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 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 2008, 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 secure 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. ADB prepares its financial statements in accordance with accounting principles generally accepted in the United States of America. Table 1 presents selected financial data for 2008.

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 and liability management of individual positions and overall portfolios, and to reduce borrowing costs.

Financial instruments including all derivatives, structured and swapped borrowings, and marketable investments are recorded at their fair value while loans and unswapped borrowings are recorded at carrying book value. Non-marketable equity investments are valued either at cost less any permanent impairment, or using the equity method.

ADB complies with Financial Accounting Standards (FAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," along with 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). Effective 1 January 2008, ADB also adopted FAS 157, "Fair Value Measurements," and FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities (including an amendment of Financial Accounting Standards Board Statement No. 115)."

FAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. 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. Compliance with hedge accounting requirements 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. Accord-

TABLE 1: Selected Financial Data
(31 December, amounts in $ Million)

	Statutory Basis				
	2008	2007	2006	2005	2004
Revenue and Expenses					
From Loan	1,358.0	1,442.3	1,210.1	1,036.3	1,038.3
From Investments	677.2	683.2	564.5	377.4	265.6
From Guarantees	6.9	5.1	4.1	4.1	3.5
From Equity Investments	3.7	58.9	41.5	3.3	(0.7)
From Other Sources	18.7	18.8	18.7	11.3	6.4
Total Revenue	**2,064.5**	**2,208.3**	**1,838.9**	**1,432.4**	**1,313.1**
Borrowings and Related Expenses	1,208.4	1,389.8	1,116.3	893.2	861.7
Administrative Expenses[a]	141.0	127.3	127.7	135.7	118.3
Technical Assistance to Member Countries	8.4	(0.7)	(1.2)	(3.4)	(2.4)
Provision for Losses	(3.5)	(0.6)	(32.5)	(3.5)	2.2
Other Expenses	6.3	4.0	3.7	4.2	3.1
Total Expenses	**1,360.6**	**1,519.8**	**1,214.0**	**1,026.2**	**982.9**
Net Realized (Losses) Gains	(28.1)	22.9	80.6	16.9	59.4
Net Unrealized Gains (Losses)	450.6	53.8	(135.4)	(309.2)	41.0
Cumulative Effect of Change in Accounting Principle	–	–	–	(4.6)	–
Net Income	1,126.3	765.2	570.1	109.3	430.6
Average Earning Assets[b]	50,394	42,780	37,904	36,092	36,364
Annual Return on Average Earning Assets	2.24%	1.79%	1.50%	0.30%	1.18%
Return on Loans	3.84%	5.00%	4.98%	4.35%	4.16%
Return on Investments	3.20%	4.68%	4.18%	2.96%	2.21%
Cost of Borrowings	4.11%	4.32%	4.81%	5.04%	3.37%
	Pre-FAS 133/159[d] Basis				
Net Income	699.7	711.4	705.5	415.6	389.6
Average Earning Assets[b]	50,443	42,757	37,859	36,076	36,306
Annual Return on Average Earning Assets[c]	1.39%	1.66%	1.86%	1.15%	1.07%
Return on Loans	4.14%	5.14%	4.94%	4.35%	4.16%
Return on Investments	3.70%	4.72%	4.27%	2.99%	2.34%
Cost of Borrowings	3.29%	4.68%	4.31%	3.75%	3.58%
	Current Value Basis				
Net Income	101.9	1,159.0	544.1	93.7	562.8
Average Earning Assets[b]	51,575	43,726	39,130	37,948	39,391
Annual Return on Average Earning Assets	0.20%	2.65%	1.31%	0.23%	1.47%
Return on Loans	9.18%	6.40%	2.58%	(1.18%)	4.25%
Return on Investments	3.51%	7.77%	5.48%	(1.11%)	3.51%
Cost of Borrowings	7.17%	5.32%	3.51%	(1.34%)	3.56%

( ) = negative, FAS = Financial Accounting Standards.

a Net of administration expenses allocated to the Asian Development Fund and loan origination costs that are deferred.

b Composed of investments and related swaps, outstanding loans (excluding net unamortized loan origination cost/front-end fees) and related swaps and equity investments.

c Represents net income before net unrealized gains/losses on derivatives, over average earning assets.

d FAS 159 is applicable to 2008 only.

ingly, 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.

FAS 155 allows fair value measurement for hybrid financial instruments that contain embedded features that would otherwise be required to be treated as a separate derivative instrument (bifurcated) in the reported finan-

TABLE 2: Condensed Current Value Balance Sheets as at 31 December 2008 and 2007
($ Thousand)

	31 December 2008					31 December 2007
	Statutory Basis	Reversal of FAS 133/159 Effects[a]	Pre–FAS 133/159 Basis	Current Value Adjustments	Current Value Basis	Current Value Basis
Due from banks	$ 142,238	$ –	$ 142,238	$ –	$ 142,238	$ 108,821
Investments and accrued income	15,544,399	–	15,544,399	–	15,544,399	13,440,728
Securities transferred under repurchase agreement	309,358	–	309,358	–	309,358	5,041,387
Securities purchased under resale arrangement	511,756	–	511,756	–	511,756	427,132
Loans outstanding and accrued interest	36,150,156	(451)	36,149,705	1,622,166	37,771,871	31,434,283
Provision for loan losses and unamortized net loan origination costs	59,088	–	59,088	–	59,088	27,087
Equity investment	641,427	(6,060)	635,367	6,060	641,427	808,157
Receivable from members	144,514	–	144,514	(50,790)	93,724	105,027
Receivable from swaps						
Borrowings	23,831,087	(2,237,329)	21,593,758	2,237,329	23,831,087	17,968,867
Others	882,793	(163,125)	719,668	163,125	882,793	512,089
Other assets	504,936	–	504,936	–	504,936	463,793
TOTAL	$ 78,721,752	$ (2,406,965)	$ 76,314,787	$ 3,977,890	$ 80,292,677	$ 70,337,371
Borrowings and accrued interest	$ 36,026,446	$ 5,912	$ 36,032,358	$ 1,816,481	$ 37,848,839	$ 32,023,669
Payable for swaps						
Borrowings	24,867,815	(1,347,193)	23,520,622	1,347,193	24,867,815	16,936,964
Others	1,198,781	(361,357)	837,424	361,357	1,198,781	583,320
Payable under securities repurchase arrangement	301,759	–	301,759	–	301,759	5,092,316
Accounts payable and other liabilities	1,057,481	–	1,057,481	–	1,057,481	722,402
Total Liabilities	63,452,282	(1,702,638)	61,749,644	3,525,031	65,274,675	55,358,671
Paid-in capital	3,777,071	–	3,777,071	–	3,777,071	3,842,293
Net notional maintenance of value receivable	(564,383)	–	(564,383)	–	(564,383)	(661,197)
Ordinary reserve	9,532,487	1,194	9,533,681	877,280	10,410,961	9,642,454
Special reserve	209,723	–	209,723	–	209,723	202,847
Loan loss reserve	195,062	–	195,062	–	195,062	182,100
Surplus	894,594	–	894,594	–	894,594	616,300
Cumulative revaluation adjustments account	(23,336)	23,336	–	–	–	–
Net income[b] — 31 December 2008	1,119,473	(426,647)	692,826	(597,852)	94,974	–
Net income[b] — 31 December 2007	227,500[c]	(227,500)	–	–	–	1,153,903
Accumulated other comprehensive income	(98,721)	(74,710)	(173,431)	173,431	–	–
Total Equity	15,269,470	(704,327)	14,565,143	452,859	15,018,002	14,978,700
TOTAL	$ 78,721,752	$ (2,406,965)	$ 76,314,787	$ 3,977,890	$ 80,292,677	$ 70,337,371

( ) = negative, FAS = Financial Accounting Standards.
a Includes reversal of unrealized (gains) losses attributed to equity investments accounted for under equity method.
b Net income after appropriation of guarantee fees to Special Reserve.
c Cumulative effect of FAS 157/159 adoption to prior years' net income.

cial statements under FAS 133. As of 31 December 2008, ADB holds a relatively small portion of hybrid financial instruments in its borrowing portfolio.

FAS 159 expands the scope of financial assets and liabilities that companies may carry at fair value. Effective 1 January 2008, ADB utilized this election to fair value all non-hybrid borrowings that are swapped. As a result of this election, all borrowings that are swapped and their related derivatives are reported at fair value, with changes in fair value reported in earnings. However, ADB still reports all of its loans and those borrowings that are not swapped at amortized cost.

FAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements about fair value measurements. In compliance with this standard, and in conjunction with the FAS 159 election above, ADB incorporated its credit risk (as a credit spread) in fair valuing its liabilities. The combined effect of the adoption of FAS 157 and 159 was to increase the opening balance of retained income as at 1 January 2008 by $227.5 million.

In March 2008, the Financial Accounting Standards Board (FASB) issued FAS 161 "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133," which requires enhanced disclosures about an entity's derivative and hedging activities and thereby improve the transparency of financial reporting. This statement is effective for financial statements issued for fiscal years and interim periods beginning after 15 November 2008.

Supplemental Reporting. Because of the asymmetry created in the financial statements resulting from applying fair value to the derivatives and swapped borrowings, while loans are carried at amortized cost less provision, management believes that the reported income does not appropriately capture the true economic income of ADB. Therefore, ADB has decided to continue issuing two non-US GAAP supplemental financial reports using current value and pre-FAS 133/159 to better reflect its financial position and risk management. Applications of consistent approaches on these statements allow better analysis for management information and decision making.

For current value reporting all financial instruments are measured using a model based on the present value of expected cash flow. The model utilizes market data to determine the cash flow and discount rates for each instrument. Under pre-FAS 133/159, loans, promissory notes, swapped borrowings, and all derivative instruments are reported at cost.

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 133/159 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 this inherent risk 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 $1.5 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 negative adjustment of $68.8 million resulted from unrealized losses on asset swaps due to declining interest rates in related 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. This consists of promissory notes that 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 calculated using market-based valuation models incorporating observable market data.

The $926.3 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 2008, the current value net income is $101.9 million compared with pre-FAS 133/159 net income of $699.7 million and statutory reported net income of $1,126.3 million (Table 3).

Current Value Adjustments. The total current value adjustment of $597.9 million ($447.5 million in 2007) represents the change in the current value of all ADB financial instruments during the year. The adjustment reflects changes

TABLE 3: Condensed Current Value Income Statements for the Years Ended 31 December 2008 and 2007
($ Thousand)

	31 December 2008					31 December 2007
	Statutory Basis	Reversal of FAS 133/159 Effects[a]	Pre–FAS 133/159 Basis	Current Value Adjustments	Current Value Basis	Current Value Basis
REVENUE						
From loans	$ 1,357,981	$ –	$ 1,357,981	$ –	$ 1,357,981	$ 1,442,338
From investments	677,175	–	677,175	–	677,175	683,212
From guarantees	6,876	–	6,876	–	6,876	5,049
From equity investments	3,737	24,055	27,792	(24,055)	3,737	58,897
From other sources - net	18,685	–	18,685	–	18,685	18,835
Total Revenue	2,064,454	24,055	2,088,509	(24,055)	2,064,454	2,208,331
EXPENSES						
Borrowings and related expenses	1,208,391	–	1,208,391	–	1,208,391	1,389,778
Administrative expenses	141,047	–	141,047	–	141,047	127,327
Technical assistance to member countries	8,357	–	8,357	–	8,357	(683)
Provision for losses	(3,467)	–	(3,467)	3,467	–	–
Other expenses	6,272	–	6,272	–	6,272	3,998
Total Expenses	1,360,600	–	1,360,600	3,467	1,364,067	1,520,420
Net realized gains	(28,096)	–	(28,096)	–	(28,096)	22,905
Net unrealized gains	450,591	(450,702)[b]	(111)	24,055	23,944	14
Current value adjustments[c]	–	–	–	(597,852)	(597,852)	447,543
Provision for losses	–	–	–	3,467	3,467	579
NET INCOME	$ 1,126,349	$ (426,647)	$ 699,702	$ (597,852)	$ 101,850	$ 1,158,952

( ) = negative, FAS = Financial Accounting Standards.
a Includes reversal of unrealized (gains) losses attributed to equity investments accounted for under equity method.
b FAS 133/159 adjustments are reversed as the current value adjustments incorporate the effect of net unrealized losses on derivatives and swapped borrowings under FAS 133 and FAS 159.
c Current value adjustments include the effect of FAS 133/159 adjustments and the net unrealized losses on equity investments accounted for under equity method.

in interest rates, currency exchange rates, and credit risks. This comprised a net unfavorable adjustment of $257.6 million from the change in the valuation of all outstanding financial instruments, $107.6 million from translation adjustments, and $259.8 million adjustment in pension and postretirement benefit liability, offset by $27.2 million net unrealized gains on investments ($251.3 million gain for investments; $224.1 million loss for equity investments) (Table 4).

Impact of Changes in Interest Rates. The net decrease in the current value adjustments on the balance sheet during 2008 was $257.6 million. It was a result of the increase in unrealized losses in the borrowing portfolio of $831.1 million, unfavorable results for investments of $89.5 million and equity investments of $24.1 million, offset by increase in unrealized gains for loans of $668.1 million, and decrease in unrealized losses on other assets of $19.0 million.

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 strengthening of the US dollar against most of the major currencies in 2008 resulted in a negative translation adjustment of $107.6 million compared to a favorable adjustment of $126.8 million in 2007.

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. This 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 the LIBOR-based loan on 1 July 2001, the pool-based multicurrency 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,

TABLE 4: Summary of Current Value Adjustments
($ Thousand)

	Balance Sheet Effects as of 31 December 2008					Income Statement Effects Year to Date	
	Loans After Swaps	Investments[a]	Borrowings After Swaps	Other Assets[b]	Less Prior Year Effects[c]	31 December 2008	31 December 2007
Total Current Value Adjustments on Balance Sheet	$ 1,492,746	$ (62,752)	$ (926,345)	$ (50,790)	$ (710,483)	$ (257,624)	$ 148,078
Unrealized Gains on Investments[d]						27,224[e]	232,792
Accumulated Translation Adjustments						(107,617)[f]	126,844
Pension and Post Retirement Benefit Liability Adjustments						(259,835)	(60,171)
Total Current Value Adjustments						**$ (597,852)**	**$ 447,543**

( ) = negative, FAS = Financial Accounting Standards.
a Relates to investments related swaps and equity investments under equity method.
b Relates to receivable from members.
c Prior Year Effects include cumulative current value adjustments on all financial instruments and equity investments accounted for under equity method, made in the prior years.
d Relates to unrealized gains on investments and equity investments classified as available for sale.
e Included in Other Comprehensive Income under statutory basis.
f Relates to the translation adjustments for the period and current translation effects from FAS 133/159 reversals.

ADB has been offering local currency loans to nonsovereign borrowers and expanded this to sovereign borrowers in August 2005.

Loan Approvals, Disbursements, Repayments, and Prepayments. In 2008, the Board of Directors approved 46 sovereign loans totaling \$6.9 billion, and 15 nonsovereign loans totaling \$1.8 billion, compared with 2007 approvals of 38 sovereign loans totaling \$7.3 billion and 22 nonsovereign loans totaling \$0.9 billion. Disbursements in 2008 totaled \$6.5 billion (\$5.9 billion for sovereign loans and \$0.6 billion for nonsovereign loans) representing an increase of 25% from the \$5.2 billion disbursements in 2007. Regular principal repayments for the year were \$1.6 billion (\$1.4 billion in 2007) while prepayments amounted to \$0.3 billion (\$0.1 billion in 2007). In 2008, eight loans were fully prepaid. As of 31 December 2008, the total loans outstanding after provision for losses and net unamortized loan origination cost amounted to \$35.9 billion, of which \$34.2 billion is for sovereign loans and \$1.7 billion is for nonsovereign loans.

In 2005, ADB established the multitranche financing facility, 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 2008, six multitranche financing facilities totaling \$4.3 billion (seven multitranche financing facilities totaling \$4.0 billion in 2007), were approved under OCR. Periodic financing requests under multitranche financing facilities amounting to \$1.8 billion were approved in 2008 (\$2.0 billion in 2007).

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 2008, two loans to state-owned enterprises without sovereign guarantee totaling \$300 million were approved (one loan for \$10 million in 2007).

Status of Loans. One nonsovereign loan with an outstanding principal balance of \$1.7 million (four loans totaling \$16.5 million in 2007) was in non-accrual status as of 31 December 2008. The \$14.8 million decline is mainly attributed to the sale or restructuring of three loans, which were in nonaccrual status.

One sovereign loan was restored to accrual status in May 2008, following full settlement of overdue principal and interest.

Loan Charges on Sovereign Loans. 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 2009. 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 below.

Table 5: **Lending Rates**[a]
(% per annum)

	2008	2007	PSCLs
1 January	1.90	1.31	Japanese yen
	6.12	5.91	US dollar
1 July	1.98	1.69	Japanese yen
	5.64	6.34	US dollar

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.

ADB also charges a front-end fee of 1% on sovereign loans to cover the administrative costs incurred in loan origination. 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 2009. 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 2009. 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.

Rebates and surcharges are standard features of sovereign LIBOR-based loans. To maintain the principle of cost pass-through pricing, ADB returns the 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. 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 months. 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 $81.1 million to its LIBOR-based loan sovereign borrowers in 2008 ($38.1 million in 2007).

Table 6: **Rebate Rates**
(% per annum)

	US dollar	Japanese yen
1 January 2008	0.34	0.31
1 July 2008	0.33	0.39

Loan Charges on Nonsovereign Loans. 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 market-based front-end fee on nonsovereign loans to cover the administrative costs incurred in loan origination. Front-end fees are typically in the range of 1% to 1.5% depending on the transaction. Based on the LIBOR-based lending policy, ADB applies a commitment fee typically in the range of 0.50% to 0.75% per annum on the undisbursed commitment.

Local currency loans are priced based on relevant local funding benchmarks or ADB's funding costs and a risk-based spread.

Official Cofinancing for Loans. In 2008, $837.6 million from official sources was mobilized in loan cofinancing with partial administration by ADB for four loan projects totaling $752.4 million.

Technical Assistance. From 1967 to 1991, technical assistance expenses were charged to OCR and other technical assistance funding resources—the Technical Assistance Special Fund (TASF), the Japan Special Fund, and trust or grant funds. From 1992 to 2000, no technical assistance expenses were charged to OCR. In 2001, the Board of Directors approved the financing of high-priority technical assistance 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 TASF and of financing technical assistance activities through it and other various funding resources. On an exceptional basis, ADB committed $10.0 million from OCR net income as contribution to the Java Reconstruction Fund in November 2008, for the Yogyakarta and Central Java reconstruction. This was treated as a technical assistance grant in 2008.

Guarantees. ADB provides guarantees[1] 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 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 2008, ADB provided $10.0 million for one political risk guarantee operation.

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 2008, $565.0 million for syndications through B-loans[3] was provided for three 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 $911.1[4] million at end 2008. This represented about 61% of the ceiling defined by the Charter.

As of 31 December 2008, the total exposure of nonsovereign operations in equity investments amounted to about $815.0 million.

In 2008, seven equity investments totaling $123.1 million were approved compared with five equity investments totaling $79.8 million in 2007. In the same year, ADB disbursed a total of $125.7 million in equity investments, 8.7% increase from $115.6 million disbursed in 2007, and received a total amount of $53.6 million from capital distributions and divestments, whether in full or in part, in 20 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 $14.3 billion as of 31 December 2007 to $15.3 billion as of 31 December 2008. This was due primarily to net income for the year of $1.1 billion; the favorable effect of FAS 157/159 adoption to prior years' income amounting to $227.5 million; the net effect of change in special drawing rights value on capital and reserves of $33.1 million; and additional capital subscription received of $7.4 million. These were offset by net decrease in other comprehensive income of $276.7 million (adjustment to pension and post retirement benefit obligation of $259.8 million, unfavorable translation adjustments of $43.4 million; and amortization of FAS 133 adjustment of $0.7 million; offset by unrealized gain on investments and equity investments of $27.2 million); and allocations to the Asian Development Fund and Climate Change Fund of $40.0 million each, and to the Technical Assistance Special Fund of $23.0 million.

The total authorized and subscribed capital of ADB is 3,546,311 shares valued at $54,890.2 million as of 31 December 2008. Of the subscribed capital, $3,860.6 mil-

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 issued for projects in which ADB satisfies its participation requirement.
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 Excluding ADB's share on net unrealized gains of investee companies accounted under equity method totaling $6.1 million.

lion was paid-in and $51,029.6 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 2008, the Board of Governors approved the allocation of 2007 net income of $760.2 million to the cumulative revaluation adjustments account for $87.6 million, to loan loss reserve for $13.0 million, to surplus and ordinary reserves for $278.3 million each, to Asian Development Fund and Climate Change Fund for $40.0 million each, and to Technical Assistance Special Fund for $23.0 million.

In December 2008, the Board of Directors approved the revised policy on ADB's lending limitation, which limits the total amount of disbursed loans, approved equity investments, and the maximum amount that could be demanded from ADB under its guarantee portfolio, to the total amount of ADB's unimpaired subscribed capital, reserves, and surplus. In addition, the gross outstanding borrowings shall not exceed the sum of callable capital from nonborrowing members, paid-in capital, and reserves (including surplus). As of 31 December 2008, headroom for lending was $29.2 billion and for borrowings, $8.9 billion, based on the new policy (compared with $35.5 billion for lending and $16.4 billion for borrowings as of 31 December 2007[5]).

On 6 May, the Board of Directors reported to the Board of Governors on the status of ADB's resources and highlighted the need to initiate a study on financial resources. Accordingly, ADB prepared a working paper that provided the required analysis and context to assess ADB's financial resource position during the implementation period of Strategy 2020, and reviewed all possible avenues for resource mobilization.

The working paper was discussed by the Board of Directors on 6 October. The Directors noted that, while the technical issues were well presented in the working paper, the developmental and political issues are equally important to address in the context of the general capital increase and therefore requested the preparation of a second working paper. The second working paper was discussed by the Board of Directors in February 2009. Management is currently reviewing and preparing a proposal on the fifth general capital increase for ADB, which is scheduled for board of directors' discussion in April 2009.

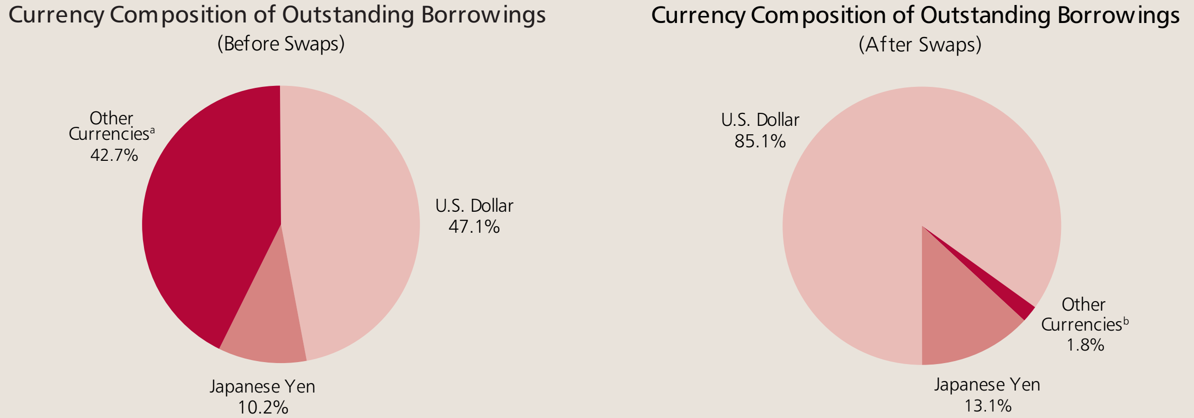
Borrowings. ADB's primary borrowing objective is to ensure availability of funds at the most stable and lowest possible cost for its operations. Subject to this objective, ADB seeks to diversify its funding sources across markets, instruments, and maturities. To achieve the objective, ADB continued in 2008 a strategy of issuing liquid benchmark bonds to maintain its strong presence in key currency bond markets, and raising funds through opportunistic financing and private placements, such as retail-targeted transactions and structured notes, which provide ADB with cost-efficient funding levels. 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.

2008 Funding Operations. During 2008, ADB completed 113 borrowing transactions raising about $9.4 billion in long- and medium-term funds compared with $8.9 billion in 2007. The new borrowings were raised in seven currencies: Australian dollar, Japanese yen, New Zealand dollar, Pound sterling, South African rand, Turkish lira, and US dollar. After swaps, $9.2 billion or 97.6% of the 2008 borrowings were in US dollar, and the remaining $0.2 billion or 2.4% were in Japanese yen. The average maturity of 2008 borrowings was 3.5 years compared with 5.2 years in 2007. Of the total 2008 borrowings, $4.8 billion was raised through 11 public offerings, and 102 private placements amounting to $4.6 billion. In addition, ADB raised $2.9 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 2008 borrowings compared with borrowings in 2007.

Local Currency Bond Issues. ADB continued to pursue its objective of contributing to the development of region-

5 Recalculated based on the new policy.

Figure 1: **Effect on Currency Composition**



a Other currencies include Australian dollar, Canadian dollar, Chinese yuan, Euro, Hong Kong dollar, Indian rupee, Kazakhstan tenge, Malaysian ringgit, Mexican peso, New Taiwan dollar, New Zealand dollar, Philippine peso, Pound sterling, Singapore dollar, South African rand, Swiss franc, Thai baht, and Turkish lira.
b Other currencies include Chinese yuan, Indian rupee, Kazakhstan tenge, Philippine peso, Pound sterling, and Swiss franc.

Figure 2: **Effect on Interest Rate Structures**

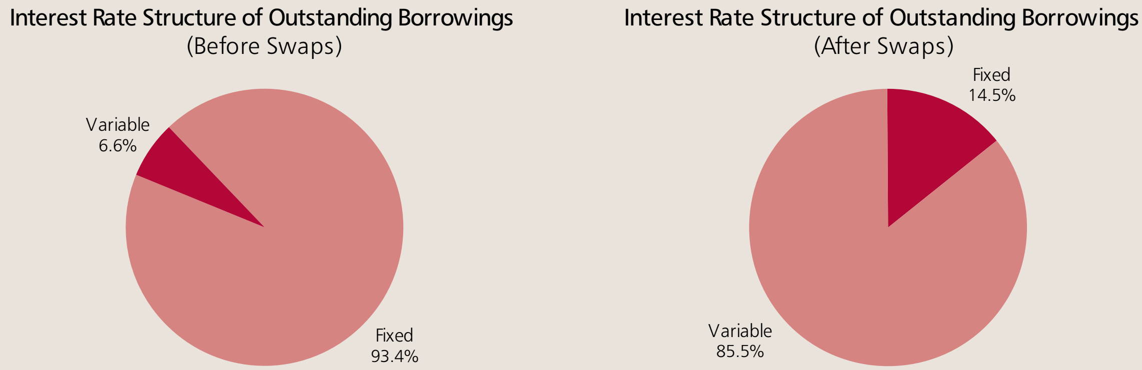


Table 7: **Borrowings**
(Amounts in $ Million)

	2008	2007
Long Term		
Total Principal Amount	9,372.1	8,854.3
Average Maturity to First Call (years)	3.5	5.2
Average Final Maturity (years)	4.4	9.4
Number of Transactions		
Public Offerings	11	10
Private Placements	102	84
Number of Currencies (before swaps)		
Public Offerings	4	8
Private Placements	6	9
Short Term[a]		
Total Principal Amount[b]	2,866.6	3,139.1
Number of Transactions	21	24
Number of Currencies	2	3

a All euro-commercial papers.
b At year-end, the outstanding principal amount was nil in 2008 and 2007.

al bond markets. Although this year's market conditions have not been favorable for ADB to issue local currency bonds, ADB raised about $200 million equivalent through cross-currency swaps to meet local currency funding requirements in Indian rupee, Indonesian rupiah, and Philippine peso.

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 capital 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 2008. Interest rate swaps are also used for asset and liability management

Table 8: **Year-End Balance of Liquidity Portfolio**[a]
($ Million)

	2008	2007
Prudential Liquidity Portfolio	9,604.5	9,209.3
Operational Cash Portfolio	298.2	395.1
Cash Cushion Portfolio	2,605.9	778.8
Discretionary Liquidity Portfolio	2,622.0	2,550.5
Other Portfolio	626.1	645.7
TOTAL	15,756.7	13,579.4

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

Table 9: **Return on Liquidity Portfolio**
(%)

	Annualized Financial Return	
	2008	2007
Prudential Liquidity Portfolio	6.43	5.84
Operational Cash Portfolio	2.03	3.95
Cash Cushion Portfolio	2.59	4.67
Discretionary Liquidity Portfolio[a]	0.44	0.28
Other Portfolio	2.83	3.64

a Spread over funding cost at 31 December.

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 subportfolios—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 2008 and 2007, 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 8.

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 2.3 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.

Table 10: **Contractual Cash Obligations**
($ Million)

	2008	2007
Long-Term Debt	35,713.5	32,187.2
Undisbursed Loan Commitments	20,648.5	19,011.3
Undisbursed Equity Investment Commitments	275.7	344.0
Guarantee Commitments	1,772.6	1,460.6
Other Long-Term Liabilities	712.7	450.6
TOTAL	59,123.0	53,453.7

Contractual Obligations

In the normal course of business, ADB enters into various contractual obligations that may require future cash payments. Table 10 summarizes ADB's significant contractual cash obligations at 31 December 2008 and 2007. 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 133/159. Other long-term liabilities correspond to accrued liabilities, including pension and postretirement medical benefits.

Financial Risk Management

In its development banking operations, ADB faces various risks including credit, market, liquidity, and operational. Among these risks, sovereign credit risk is the principal risk as loans to developing member countries represent 91% of ADB's operations portfolio with the remaining 9% invested in nonsovereign entities. ADB takes a conservative approach to managing market and liquidity risks. To ensure strong risk-bearing capacity, the institution maintains conservative capital adequacy.

The Risk Management Unit independently identifies, measures, monitors, and manages these risks in accordance with industry best practice. The unit is under the Office of the President and reports to the managing director general. The Risk Committee, chaired by the managing director general, provides senior management oversight of the risk management function and makes recommendations on risk policies and actions.

Credit Risk

ADB principally faces three forms of credit risk: sovereign, nonsovereign, and counterparty and issuer.

Sovereign. Sovereign credit risk is the risk that a sovereign borrower may default on its loan or guarantee obligations. ADB relies on monitoring, loan loss reserves, and conservative capital adequacy to manage sovereign credit risk.

ADB uses a 10-category rating scale to evaluate its sovereign borrowers. During 2008, the weighted average risk rating increased from 4.83 to 4.85, which indicates slightly weakening credit quality. Because some of the low risk borrowers were upgraded in 2008, the small change in the weighted average risk rating understates the impact of the financial crisis and subsequent economic slowdown to some sovereign borrowers.

Concentration risk, which occurs when a small group of borrowers account for a large share of the portfolio, is a key concern for ADB. During 2008, ADB's exposure to its three largest sovereign borrowers was essentially constant at 71%.

Table 11: **Sovereign Borrower Concentration**
As of 31 December 2008 and 2007
(%)

Country	2008	2007
Indonesia	29	31
China, People's Republic of	24	25
India	18	16
Pakistan	13	9
Philippines	11	13
Others	6	6

Note: Figures may not add up to 100 due to rounding.

ADB holds provisions to offset known or probable losses in specific transactions and loan loss reserves to offset the average losses that ADB would expect to incur in the course of its lending operations. The sum of provisions and the loan loss reserve represents ADB's expected loss. Following the decline in credit quality, the expected loss for the sovereign portfolio approximately doubled in 2008.

Table 12: **Sovereign Portfolio Expected Loss**
As of 31 December 2008 and 2007

	2008		2007	
	$ Million	%	$ Million	%
Provision for loan losses	4.4	0.0	5.7	0.0
Loan loss reserve requirement[a]	423.7	1.0	166.7	0.6
Expected Loss	428.0	1.0	172.4	0.6

a The loan loss reserve requirement is subject to Board of Governors' approval during the annual meeting in May 2009.
Note: 0.0 is less than 0.05%.

Nonsovereign. Nonsovereign credit risk is the risk that a nonsovereign entity, such as a private-sector firm, state-owned enterprise or local government, may default on its loan or guarantee obligations. These transactions lack the backing of a national government.

Management of nonsovereign credit risk begins during the earliest stages of each proposed transaction. In addition to evaluating the development impact, ADB considers a proposal's credit strength, corporate management and governance, and financial, commercial, and technical viability. Not only do the business units undertake this due diligence, but the Risk Management Unit also conducts an independent assessment of each proposed transaction.

Currently, ADB uses a 7-scale rating system to evaluate its nonsovereign borrowers. During 2008, average credit quality worsened, and the weighted average credit rating increased from 3.5 to 3.7. The deteriorating macroeconomic conditions in some developing member countries led to the downgrade of firms operating in these environments.

ADB uses a variety of limits to manage concentration risk in the nonsovereign portfolio. The total assistance to a single project must not exceed 25% of the total project cost or $250.0 million, whichever is lower. This limit ensures that exposure to a single project or obligor does not exceed 5% of the Board-approved ceiling of $5.0 billion for nonsovereign operations. Furthermore, there are nonsovereign exposure limits for corporate groups, industry subsectors, and countries.

ADB must closely monitor country and sector concentrations in the nonsovereign portfolio particularly due to the nature of its development mandate. Although country concentration is still significant, it decreased in 2008 with the three largest country exposures falling from 49% to 42% of the portfolio. Sector concentration was more or less constant. ADB has focused on the energy and finance sectors for their development significance, and they continued to represent over 75% of the portfolio in 2008.

In addition to due diligence and limits, ADB monitors its portfolio to identify any deterioration of credit quality and uses loan loss reserves and loan provisions to offset expected losses. During 2008, expected losses increased due to weakening credit quality.

Table 13: **Nonsovereign Country Concentration**
As of 31 December 2008 and 2007
(%)

Country	2008	Country	2007
India	20	China, People's Republic of	20
China, People's Republic of	14	India	17
Kazakhstan	8	Kazakhstan	12
Pakistan	7	Bangladesh	8
Philippines	7	Viet Nam	5
Others	43	Others	38

Note: Figures may not add up to 100 due to rounding.

Table 14: **Nonsovereign Sector Concentration**
As of 31 December 2008 and 2007
(%)

Sector	2008	2007
Energy	44	36
Finance	31	36
Investment funds	12	17
Transport and Communications	6	5
Industry and Trade	5	4
Others	2	1

Note: Figures may not add up to 100 due to rounding.

Table 15: **Nonsovereign Portfolio Expected Loss**
As of 31 December 2008 and 2007

	2008		2007	
	$ Million	%	$ Million	%
Provision for loan losses	4.8	0.2	9.4	0.3
Loan loss reserve requirement[a]	69.5	2.7	28.4	1.0
Expected Loss	74.4	2.8	37.7	1.4

a The loan loss reserve requirement is subject to Board of Governors' approval during the annual meeting in May 2009.

Issuer and Counterparty. Issuer risk is the risk that a bond issuer may default on its interest or principal payments; it applies to both investments which ADB internally manages and those investments for which it retains external asset managers. Counterparty risk is the risk that a counterparty may fail to meet its contractual obligations to ADB. Issuer and counterparty risks principally affect the Treasury portfolio.

To control issuer and counterparty credit risk, ADB only transacts with financially sound institutions with ratings from at least two reputable public rating agencies. At the end of 2008, 92% of the Treasury portfolio was rated at least AA- with a higher proportion invested in AAA institutions than in 2007, as ADB sought to mitigate its exposure to counterparties vulnerable to the financial crisis. Moreover, the Treasury portfolio is generally invested in conservative assets, such as money market instruments and government securities. During 2008, the former decreased and the latter increased as ADB sought lower-risk instruments due to the financial crisis. In addition, ADB has established con-

Table 16: **Issuer and Counterparty Exposure by Credit Rating**
As of 31 December 2008 and 2007
(%)

	2008	2007
AAA, AAA-	65	42
AA+, AA, AA-	27	52
A+, A, A-	7	6
Below A-	1	0

Note: 0 is less than 0.5%.

Table 17: **Issuer and Counterparty Exposure by Asset Class**
As of 31 December 2008 and 2007
(%)

	2008	2007
Government Securities	45	27
Government Sponsored Entity Securities	25	12
Deposits	10	39
Corporate Securities	9	9
Derivative Exposures	3	7
Asset- and Mortgage-Backed Securities	4	4
Cash	3	2

Note: Figures may not add up to 100 due to rounding.

servative exposure limits for its corporate investments, depository relationships, and other asset classes.

ADB has not been materially impacted by the collapse in credit quality of US mortgage-backed securities. ADB's exposure to these instruments is small, and any losses have been offset by gains in ADB's higher quality investments, whose values have increased as investors have moved to safer assets.

To mitigate counterparty credit risk arising through derivative transactions, ADB has strict counterparty eligibility criteria. In general, ADB will only undertake swap transactions with counterparties 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, derivative positions are marked-to-market daily and collateral calls, mainly cash and US Treasury securities, are made in accordance with the credit support annex. ADB also sets exposure limits for individual swap counterparties and monitors these limits against both current and potential exposures.

Market Risks

Market risk is the risk of loss on financial instruments due to changes in market prices. ADB principally faces three forms of market risk: interest rate, foreign exchange, and equity price.

Interest Rate. ADB is primarily exposed to interest rate risk through the Treasury portfolio. Interest rate risk in the operations portfolio is fully hedged as borrowers' interest payments are matched to ADB's borrowing expenses. Therefore, the borrower assumes the risk of fluctuating interest rates whereas ADB's margin remains largely constant. ADB monitors and manages interest rate risks in

Table 18: **Interest Rate Risk**
As of 31 December 2008 and 2007
(%)

	2008	2007
Duration	1.6	1.5
Interest Rate VaR	4.9	3.5

VaR = value-at-risk.

the Treasury portfolio by employing various quantitative methods. It marks all positions to market, monitors interest rate risk metrics, and employs stress testing and scenario analysis.

ADB principally uses two metrics to measure interest rate risk, duration and interest rate value-at-risk (VaR). Duration is the estimated percentage change in the portfolio's value in response to a 1% parallel change in interest rates. During 2008, interest rate risk as measured by duration remained essentially constant. Although the portfolio's asset composition shifted from deposits to government securities the aggregate maturity of the assets did not materially change. Interest rate VaR is a measure of possible loss at a given confidence level in a given timeframe due to changes in interest rates. ADB uses a 95% confidence level and a 1-year time horizon. In other words, ADB would expect to lose at least this amount once every 20 years due to fluctuations in interest rates. Unlike duration, which ADB uses to measure interest rate risk across the Treasury portfolio, ADB only uses VaR for the Prudential Liquidity Portfolio, which is the most exposed to interest rate risk. In 2008, interest rate risk in the Prudential Liquidity Portfolio increased primarily due to the increase in interest rate volatility.

Foreign Exchange. In line with the Charter, ADB ensures that its operations assume a minimum exposure to exchange rate risk. In both the operations and Treasury portfolios, ADB is required to match its loans and investments to the same currencies in which funds are received. Borrowed funds or funds to be invested may only be converted into other currencies provided that they are fully hedged through cross currency swaps or forward exchange agreements. Given its multicurrency operations, however, ADB is exposed to fluctuations in reported US dollar results due to currency translation adjustments.

Equity Price. Equity price risk arises through ADB's investments in equity securities and private equity funds. ADB's

Charter limits equity investments to 10% of unimpaired paid-in capital, reserves, and surplus less special reserves. Additionally, private equity funds are limited to 5% of this sum. ADB manages equity price risk using the same due diligence and monitoring procedures as described under nonsovereign credit risk.

Liquidity Risk

ADB's liquidity policy ensures the availability of sufficient cash flows to meet all financial and operational commitments despite uncertain borrowing conditions. Under the current framework, ADB holds sufficient liquidity to fund 18 months of operations. ADB's liquidity requirements are primarily determined by expected loan disbursements, loan amortization prepayments, debt payments, and cash from net income.

In addition, ADB holds discretionary liquidity to provide flexibility in funding and debt redemptions. Liquidity levels and net cash requirements are monitored on an ongoing basis and reviewed by the Board of Directors quarterly.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. ADB is exposed to many types of operational risk, which it mitigates through sound internal controls. ADB has a rigorous process for approving transactions to minimize errors in the lending function. ADB has also adopted a strategy to strengthen business continuity, and particularly information technologies, to reduce the impact of disruptions.

Capital Adequacy

Capital is a financial institution's ultimate protection against unexpected losses that may arise from various risks. In ADB's context, it also protects shareholders from the possibility of having to contribute callable or additional paid-in capital. ADB uses stress testing to assess its capital adequacy on a regular basis. Throughout 2008, ADB's capital position remained strong.

The capital stress test assesses ADB's ability to absorb credit shocks, which are the institution's principal risk, while supporting continued lending in line with its development mandate. The desired outcome of the stress test is that ADB should have sufficient capital to (i) absorb an income loss due to the credit shock, and (ii) generate sufficient income to support post-shock loan growth. For the stress test, ADB generates thousands of potential portfolio scenarios and imposes credit shocks that are large enough to account for 99% of those scenarios. ADB then assesses the impact of these shocks on its capital by modeling its equity-to-loan ratio over the next 10 years. With an equity-to-loan ratio of 38% at the end of 2008, the current stress test results comfortably exceeded the desired outcome described above.

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

Internal Control Over Financial Reporting

In line with global best practices on corporate governance, ADB's management carried out an evaluation of the adequacy and effectiveness of internal control over financial reporting using criteria established in Internal Control - Integrated Framework issued by the Committee of the Sponsoring Organization of the Treadway Commission (COSO). The evaluation includes test of key controls over financial reporting, and ADB's external auditors concurred that ADB maintained effective internal control over financial reporting for 2008.

Summary of Financial Performance

Net Income. Net income before net unrealized gains was $675.8 million, compared with $711.4 million in 2007. The decrease of $35.6 million (5.0%) was predominantly due to the following:

- $84.9 million decrease in overall loan income, mainly due to $65.8 million net decrease in interest income and other loan charges, $22.0 million increase in expenses on asset swaps hedging loan products, and $2.9 million decrease in provision for loan losses. Despite a higher outstanding loan portfolio, overall loan income decreased because of lower US dollar LIBOR compared with the same period in 2007;
- $28.1 million decrease in investment income resulting from lower investment returns associated with the decrease in the interest rate environment;
- $80.8 million decrease in income from equity investments resulting mainly from $60.0 million reduction in the proportionate share of income from private equity funds, which are accounted for under equity method, $17.0 million decrease in net realized gains on disposal of equity investments, and recognition of $8.7 million impairment loss mostly associated with restructured accounts, net of $5.0 million increase in dividend income;
- $13.7 million increase in administrative expenses allocated to OCR. This was driven by the $15.9 million increase in overall administrative expenses ($363.7 million in 2008; $347.8 million in 2007) mainly attributed to increases in salaries ($9.5 million), business travel ($3.3 million), and contractual services ($2.2 million). This was offset by $1.5 million decrease in deferred loan origination costs related to new loans and guarantees;
- $9.0 million increase in technical assistance to member countries following the $10.0 million grant provided to the Java Reconstruction Fund; and
- $181.6 million decrease in overall borrowings and related expenses resulting mainly from declining interest rates in some markets compared with the same period in 2007.

Net unrealized gains of $450.6 million for the year ended 31 December 2008 ($53.8 million in 2007) are primarily the favorable result of FAS 133, 155, and 159 application totaling $451.0 million ($57.5 million in 2007), increasing the net income to $1,126.3 million for the year ended 31 December 2008 from $765.2 million for the year ended 31 December 2007.

Net Unrealized Gains and Losses on Financial Instruments as per FAS 133, 155, and 159. ADB posted net unrealized gain of $1,441.7 million on derivatives used for hedging transactions compared to net unrealized loss of $351.1 million in 2007. Corresponding unrealized loss on the hedged borrowings were $1,522.9 million in 2008 compared to an unrealized gain of $408.6 million in 2007. The gain on derivatives were primarily due to significant downward shift of the short to medium-term yield curves of the major currencies, partially offset by the weakening of most major currencies (with the exception of Japanese yen) against the US dollar in 2008. The effect of declining interest rates coupled with strengthening 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 swaps relating to non-structured debts which are designed to behave as long-term fixed assets denominated in the hedged-borrowings in original currencies. The liability portion of the swaps would behave similar to long-term US dollar LIBOR-based liabilities.

Effective 1 January 2008, ADB adopted FAS 159 for non-structured swapped borrowings. The adoption of FAS 159 resulted in a favorable adjustment of $227.5 million, which was recorded as an adjustment to the beginning balance of reserves. Fair valuation of the non-structured swapped borrowings resulted in an unrealized loss of $2,035.9 million for 2008 offsetting the gain on the hedged swap position of $2,001.4 million. However, the liquidity crisis resulting from the current global financial situation led to widening of the funding spreads resulting in a net gain of $531.7 million from the application of credit spread (FAS 157) to the entire portfolio that are carried at fair value, including structured borrowings.

The appreciation of Japanese yen against the US dollar in 2008 affected the structured debt portfolio to a certain extent. The decrease 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 gain of $140.0 million for the year ended 31 December 2008. The unrealized gains were due mainly to movements of foreign exchanges and interest rates. As the structured instruments are fully hedged, 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 FAS 159, 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.

Financial Accounting Standards Board issued FAS 157–Fair Value Measurements, in September 2006, and FAS 159–Fair Value Option for Financial Assets and Financial Liabilities, in February 2007. 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.

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.

SPECIAL FUNDS

ADB is authorized by its Charter to establish and administer special funds. These are the Asian Development Fund, Technical Assistance Special Fund, Japan Special Fund, ADB Institute Special Fund, the Asian Tsunami Fund, the Pakistan Earthquake Fund, the Regional Cooperation and Integration Fund, and the Climate Change 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

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-two donor members (regional and nonregional) have contributed to the fund. Cofinancing with bilateral and multilateral development partners complement ADB's ADF resources.

In August 2008, the Board of Governors adopted the resolution providing for the ninth replenishment of the ADF (ADF X) and the fourth regularized replenishment of the TASF. The resolution provides for a substantial replenishment of the ADF to finance ADB's concessional program for the 4-year period from January 2009, and for a replenishment of the TASF in conjunction with the ADF replenishment, to finance technical assistance operations under the TASF. Total replenishment size is special drawing rights (SDR) 7.1 billion ($11.3 billion), consisting of SDR6.9 billion for ADF X and SDR0.2 billion for TASF. About 37% of the replenishment will be financed from new donor contributions amounting to SDR2.6 billion ($4.2 billion equivalent). The replenishment shall be effective upon receipt of the Instruments of Contribution for Unqualified Contribution commitments in an aggregate amount equivalent to at least SDR1.3 billion, and such date should not be later than 1 July 2009.

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. A series of workshops were conducted from late 2007 to October 2008 to promote borrowers' awareness of the conversion option, and assist borrowers in making informed decisions. As of December 2008, 16 out of 30 ADF borrowing countries have signified their agreement to the conversion and $11.5 billion of outstanding legacy loans had been converted to SDR loans.

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 2008, the interest rate was set at 3.15%. Three loans were approved under this new facility in 2008.

Financial Framework. In December 2007, the Board of Directors approved a new ADF financial framework that 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.

Heavily Indebted Poor Countries (HIPC) Debt Relief. ADF donors requested ADB's participation in the HIPC debt relief. In line with this, ADB Board of Governors adopted Board Resolution No. 329 on 7 April 2008 for ADB to participate in the HIPC debt relief, and to provide Afghanistan with debt relief. The estimated principal amount of Afghanistan's ADF debt to be forgiven and charged against ADF income is $89.8 million.[6]

The HIPC Initiative was launched in 1996 by the International Development Association and International Monetary Fund 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. 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 International Development Association and International Monetary Fund 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. As of 31 December 2008, provision of $0.5 million has been written off under this arrangement, bringing the balance to $87.5 million, at 31 December 2008 exchange rate.

Table 19: Asian Development Fund Commitment Authority[a]
31 December 2008 and 2007
($ Million)

	2008	2007
Carryover from ADF VIII Commitment Authority[b]	124.4	126.9
ADF IX Contributions[c]	2,976.5	2,144.4
ADF VIII Contributions	161.6	164.6
OCR Net Income Transfer	160.0	120.0
Expanded Advance Commitment Authority	3,895.7	2,979.7
Loans Savings and Cancellation	1,133.3	890.8
Credits from Accelerated Note Encashment Program	63.0	–
Provision for Disbursement Risk[d]	(158.4)	(157.9)
Provision for Foreign Exchange Volatility[e]	15.2	–
Total ADF IX Commitment Authority	8,371.3	6,268.5
Loans and Grants Committed	8,248.7	5,833.1
ADF Commitment Authority Available for Future Commitments	122.6	435.4

( ) = negative, ADF = Asian Development Fund, OCR = ordinary capital resources.
a The schedule reflects cumulative commitment authority for ADF IX.
b The US dollar equivalent of SDR80.4 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.
e Represents an allowance to cover the shortfall in the commitment authority due to exchange rate fluctuation during the last 3 months of 2008.
Note: Total 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 2008, 30 donors have committed a total of $3.7 billion[7] to ADF IX, including contributions of Ireland ($32.5 million) and Brunei Darussalam ($9.5 million). Total deposited installment payments amounting to $3.4 billion[7] include $3.0 billion for ADF operations, $0.2 billion for Technical Assistance Special Fund, and $0.2 billion for financing forgone interest of grants. The remaining unpaid contributions under ADF VIII as of 31 December 2008 amounted to $168.8 million[7] (For details of amounts released for operational commitment in 2008, see the column labeled "Addition" in Statistical Annex 23.)

In May 2008, the Board of Governors approved the transfer of $40 million to ADF as part of OCR's net income allocation ($40 million in 2007). In addition, a total of $1,133.3 million from loan savings and cancellations have been included in the commitment authority. This resulted from Management's continuous assessment of

6 Based on the disbursed and outstanding debt as of 20 March 2006, converted to US dollar using the exchange rate as of 7 April 2008.
7 US dollar equivalent at 31 December 2008 exchange rates.

opportunities for freeing committed resources through cancellations of unused loan balances. During 2008, promissory notes totaling $603.1 million have been encashed, $58.6 million of which was transferred to the Technical Assistance Special Fund.

Loan Approvals, Disbursements, and Repayments. In 2008, 36 ADF loans totaling $1.8 billion were approved compared with 36 loans totaling $1.9 billion in 2007. Disbursements during 2008 totaled $2.0 billion, an increase of 26.3% from $1.6 billion in 2007. At the end of the year, cumulative disbursements from ADF resources were $27.0 billion. Loan repayments during the year amounted to $676.9 million. At year-end, outstanding ADF loans amounted to $26.4 billion.

Status of Loans. At the end of the year, 28 sovereign loans to Myanmar with total principal outstanding of $565.8 million were in non-accrual status representing about 2.1% of the total outstanding ADF loans.

Investment Portfolio Position. The ADF investment portfolio[8] amounted to $6.3 billion at 31 December 2008 compared with $7.0 billion in 2007. About 16% of the portfolio was invested in bank deposits, and 84% was invested in fixed income securities. The annualized rate of return on ADF investments including unrealized gains and losses was 5.2% (4.7% in 2007).

Grants. With the introduction of grant financing in ADF IX, 27 grants (24 in 2007) were approved in 2008 totaling $707.4 million ($519.3 million in 2007), while 27 grants (17 in 2007) totaling $539.8 million ($377.8 million in 2007) became effective.

Cofinancing for Loans. In 2008, $87.0 million was mobilized in official loan cofinancing for two loan projects totaling $126.0 million.

Technical Assistance Special Fund

The Technical Assistance Special Fund was established to provide technical assistance on a grant basis to developing member countries of the Asian Development Bank and regional technical assistance.

Table 20: **Technical Assistance Special Fund**
Cumulative Resources
($ Million)

	2008	2007
Regularized Replenishment Contributions	432.6	425.7
Allocations from OCR Net Income	706.0	683.0
Direct Voluntary Contributions	89.2	88.8
Income from Investment and Other Sources	178.3	167.3
Transfers from the TASF to the ADF	(3.5)	(3.5)
TOTAL	1,402.6	1,361.3

( ) = negative, ADF = Asian Development Fund, OCR = ordinary capital resources, TASF = Technical Assistance Special Fund.

In August 2008, the Board of Governors adopted the resolution providing for the ninth replenishment of the ADF (ADF X) and the fourth regularized replenishment of the Technical Assistance Special Fund (TASF). Considering the demand estimate and the availability of funds from other sources, the donors agreed to contribute 3% of the total replenishment size as the fourth replenishment of the TASF. The replenishment will cover the 4-year period 2009 to 2012 (see related notes under ADF).

Contributed Resources. As of 31 December 2008, 28 donors committed a total of $219.5 million to TASF, as part of the ADF IX and the third regularized replenishment of TASF. Of the total commitment, $202.9 million have been received.

During the year, India made a direct voluntary contribution amounting to $0.25 million, and Pakistan, $0.07 million. In addition, $23.0 million was allocated to TASF as part of OCR's 2007 net income allocation, and a total of $7.0 million regularized replenishment was received. At the end of 2008, total TASF resources amounted to $1,402.6 million, of which $1,299.9 million was committed, leaving an uncommitted balance of $102.7 million (Statistical Annex 24).

Operations. Technical assistance (TA) commitments (approved and effective) increased from $77.5 million in 2007 to $108.2 million in 2008 for 156 TA projects that were made effective during the year, net of $15.6 million ($11.9 million in 2007) write back of undisbursed commitments for completed and cancelled TA projects. Undisbursed commitments for technical assistance increased to $222.7 million as of 31 December 2008 ($183.7

8 Includes securities purchased under resale arrangement.

million as of 31 December 2007). TASF financed 43.5% of all TA activities approved in 2008.

Investment Position. As of 31 December 2008, total TASF investment portfolio, including securities purchased under resale arrangement, amounted to $295.7 million, slightly higher than the $295.1 million as of year-end of 2007. Despite a higher investment portfolio in 2008, total revenue from investments decreased to $10.9 million, from $14.2 million during the same period in 2007, due mainly to the decrease in yield on US dollar placements.

Japan Special Fund

The Japan Special Fund was established in 1988 when ADB acting as the administrator, entered into a financial arrangement with Japan, who agreed to make the initial contribution, to help developing member countries of ADB restructure their economies and broaden the scope of opportunities for new investments, mainly through technical assistance operations.

Contributed Resources. In January 2008, Japan contributed ¥1.9 billion ($17.4 million equivalent) as a regular contribution to Japan Special Fund. As of 31 December 2008, Japan's cumulative contribution to the fund since its inception in 1988 amounted to ¥112.9 billion (about $973.7 million equivalent) comprising regular contributions of ¥94.8 billion ($822.9 million equivalent) and supplementary contributions of ¥18.1 billion ($150.8 million equivalent). The uncommitted balance including approved technical assistance but not yet effective as of 31 December 2008 was $86.8 million.

Operations. The technical assistance (TA) grants financed by Japan Special Fund continued to support ADB operations aimed at reducing poverty. In 2008, 57 TA projects totaling $55.0 million were approved, and 69 TA projects totaling $59.6 million became effective. The undisbursed TA commitments increased to $95.8 million as of 31 December 2008 ($82.9 million as of 31 December 2007).

Sector Activities. In 2008, the Japan Special Fund (JSF) financed 20% of the total amount of technical assistance (TA) that ADB approved, including 47% of the total amount of project preparatory TA during the year.

Table 21: Japan Special Fund
Technical Assistance by Sector, 2008

	$ Million[a]	%
Agriculture and Natural Resources	13.5	25
Transport and Communications	10.1	18
Multisector	9.1	17
Education	4.5	8
Law, Economic Management and Public Policy	4.4	8
Energy	4.4	8
Industry and Trade	3.8	7
Finance	2.9	5
Water Supply, Sanitation and Waste Management	1.9	3
Health, Nutrition, and Social Protection	0.4	1
TOTAL	55.0	100

a Totals may not add due to rounding.

Table 21 illustrates the breakdown of JSF approvals by sector.

Investment position. As of 31 December 2008, total Japan Special Fund investment portfolio amounted to $198.9 million, lower than the balance of $215.1 million as of 31 December 2007. With this, and with lower yield on US dollar placements, revenue from investments decreased, from $11.8 million in 2007 to $6.5 million in 2008.

ADB Institute Special Fund

The ADB Institute was established in 1996 as a subsidiary body of ADB, whose objectives are the identification of effective development strategies and capacity improvements for sound development management in developing member countries.

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 2008, Japan committed its 13th contribution in the amount of ¥0.70 billion ($7.8 million equivalent), which was reported as Due from Contributors.

As of 31 December 2008, cumulative contributions committed amounted to ¥16.5 billion (about $141.2 million equivalent) excluding translation adjustments. Of the total contributions received, $125.5 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 $15.6 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.

Contributed Resources. ADB contributed $600 million to the fund, of which, $50 million unutilized funds were transferred back to OCR ($40 million in November 2005 and $10 million in June 2006). In addition, Australia contributed $3.8 million, and Luxembourg, $1.0 million. As of 31 December 2008, total resources of the fund amounted to $625.9 million, $579.5 million of which has been utilized, leaving an uncommitted balance of $46.4 million ($40.0 million as of 31 December 2007).

Operations. There were no technical assistance or grants that were approved or made effective during the year. The balance of undisbursed commitments as of 31 December 2008 amounted to $248.3 million, compared with $389.1 million as of year-end of 2007.

Investment position. As of 31 December 2008, Asian Tsunami Fund's investment portfolio amounted to $251.3 million ($366.5 million as of 31 December 2007). With the lower portfolio, and lower yield on US dollar placements, revenue from investments decreased, from $22.3 million in 2007 to $9.1 million in 2008.

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.

Contributed Resources. ADB contributed $80 million to the fund. In addition, Australia contributed $15.0 million; Belgium, $14.3 million; Finland, $12.3 million; and Norway, $20.0 million. As of 31 December 2008, total resources of the fund amounted to $142.4 million, $140.2 million of which has been utilized, leaving an uncommitted balance of $2.2 million (negative $3.5 million as of 31 December 2007).

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 were made in three equal installments of €3.3 million from 2007 to 2008, while Norway's contributions were undertaken in four equal installments of $5.0 million in 2006–2008.

Operations. There were no technical assistance or grants that were approved or made effective during the year. The balance of undisbursed commitments as of 31 December 2008 amounted to $66.2 million, compared with $73.2 million as of year-end of 2007.

Investment position. As of 31 December 2008, Pakistan Earthquake Fund's investment portfolio amounted to $61.3 million ($60.7 million as of 31 December 2007). With the increase in the average investment portfolio, revenue from investments for 2008 increased to $3.1 million from $2.4 million in 2007.

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.

Contributed Resources. ADB contributed $40 million to the fund as part of the 2006 OCR net income allocation. As of 31 December 2008, total resources of the fund amounted to $42.5 million, $17.9 million of which has been utilized, leaving an uncommitted balance of $24.6 million ($33.8 million as of 31 December 2007).

Operations. In 2008, 13 technical assistance totaling $10.5 million became effective (four technical assistance and one supplementary approval totaling $7.4 million in 2007). The balance of undisbursed commitments as of 31 December 2008 amounted to $16.6 million, compared with $7.4 million as of year-end of 2007.

Investment position. As of 31 December 2008, Regional Cooperation and Integration Fund's investment portfolio amounted to $39.3 million ($39.9 million as of 31 December 2007). With the increase in average volume of investments, which was offset by lower yield on US dollar placements, revenue from investments for 2008 was just slightly higher than the revenue for 2007 ($1.24 million in 2008; $1.19 million in 2007).

Climate Change Fund

The Climate Change Fund was established in April 2008 to facilitate greater investments in DMCs to address the causes and consequences of climate change alongside ADB's own assistance in various related sectors.

Contributed Resources. ADB provided the initial contribution of $40.0 million in May 2008, as part of OCR's 2007 net income allocation. With accumulated investment income of $0.5 million, total resources of the fund as of 31 December 2008 amounted to $40.5 million, $3.1 million of which has been utilized, leaving an uncommitted balance of $37.4 million.

Operations. In 2008, one technical assistance amounting to $3.0 million was approved and became effective. There has been no disbursement yet for this technical assistance.

Investment position. As of 31 December 2008, Climate Change Fund's investment portfolio amounted to $38.9 million, providing $0.5 million revenue for the period.

GRANT COFINANCING

Trust funds and project-specific grants are key instruments to mobilize and channel grants from external sources to finance technical assistance and components of investment projects. They play an important role in complementing ADB's own resources to meet capacity development and other specific demands from DMCs. Multilateral, bilateral, and private sector partners have contributed more than $2.0 billion in grants to ADB operations (Table 22). In 2008, a total of $154.2 million in grant cofinancing was mobilized comprising $84.2 million for 76 technical assistance projects and $70.0 million for 17 investment projects. By year-end, there were 29 trust funds under active administration by ADB which included 19 active single donor trust funds to finance activities in various sectors or for specific themes, and 10 multidonor trust funds to finance activities with a thematic focus, including poverty reduction, governance, gender and development, managing for development results, HIV/AIDS, water, energy, education, information and communications technology, and trade and finance.

Initially, trust funds were established through donor-specific channel financing agreements, for a wide range of sectors, focused primarily on financing technical assistance operations. More recently, in response to the changing needs of developing member countries and consistent with ADB's financing partnership strategy[9] and harmonization efforts, ADB has established some trust funds based on common agreements with development partners and financing through instruments of contribution. These are established under an umbrella facility of sector- and theme-focused financing partnership, and finance technical assistance and grant components of investment projects.

Technical Assistance and Grant Funds under Financing Partnership Facilities and Special Initiatives. ADB has established two multidonor and three single donor trust funds under the financing partnership facilities framework, to support both technical assistance and grant components of investment projects in priority sectors consistent with Strategy 2020. Since 2006, about $100.0 million has been mobilized from bilateral sources to finance activities in the water sector, for clean energy, and for regional cooperation and integration.

Japan made its initial contributions of $23.1 million to the Asian Clean Energy Fund and $11.5 million to the Investment Climate Facilitation Fund, the two new initiatives that were established last year under the Clean Energy Financing Partnership Facility and Regional Co-

9 ADB. 2006. *ADB's Financing Partnership Strategy*. Manila.

operation and Integration Facility. Austria and Spain each contributed $5 million to the Multidonor Water Trust Fund. Spain and Sweden made their first contributions of $5 million and $4.7 million respectively, to the Multidonor Clean Energy Fund. Australia expressed its intent to make a total additional contribution of A$25 million each to these multidonor funds by 2011.

Under ADB's Carbon Market Initiative, the Future Carbon Fund was established in 2008 complementing the existing Asia Pacific Carbon Fund. The fund will provide financing up front for ADB-supported projects that will continue to generate carbon credits after 2012. The initial target size of the fund is $100 million and may be increased to $200 million if there is sufficient demand.

Japan Fund for Poverty Reduction

The Japan Fund for Poverty Reduction (JFPR) 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, $300.3 million for 116 projects has been approved, of which 13 projects valued at $34.0 million were approved in 2008 (www.adb.org/JFPR; Statistical Annex 27). A number of projects have been completed this year and these are the subjects of knowledge-sharing sessions organized by ADB. In 2008, the JFPR publication series was launched which will focus on the impact and outcomes, and lessons learned from JFPR projects.

Japan Scholarship Program

The Japan Scholarship Program (JSP) 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. JSP is funded by Japan and administered by ADB. Currently, 20 institutions in 10 countries participate.

Between 1988 and 2008, Japan contributed $100.1 million. A total of 2,417 scholarships has been awarded to recipients from 35 member countries. Recently, an average of about 150 scholarships have been awarded each year. Of the total, 2,053 have completed their courses. Women have received 823 scholarships.

Table 22: **Schedule of Contributions and Net Assets**
Grants from External Sources
As of 31 December 2008
($ Million)

	Contribution	Net Assets[a]
Administered by ADB		
Country		
Australia	161.3	13.6
Austria	6.0	3.3
Belgium	29.2	27.1
Brunei Darussalam	0.6	(0.0)
Canada	124.1	51.6
China, People's Republic of	20.2	8.3
Denmark	24.7	2.9
European Community	250.0	93.9
Finland	56.8	31.5
France	33.4	4.1
Ireland	2.2	0.5
Italy	2.7	0.9
Japan[b]	526.8	214.2
Korea, Republic of	20.1	13.9
Luxembourg	18.2	15.5
The Netherlands	370.1	126.8
New Zealand	31.6	0.6
Norway	117.5	43.6
Portugal	15.0	15.1
Spain	47.6	37.8
Sweden	142.2	49.9
Switzerland	40.0	28.0
United Kingdom and Northern Ireland	491.9	139.8
United States	1.8	0.4
Subtotal	2,534.0	923.3
Others		
Cities Alliance	0.5	(0.0)
Global Environment Fund	76.0	28.3
Nordic Development Fund	11.0	(0.4)
Private Sector/Foundations	3.0	0.1
Public Private Infrastructure Advisory Facility	0.4	(0.0)
Trust Fund for Forest (Viet Nam)	17.2	1.5
United Nation Development Programme	111.2	0.3
Subtotal	219.3	29.8
Not Administered by ADB		
Country		
Switzerland	25.7	6.6
Kuwait	15.0	1.0
Subtotal	40.7	7.6
Grand Total	**2,794.1**	**960.7**

Note: Figures may not add to total due to rounding.
( ) Negative; 0.0 is less than $50,000.
a Excludes projects approved but not yet effective.
b Includes Japan Fund for Poverty Reduction, Japan Scholarship Program, Japan Fund for Information, Communication and Technology, and Japan Fund for Public Policy Training.