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Sida Sovereign Portfolio Risk Transfer

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Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
MDB	–	multilateral development bank
OCR	–	ordinary capital resources
Sida	–	Swedish International Development Cooperation Agency

NOTE

In this report, “\$” refers to US dollars.

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I. INTRODUCTION

1. The Asian Development Bank (ADB) has entered into a risk transfer with the Swedish International Development Cooperation Agency (Sida). Under the arrangement, Sida will guarantee a repayment of principal of up to \$155 million of ADB's sovereign ordinary capital resources (OCR) portfolio of ongoing loans to support ADB's sustainable level of lending. The risk transfer was signed on 21 September 2016 pursuant to ADB's Credit Enhancement Policy.¹ The purpose of the risk transfer arrangement is to free up capital for priority areas in ADB's operations. The risk transfer is expected to increase OCR lending capacity by about \$50 million per year from 2016 to 2026 for a total of about \$500 million. This will enable ADB to increase lending operations in its developing member countries and sustain its overall efforts to eradicate extreme poverty, while enhancing the inclusiveness of its operations.

II. SOVEREIGN RISK TRANSFER

2. The Midterm Review of Strategy 2020² and its action plan call for enhancing ADB's lending capacity to enable ADB to respond to the Asia and the Pacific Region's need for large-scale development financing. To ensure that ADB has the necessary resources to implement the priorities identified in the midterm review, ADB has strengthened its lending capacity, particularly by combining Asian Development Fund lending operations with the OCR balance sheet, improving business processes and incentives for cofinancing, streamlining resource allocations for private sector operations, expanding local currency financing and guarantees, and improving and expanding the use of instruments and facilities.

3. Concurrently, the Group of Twenty's (G20) Multilateral Development Banks Action Plan to Optimize Balance Sheets, endorsed in November 2015, includes ADB's exploration of risk transfers in the sovereign portfolio as a novel development financing instrument. These risk transfers can (i) alleviate the credit and concentration risks constraining the balance sheets of multilateral development banks (MDBs), (ii) improve the overall risk composition of these balance sheets, and (iii) free up the balance sheet to support larger volumes of operations. The risk transfer agreement generates additional lending capacity by reducing both the expected and unexpected loss in the loan portfolio.

4. Risk transfer agreements transfer specified risks from one party to another party in return for a fee. This can release capacity for additional operations by improving the risk profile of bank balance sheets and reducing the capital held in reserve to cover guaranteed loans. While risk transfers are common practice in private sector finance—and fundamental to the insurance industry—this is the first time a risk transfer arrangement has been applied to a sovereign loan portfolio of any multilateral development bank. For this pioneering first transaction, Sida selected loans from a portfolio of \$48.77 billion of ADB's disbursed and ongoing loans to demonstrate the successful implementation of the pilot. This will facilitate learning from the novel financing arrangement, and possibly enable the replication of the instrument in larger transactions both at ADB and other MDBs.

5. The Sida–ADB engagement under the arrangement will continue for the duration of the risk transfer from 2016 to 2026 and will consist of dialogue on an annual report to Sida on areas that will facilitate ADB's strategic shift towards greater inclusiveness, including implementation of the inclusive business action plan, guidelines on mainstreaming inclusive economic growth in

¹ ADB. 2006. *Review of ADB's Credit Enhancement Operations*. Manila.

² ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

the country partnership strategies, and inclusiveness results in selected model projects. The logical framework for the transaction is in the Appendix.

III. CONCLUSION

6. The sovereign risk transfer with Sida is a creative, innovative, and pioneering arrangement that leverages resources and expands ADB's operational lending capacity. It is in line with the G20 efforts to expand the use of MDBs' capital endowments and development financing possibilities in the context of the Addis Ababa Action Agenda,³ which was adopted in 2015. ADB's Midterm Review of Strategy 2020 also calls for augmenting lending capacity. The additional lending capacity generated by this risk transfer will help ADB (i) meet the strong demand for its operations to increase inclusiveness, and (ii) support its developing member countries in financing the Sustainable Development Goals. It will also help abate unconstructive trade-offs within ADB's resource allocation by releasing additional resources available for approval.

³ United Nations. 2015. Background paper for the Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda). Ethiopia. 13–16 July.

LOGICAL FRAMEWORK

Items	Intervention logic	Objectively verifiable indicators of achievement	Sources and means of verification	Assumptions
Impact	Replication of the risk transfer approach, expanding additional lending capacity in ADB	Number of risk transfer agreements	ADB's documentation	ADB remains relevant Fiscal conditions of bilateral partners are satisfactory, enabling allocation of resources for risk transfer.
Expected results (outcome)	ADB's implementation of the Midterm Review of Strategy 2020 in the areas of inclusive growth and inclusive business facilitated through extra lending room	Enhanced capacity to lend as the Sida risk transfer creates headroom of about \$50 million per year, totalling \$500 million in sustainable level of lending Indicators for implementation of the midterm review as per below	ADB balance sheet Reporting on sustainable level of lending and additional lending capacity ADB reporting selected indicators from corporate results framework and standard explanatory data indicators	ADB calculations are correct Factors contributing to multiplier do not reduce SLL
Expected results (outcome)	<ol style="list-style-type: none"> 1. Actions implemented in line with the midterm review in the areas of inclusive growth and inclusive business 2. Enhanced inclusiveness demonstrated through model projects totalling about \$500 million, approved and implemented 3. Results relevant to inclusive growth and inclusive business as being monitored through ADB's corporate results framework 4. Results in line with ADB's inclusive business plan 	<p>Progress on midterm review action plan (activities 1.1–1.4 below)</p> <p>Number and volume of ADB projects presenting dimensions of inclusiveness for individual projects up to at least \$500 million</p> <p>Selected indicators from the ADB's corporate results framework</p> <p>Inclusive business action plan</p>	<p>ADB presenting evidence that the conditions precedent have been fulfilled Board and management meeting minutes</p> <p>Annual report</p> <p>Annual report</p> <p>Annual ADB development effectiveness review report and annual report</p>	<p>Developing member country governments wish to borrow for inclusive projects</p>

Items	Intervention logic	Objectively verifiable indicators of achievement	Sources and means of verification	Assumptions
Expected results (outputs)	1.1. ADB inclusive business action plan approved by ADB 1.2. Strengthened staff guidelines on inclusive economic growth in country partnership strategies approved by ADB (condition precedent) 1.3. Corporate results framework (2013–2016) update approved by ADB 1.4. Improved country partnership strategies in supporting inclusive economic growth	7 April 2016 15 April 2015 December 2014 Quality at entry of country partnership strategies in supporting inclusive economic growth rated satisfactory	ADB intranet ADB Intranet ADB Website Annual ADB development effectiveness review report and annual report	

ADB = Asian Development Bank, Sida = Swedish International Development Cooperation Agency, SLL = sustainable level of lending.

Source: Guarantee agreement relating to a portfolio of ADB's sovereign loans between ADB as Guarantee Beneficiary and Sweden represented by Sida as Guarantor, signed on 21 September 2016.