverty. In January 2007, Japan contributed ¥3.3 billion (\$27.7

9 Based on the disbursed and outstanding debt as of 20 March 2006, converted to US dollar using the exchange rate as of end of March 2006.

**TABLE 14 Japan Special Fund
Technical Assistance by Sector, 2007^a**

	\$ Million ^b	%
Transport and Communications	10.4	24
Law, Economic Management, and Public Policy	8.6	20
Energy	8.3	19
Water Supply, Sanitation, and Waste Management	3.4	8
Agriculture and Natural Resources	3.4	8
Multisector	3.3	8
Finance	2.6	6
Education	1.8	4
Health, Nutrition, and Social Protection	1.3	3
Total	43.1	100

% = percent, \$ = US dollar.

a Includes approved but not yet effective.

b Totals may not add due to rounding.

million equivalent) as a regular contribution. As of 31 December 2007, Japan's cumulative contribution to the fund since its inception in 1988 amounted to ¥111.0 billion (about \$956.4 million equivalent) comprising regular contributions of ¥92.9 billion (\$805.6 million equivalent) and supplementary contributions of ¥18.1 billion (\$150.8 million equivalent). In 2007, ADB approved 55 TA projects financed by the Japan Special Fund totaling \$43.1 million inclusive of those that were approved but not yet effective (Table 14). The uncommitted balance including approved technical assistance not yet effective as of 31 December 2007 was \$103.8 million.

Sector Activities. In 2007, the Japan Special Fund financed 18.0% of the total amount of technical assistance that ADB approved, including 52.0% of the total amount of project preparatory technical assistance during the year. Table 14 illustrates the breakdown of Japan Special Fund approvals by sector.

ADB Institute Special Fund

The costs for operating the ADB Institute are met from the ADB Institute Special Fund which is administered by ADB in accordance with the Statute of ADB Institute. In 2007, Japan committed its 12th contribution in the amount of ¥1.32 billion (\$11.7 million equivalent) which was reported as Due from Contributors.

As of 31 December 2007, cumulative contributions committed amounted to ¥15.8 billion (about \$133.0 million equivalent) excluding translation adjustments. Of the total contributions received, \$114.8 million had been used by the end of the year mainly for research and capacity-building activities including organizing

symposia, forums, and trainings; preparing research reports, publications, and websites; and for associated administrative expenses. The balance of net current assets (excluding property, furniture, and equipment) available for future projects and programs was about \$18.2 million.

Asian Tsunami Fund

The Asian Tsunami Fund was established on 11 February 2005 in response to the special circumstances surrounding the developing member countries that were stricken by the effects of the tsunami on 26 December 2004. ADB contributed \$600.0 million to the fund, of which, \$50.0 million unutilized funds were transferred back to OCR (\$40.0 million in November 2005 and \$10.0 million in June 2006). In addition, Australia and Luxembourg contributed \$3.8 million and \$1.0 million, respectively.

Review of Activities. No technical assistance/grants were approved or made effective during the year. As of 31 December 2007, the uncommitted resources of the fund amounted to \$40.0 million, an increase of \$20.5 million from 2006 which is mainly from investments income.

Pakistan Earthquake Fund

The Pakistan Earthquake Fund was established in November 2005 in response to the special needs of Pakistan subsequent to the earthquake on 8 October 2005. The dedicated fund is to deliver emergency grant financing for investment projects and technical assistance to support immediate reconstruction, rehabilitation, and associated development activities. ADB contributed \$80.0 million to the fund. In addition, Australia, Belgium, Finland, and Norway committed \$15.0 million, \$9.1 million, \$12.3 million and \$15.0 million, respectively.

The contributions of Belgium and Norway were in the form of debt-for-development swap agreements. The agreements involved the conversion of Pakistan's loan service payments to the two countries for their loans to Pakistan of up to €9.9 million and \$20.0 million, respectively, into Belgium's and Norway's contributions to the Pakistan Earthquake Fund. Belgium's contributions will be made in three equal installments of €3.3 million from 2007 to 2008, while Norway's contributions will be undertaken in four equal installments of \$5.0 million in 2006–2008. As of 31 December 2007, the amounts of €6.6 million and \$15.0 million have been received from Belgium and Norway, respectively. These form part of the Contributed Resources of Pakistan Earthquake Fund. The remaining commitments are expected to be received in the next 5 months.

Review of Activities. In 2007, one technical assistance and one supplementary grant amounting to \$2.0 million and \$30.0 million, respectively, were approved and became effective. As of 31 December 2007, total amount committed exceeded cumulative resources by \$3.5 million. This is expected to be covered by the additional resources from Norway and Belgium, as detailed above.

Regional Cooperation and Integration Fund

The Regional Cooperation and Integration Fund was established in February 2007 in response to the increasing demand for regional cooperation and integration activities among ADB's member countries in Asia and the Pacific. Its main objective is to improve regional cooperation and integration (RCI) in Asia and the Pacific by facilitating the pooling and provision of additional financial and knowledge resources to support RCI activities. ADB contributed \$40.0 million to the fund as part of the 2006 OCR net income allocation.

Review of Activities. In 2007, four technical assistance (TA) and one supplementary TA totaling \$7.4 million became effective. Total resources of the fund as of 31 December 2007 amounted to \$41.2 million, leaving an uncommitted balance of \$33.8 million.

TRUST FUNDS MANAGED BY ADB

In addition to OCR and the Special Funds, ADB also manages and administers the Japan Scholarship Program, Japan Fund for Poverty Reduction, Japan Fund for Information and Communication Technology, Japan Fund for Public Policy Training, and trust funds provided by bilateral donors through channel financing arrangements and financing partnership facilities to support technical assistance and soft components of loans. These funds do not form part of ADB's own resources.

Japan Scholarship Program

The Japan Scholarship Program was established in 1988 to provide an opportunity for well-qualified citizens of developing member countries to undertake postgraduate studies in economics, management, science and technology, and other development-related fields at selected educational institutions in Asia and the Pacific. The Japan Scholarship Program is funded by Japan and administered by ADB. Currently, 20 institutions in 10 countries participate.

Between 1988 and 2007, Japan contributed \$92.6 million. A total of 2,235 scholarships have been awarded to recipients from 35 members. Recently, an average of about 150 scholarships has been awarded

each year. Of the total, 1,890 have completed their courses. Women have received 752 scholarships. (www.adb.org/JSP)

Japan Fund for Poverty Reduction

The Japan Fund for Poverty Reduction was established in May 2000 as a trust fund to support poverty reduction and social development activities that can add substantial value to ADB projects. Since 2000, Japan has contributed \$360.4 million in total. To date, \$266.3 million for 103 projects has been approved, of which 13 projects valued at \$22.0 million were approved in 2007 (www.adb.org/JFPR; Statistical Annex 27). A number of projects have been completed, and these have been the subject of knowledge-sharing sessions organized by ADB. A special evaluation study on JFPR was conducted in 2007 and the report may be downloaded from www.adb.org/evaluation.

GRANT COFINANCING ACTIVITIES

Official grant cofinancing plays a vital role in ADB operations, particularly in view of the continuing constraints on Technical Assistance Special Fund and ADF resources. These grant funds finance mostly soft components of loan projects and support technical assistance. Most grants are provided by bilateral donors under channel financing arrangements and financing partnership facilities with multidonors including instruments of contributions (Table 15). ADB acts as administrator of the funds and applies its own guidelines and procedures in recruiting consultants, making disbursements, and supervising projects.

Efforts continued to mobilize grant funds not only from official sources but also from private sector entities. Funds mobilized from private sector entities mostly cofinanced regional technical assistance (TA) projects in the environment sector. In 2007, a total of \$191.1 million in grants was mobilized comprising \$101.4 million for 10 investment projects and \$89.7 million in TA for 60 projects.

Channel Financing Arrangements

Under a channel financing arrangement, the donor enters into a comprehensive agreement with ADB whereby the donor provides an untied grant fund to be administered by ADB, but the fund does not become part of ADB's own resources. The donor indicates its preferred sectors and recipient countries. ADB regularly provides a list and description of proposed technical assistance projects that satisfy the donor's preferences, and they agree on the specific activities to be financed. Funds provided under a channel financ-

ing arrangement are usually transferred to an interest-bearing account and may also be invested by ADB pending disbursement. Donors are provided with regular financial statements and progress reports on the use of the funds. ADB is responsible for project preparation, processing, and administration. Channel financing arrangements may be replenished with additional funds at the donor's discretion.

The primary advantage of channel financing arrangements is that funding for several individual technical assistance projects may be provided under a single agreement. Accordingly, they minimize the need for detailed negotiations on a case-by-case basis and foster administrative efficiency. The first channel financing arrangement was negotiated in 1980. Since then, ADB has entered into channel financing arrangements with the following bilateral development partners: Australia, Belgium, Canada, Denmark, Finland, France, Ireland, Italy, Luxembourg, the Netherlands, New Zealand, Norway, People's Republic of China, Republic of Korea, Spain, Sweden, Switzerland, and United Kingdom.

In 2007, Spain and Luxembourg made an additional contribution of \$2.6 million and \$0.2 million, respectively, while Finland channeled an additional \$1.0 million for the Tonle Sap Initiative in Cambodia.

In addition to the traditional type of channel financing arrangement which may be used for several sectors, thematic channel financing arrangements with bilateral agencies have increased sharply in recent years in such areas as renewable energy, climate change, poverty reduction, governance, water, gender and development, and poverty and environment. Several thematic channel financing arrangements have been packaged as umbrella facilities to allow more than one donor to contribute. In addition, replenishments were made to the Governance (\$1.2 million from Ireland and \$0.9 million from Norway) and Gender and Development Cooperation Funds (\$1.5 million from Canada and \$1.0 million from Ireland).

Financing Partnership Facilities

Financing partnership facilities have been established to expand the scope of partnership between ADB and its financial partners. Instruments of contribution to be

executed by donors contributing to certain multi-donor trust funds have also been introduced whereby the donor shall agree to contribute amounts to be administered by ADB, substantially in accordance with the terms of the related Board paper. Under these instruments partners shall be deemed to have accepted the objectives of the activity described in Board papers.

In 2006, ADB approved an innovative Water Financing Partnership Facility aiming to raise \$100.0 million by 2008 to support its water financing program. Resources from the facility may be provided for water projects through grants, concessional loans, guarantees, or other forms of assistance under framework agreements.

ADB will manage the Asia Pacific Carbon Fund, also established in 2006, to acquire future flows of certified emission reduction credits on behalf of participants, in return for upfront cofinancing payments. So far, a total of \$151.8 million have been remitted to this fund through Instruments of Contributions from Belgium, Finland, Luxembourg, Portugal, Spain, Sweden, and Climate Cent Foundation. The use of channel financing arrangement, if preferred by a specific donor, may be allowed for future contributions.

Following the establishment of the Water Financing Partnership Facility and the Asia Pacific Carbon Fund, two more facilities were established in 2007. These are the Clean Energy Financing Partnership Facility, with Australia and Norway having contributed \$5.9 million and \$5.6 million, respectively; and the Regional Cooperation and Integration Financing Partnership Facility (classified as Special Fund).

Another initiative successfully negotiated in 2007 is the loan buy-down mechanism whereby Australia shall provide a A\$4.0 million grant into a fund managed by ADB to buy down a portion of the ADF loan for the Samoa Pier Sector Project. The loan buy down mechanism will be triggered by certain milestones during project implementation. The use of this pilot mechanism constitutes an innovative approach to promoting reforms in developing countries, especially in the Pacific region. This is the first time ADB is engaging in such a loan buy-down mechanism.

**TABLE 15 Schedule of Contributions and Net Assets
Grants from External Sources**
As of 31 December 2007
(\$ million)

	Contribution	Net Assets ^a
Administered by ADB		
Country		
Australia	180.6	109.9
Austria	1.0	–
Belgium	29.2	26.5
Canada	100.1	52.0
China, People's Republic of	20.1	12.5
Denmark	23.8	6.0
European Community	263.7	124.6
Finland	50.1	28.9
France	31.4	6.5
Ireland	2.2	1.0
Italy	2.7	0.9
Japan	486.8	188.3
Korea, Republic of	20.1	18.4
Luxembourg	17.9	16.4
Netherlands	343.3	116.7
New Zealand	30.9	0.5
Norway	128.8	66.9
Portugal	15.0	14.8
Spain	37.6	33.7
Sweden	143.9	61.8
Switzerland	40.0	27.3
United Kingdom and Northern Ireland	500.8	181.8
United States	1.8	0.4
Subtotal	2,472.0	1,095.9
Others		
Cities Alliance	0.5	(0.0)
Global Environment Fund	63.8	31.7
Private Sector/Foundations	2.8	0.1
Public Private Infrastructure Advisory Facility	0.5	0.0
Trust Fund for Forest (Viet Nam)	17.9	2.2
United Nation Development Programme	111.2	0.3
Subtotal	196.6	34.3
Not Administered by ADB		
Country		
Switzerland	25.4	6.3
Kuwait	15.0	1.0
Subtotal	40.4	7.3
Grand Total	2,708.9	1,137.6

Note: Figures may not add due to rounding.
– = 0, () = negative, 0.0 = less than \$50,000.

a Excludes projects approved not yet effective.