Faster Approach to Small Nonsovereign Transactions
ABBREVIATIONS

ADB – Asian Development Bank
AfDB – African Development Bank
DMC – developing member country
EBRD – European Bank for Reconstruction and Development
FAST – Faster Approach to Small Nonsovereign Transactions
IDB – Inter-American Development Bank
IED – Independent Evaluation Department
IFC – International Finance Corporation
NSO – nonsovereign operation
OCR – ordinary capital resources
PSOD – Private Sector Operations Department
SMEs – small and medium-sized enterprises
XARR – extended annual review report

NOTE

In this report, "$" refers to US dollars.

<table>
<thead>
<tr>
<th>Vice-President</th>
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In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.
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I. INTRODUCTION

1. **Strategy 2020 and the private sector.** Strategy 2020 is the overarching corporate strategy of the Asian Development Bank (ADB).\(^1\) Affirming the organization’s vision of an Asia and Pacific region free of poverty, Strategy 2020 positions ADB to help its developing member countries (DMCs) “reduce poverty and improve living conditions and quality of life.” To achieve these goals, Strategy 2020 identifies the private sector as one of five drivers of change. Strategy 2020 mandates ADB to expand assistance through private sector operations and private sector development to 50% of annual operations by 2020.

2. **Midterm review.** In 2014, ADB completed the Midterm Review of Strategy 2020, which aimed to help the organization prepare for the challenges of a transforming region by improving ADB’s relevance, responsiveness, and effectiveness.\(^2\) Seven of the 10 strategic priorities identified in the review seek to sharpen and rebalance ADB operations, and strengthen the organization’s responsiveness to the changing business environment in Asia and the Pacific. Enhancing ADB’s ability to achieve Strategy 2020’s requirement for private sector operations and private sector development is one of these strategic priorities.

3. **Private sector enhancements.** Based on Strategy 2020 and reaffirmed by the midterm review, ADB will increase the share of private sector operations approved from ordinary capital resources (OCR) from 17% during 2011–2013 to 25% by 2020.\(^3\) To achieve this target, the midterm review identified 12 measures to enhance private sector operations and, more generally, nonsovereign operations (NSOs), including several efforts to improve operational efficiencies. The midterm review also noted that ADB will “streamline business processes, particularly for smaller private sector transactions that have significant development impact but come with higher up-front risks and costs.”

4. **Midterm review enhancement for small nonsovereign transactions.** This paper proposes pilot-testing a streamlined approval process for small nonsovereign transactions to improve operational efficiency.\(^4\) This proposal—the Faster Approach to Small Nonsovereign Transactions (FAST)—will

   (i) streamline ADB’s approval processes for small nonsovereign transactions in line with similar processes established by peer institutions;

   (ii) offer incentives for processing small nonsovereign transactions, recognizing that such transactions may sometimes be more resource-intensive than larger transactions;

   (iii) facilitate small nonsovereign transactions in lower-income countries and frontier economies (group A and B DMCs, as stipulated by ADB’s Graduation Policy);\(^5\) and

   (iv) provide a platform for increasing activities in sectors that generate high development impact (i.e., sectors in which all segments of the population can participate and benefit, particularly the poor), such as agribusiness, health and microfinance, in all DMCs, including in middle- and higher-income countries (group C DMCs).

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\(^4\) References to “small” or “smaller” transactions in this paper relate to approvals of $20 million or less.

\(^5\) ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila. Group A countries refer to DMCs that are eligible to receive Asian Development Fund resources, while group B countries refer to DMCs that are eligible to receive a blend of Asian Development Fund and OCR resources.
II. ISSUES AND IMPLICATIONS

5. **Issue.** In carrying out its NSOs, ADB seeks interventions that will achieve commercial, economic, and developmental objectives in line with DMC partnership strategies and ADB policies. ADB aims to increase the annual volume of these interventions each year to meet the region’s development challenges. At the same time, ADB is increasing its emphasis on pursuing nonsovereign transactions that target frontier economies as well as sectors that generate high development impacts (e.g., through the provision of goods and services, or generation of employment opportunities, for the poor). The challenge for ADB is successfully increasing the number of small nonsovereign transactions, which often deliver significant development impacts, within the existing resource envelope and risk management framework.

6. **Homogeneous approval procedures.** The transaction cycle for all NSOs is identical, regardless of the amount of ADB financing. However, NSOs in frontier DMCs typically require financing in smaller amounts and may face greater risks. ADB’s due diligence and negotiation processes for financing in such DMCs therefore tend to take more time and effort than do the same processes for large nonsovereign transactions, particularly those in more developed DMCs. As a result, approval statistics demonstrate that project teams tend to target larger NSO financing—often in middle-income DMCs—rather than pursue smaller NSOs.

7. **More than 80% of nonsovereign approvals exceed $20 million.** From 2010 to 2014, ADB approved 103 NSOs worth nearly $9 billion in total. The projects ranged from $2 million to $400 million, with an average transaction size of $86 million.\(^6\) As Figure 1 indicates, small transactions represented 17.5% of NSO approvals during this 5-year period.\(^7\) The smaller percentage of annual NSO approvals for small transactions is inconsistent with the number of such transactions in DMCs that are regularly proposed to and reviewed by ADB. Many of these potential smaller transactions are declined because of the time needed to process them. To illustrate this point, the average processing time for small transactions approved during 2010–2014 was 10.1 months—from concept clearance to Board approval—compared with an average of 7.8 months to process all other transactions that were greater than $20 million.\(^8\)

![Figure 1: Nonsovereign Projects by Volume Category, 2010–2014](source: Asian Development Bank)

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\(^7\) This analysis refers only to ADB’s direct interventions and excludes activities carried out by any of its financial intermediaries, which are often well-placed to provide financing in smaller amounts within ADB’s DMC.

\(^8\) Analysis on timing excludes projects taking more than 36 months to process, which are considered outliers. The $20 million limit excludes equity investments above $10 million, which is one of the proposed sub-limits under FAST (para. 16).
8. Stronger performance of small nonsovereign transactions. Recently completed extended annual review reports (XARRs) for NSOs valued at $20 million or less show that 8% of smaller transactions were rated *highly successful* and 71% were rated *successful*—for a total of 79%.[^9] For projects valued at more than $20 million, 64% were rated *successful* or higher. The results are summarized in Table 1.

- Stronger performance of small nonsovereign transactions.

<table>
<thead>
<tr>
<th>Rating</th>
<th>Projects (No.)</th>
<th>Percentage of Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highly Successful</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>Successful</td>
<td>17</td>
<td>71</td>
</tr>
<tr>
<td>Partially Successful</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>Unsuccessful</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>24</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>


9. Implications. Because of the lack of differentiation in processing based on the financing amount, ADB’s pursuit of small nonsovereign transactions—including projects that may provide significant development impacts, such as gender equality, inclusive business, rural development, and energy for all—has been constrained, even though most of these smaller projects have been rated *successful* or better.

### III. EXPERIENCE OF OTHER MULTILATERAL DEVELOPMENT BANKS

10. Comparator approaches. ADB’s peer institutions, including the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IDB), and the International Finance Corporation (IFC), have streamlined processing of nonsovereign transactions in various ways. At a minimum, each institution has put in place a framework that allows smaller transactions to be approved through a process that does not involve the board of directors. Each comparator institution also applies other special processing procedures in recognition of the developmental nature of these smaller transactions.

11. International Finance Corporation. Among the multilateral development banks, IFC generally approves the largest volume of NSOs annually. To promote procedural efficiencies and streamline processes for IFC mandates that may cover a particular economy, sector, or stage of corporate development, nearly 90% of projects are neither discussed nor directly approved by the board of directors—about 70% are circulated and approved on a no-objection basis and 20% are approved through targeted frameworks whereby a management-level committee is responsible for approving individual transactions. Consequently, from 2010 to 2013, only about 10% of IFC’s projects were presented for a full board review.

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[^9]: Refers to XARRs published from 2010 to 2014. The development contributions of NSOs are evaluated once for each transaction 2–3 years after ADB’s investment based on evaluation guidelines compiled by the Independent Evaluation Department. The XARR evaluates the transaction’s project objectives, development impact, investment profitability, work quality, and additionality. The XARR then compiles lessons from the project and recommends follow-up actions. Transactions are rated on a four-level rating scale (for each segment), which drives the project’s overall rating.
12. **European Bank for Reconstruction and Development.** EBRD, which had faced challenges similar to those encountered by ADB in undertaking smaller transactions, established a dedicated initiative in 2004 to encourage staff to process more smaller transactions in regions of strategic interest. The resulting Early Transition Country Initiative developed frameworks that employ streamlined processing and approval procedures, including due diligence, legal documentation, and use of local laws. EBRD’s board approved the overall parameters of the initiative with a limit of €350 million, while the Small Business Investment Committee, chaired by management, is responsible for approving individual projects not exceeding €10 million under this framework. The EBRD now approves nearly 400 projects annually—about 30% of which take place in early transition countries.\(^\text{10}\)

13. **African Development Bank and Inter-American Development Bank.** AfDB and IDB each have special facilities targeting activities of small and medium-sized enterprises (SMEs) through loans to financial intermediaries. In addition to allocating program-level responsibility to management, the AfDB framework improves efficiency through a combination of simplified and standardized documentation, streamlined credit approval procedures, and individual prudential limits specific to the framework.\(^\text{11}\) Similarly, IDB has facilities that target SMEs through loans to financial intermediaries, where individual projects undergo an accelerated approval process managed by an investment committee instead of the board. As with AfDB, projects under IDB’s frameworks must fit into predetermined risk, environment, and other related parameters previously approved by the board. If the specified criteria are met, formal concept clearance is not required and the project can be approved by a committee rather than the AfDB or IDB boards.

14. **Comparator outcomes.** ADB’s peer institutions do not have a uniform approach to streamlining the processing and approval of small nonsovereign transactions. Nevertheless, in addition to satisfying the mandate of pursuing smaller developmental opportunities in frontier economies, comparator institutions report significant efficiency gains by reducing the staff hours needed to process transactions. Interviews with staff counterparts suggest such efforts reduce staff time spent on processing by about 25% at EBRD and as much as 50% at AfDB and IDB. At AfDB and IDB, staff attribute these efficiencies to the ability to seek management approval for individual transactions under their respective frameworks, as well as to additional procedural streamlining measures that are implemented before project approval. While FAST adopts some of these streamlining measures, ADB will continue to review its own end-to-end approval procedures and continue to consider adopting similar measures to further improve efficiency.

**IV. FASTER APPROACH TO SMALL NONSOVEREIGN TRANSACTIONS**

15. **Proposed solution.** The framework discussed in this paper seeks to enhance ADB’s ability to undertake smaller (and potentially highly developmental) nonsovereign transactions by proposing to streamline the approval procedures for such transactions. An internal review of challenges to enhancing NSO efficiency, building on the midterm review, found that processing advantages would be achieved, without loss of transaction quality, if the President were authorized to approve individual small investments that comply with the FAST framework. Accordingly, this paper proposes that the Board of Directors approve a framework permitting abbreviated approval processes for nonsovereign transactions where the aggregate amount of ADB’s financial assistance for any transaction does not exceed $20 million; equity investments

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\(^{10}\) EBRD defines early transition countries as those member countries that continue to face challenges in economic development and where a large proportion of the population still lives below the poverty line.

\(^{11}\) For AfDB’s SMEs program, streamlined approval procedures apply to transactions up to $9 million.
will be limited to $10 million. Each transaction will be consistent with a set of predefined key terms (each referred to as a qualifying transaction).

16. **Key terms of the framework.** It is proposed that FAST be established on a pilot basis, for 5 years from the date of approval, with an overall commitment authority of up to $200 million to accommodate a pipeline of transactions, each not exceeding $20 million (with a $10 million sub-limit on equity). To ensure that the portfolio of transactions is adequately balanced, it is proposed that FAST comply with the key terms in Table 2. Any NSO proposal that falls outside this proposed Board-approved structure would be processed under existing procedures.

### Table 2: Key Terms for the Faster Approach to Small Nonsovereign Transactions

<table>
<thead>
<tr>
<th>Key Term</th>
<th>Detail</th>
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<tbody>
<tr>
<td>Aggregate framework approval limit</td>
<td>$200 million</td>
</tr>
<tr>
<td>Individual transaction approval limit</td>
<td>$20 million, with $10 million limit on equity</td>
</tr>
<tr>
<td>Aggregate framework instrument limit</td>
<td>No more than 50% to be committed as equity</td>
</tr>
<tr>
<td>Aggregate framework geographic limit</td>
<td>No more than 50% in any single country</td>
</tr>
<tr>
<td>Aggregate framework sector limit</td>
<td>No more than 50% in any single sector</td>
</tr>
<tr>
<td>Qualifying transaction tenor or hold period</td>
<td>≤15 years for project finance, ≤10 years for all others(^a)</td>
</tr>
<tr>
<td>Risk rating at entry</td>
<td>No worse than NSO 9 (Moody's/S&amp;P B1/B+ rating)(^b)</td>
</tr>
<tr>
<td>Safeguards limit under the framework</td>
<td>No category A projects(^c)</td>
</tr>
</tbody>
</table>

S&P = Standard & Poor’s.

\(^a\) “Project finance” includes limited or non-recourse loans and guarantees. “Others” includes corporate loans, guarantees issued in support of corporate loans, and equity transactions.

\(^b\) For qualifying transactions, this refers to the rating after group and government-related support but before the application of country ceiling, as determined by the Office of Risk Management during a transaction’s final review. This will ensure that approved projects are not immediately subject to enhanced monitoring because of a heightened risk of default. For debt and guarantee transactions involving (i) corporate entities and utilities, it is the rating after group adjustment; (ii) banks, it is the rating after systemic support; (iii) nonbank financial institutions, it is the rating after adjustment for holding company status, group support, and government-related support; (iv) project finance, it is the implied project rating (measured without impact of the off-taker rating, if this entity is government-owned). Equity transactions are not risk rated.

\(^c\) No category A projects for environment, involuntary resettlement, or indigenous peoples.

Source: Asian Development Bank

17. **Term and funding source.** FAST will be implemented over an initial pilot period of up to 5 years from the date of approval. Unless otherwise indicated, each qualifying transaction will be funded by OCR and counted against the resources available for approval in the year it was approved by the President.

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\(^{12}\) The individual transaction limits apply to each new proposal and exclude any cofinancing and/or any trust funds under ADB administration. Where FAST-based financing is proposed to be provided to a business entity that has already obtained FAST-based financing, such further financing can only be provided for a stand-alone project with a financial plan that is separate from that of the earlier financing.

\(^{13}\) Appendix 2 provides an indicative pipeline of qualifying transactions. The current pipeline is dynamic and will change over time. For illustrative purposes, the current pipeline suggests that about 65% of the transactions—by number and value—will take place in frontier markets (group A and B DMCs). Of those pipeline transactions in group C DMCs, 90% involve high impact sectors that contribute to inclusiveness, such as agriculture and micro or rural lending.
V. PILOT IMPLEMENTATION

A. Institutional Arrangements

18. **Approval procedure for qualifying transactions.** It is proposed that the President—rather than the Board—make the final decision on whether to provide financing to any qualifying transaction. ADB will process each qualifying transaction in accordance with its existing policies, as well as its procedures, relating to integrity due diligence, credit risk analysis, development effectiveness analysis, safeguard compliance review, and alignment with country partnership strategies, among others. The President will consider and, if appropriate, approve the financing of each qualifying transaction based on a report that follows the format of the Board document entitled the report and recommendation of the President. It is proposed that this new decision document be disclosed to the public in accordance with ADB’s Public Communications Policy 2011, as if it were a report and recommendation of the President.

19. **Reporting mechanism.** Each report on a qualifying transaction submitted to and approved by the President will subsequently be circulated to the Board for information. The Board will also receive an annual report providing utilization statistics, an overview of all qualifying transactions, and key performance indicators (particularly development output and outcome metrics) throughout the life of each qualifying transaction.

20. **Interim assessment.** Before the third anniversary of its approval, or when 85% of the $200 million approval limit has been utilized, whichever occurs first, ADB will review FAST and subsequently seek the Board’s guidance on whether its parameters should be retained, modified (e.g., increase FAST’s overall size and/or extend the pilot period), or terminated. Any consequential or specific changes to FAST suggested during the review process will be incorporated into ADB policies and operating procedures, as appropriate.

B. Risk

21. *(This information was deemed confidential according to exception no. 97(i) of ADB’s Public Communications Policy.)*

22. **Implications for nonsovereign credit risk assessment process.** The implementation of the proposed FAST will not dilute the rigor of ADB’s existing NSO due diligence processes. The risk assessment of qualifying transactions will require the same standard of commercial, credit, legal, integrity, and safeguards review, together with the President’s clearances, as is applied to all nonsovereign transactions. While the quality standards for qualifying transactions will remain the same, ADB will, promptly upon approval of this proposal, implement several procedural enhancements in the interest of streamlining the time, documentation, procedures, and staff involvement required for processing qualifying transactions.

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14 *(This information was deemed confidential according to exception no. 97(i) of ADB’s Public Communications Policy.)*

15 *(This information was deemed confidential according to exception no. 97(i) of ADB’s Public Communications Policy.)*
C. Expected Outcomes

23. Enhancements. FAST will (i) enhance ADB’s responsiveness and efficiency in pursuing small nonsovereign transactions, which may be particularly beneficial to frontier economies and/or inclusive business opportunities; (ii) make efficient use of Board, Management, and staff time and resources; and (iii) bring certain procedural aspects of ADB's business processes in line with those of its development partners.

24. Improved quality of the nonsovereign portfolio. Over the long term, an increased number of smaller nonsovereign transactions will enhance the dispersion of credit risk in ADB’s nonsovereign portfolio.

25. Resource implications. As FAST is designed to improve efficiencies for ADB departments involved in the processing of qualifying transactions, the framework is expected to reduce the aggregate staff hours required per FAST transaction. It is anticipated that operating efficiencies gained under FAST will increase the overall number of NSO transactions undertaken by ADB each year. However, the full realization of FAST’s potential will depend on the resources that can be made available to ADB to support such growth. Any significant increase in the number of annual NSO transactions undertaken will result in a corresponding increase in the work required to be performed by ADB staff across NSO support functions, including credit assessment, credit monitoring, portfolio management, controllers, legal support, and other transaction-related activities that require engagement across ADB (e.g., treasury services). Close monitoring will be required particularly where the transactions approved under FAST involve challenging sectors and geographies.

VI. RECOMMENDATION

26. The President recommends that the Board approve

(i) the establishment of the Faster Approach to Small Nonsovereign Transactions framework on a pilot basis for an initial period expiring in March 2020 where

(a) the aggregate approval limit of the overall framework is $200,000,000; and

(b) the aggregate limit of ADB financial assistance to each individual project is $20,000,000, subject to a $10,000,000 sub-limit for equity investments; and

(ii) the authorization for the President to approve qualifying projects under the framework in accordance with the terms set forth in this paper.
ADB’S EXPERIENCE WITH SMALL NONSOVEREIGN TRANSACTIONS:
APPROVALS OF SMALL NONSOVEREIGN TRANSACTIONS, 2010–2014

(This information was deemed confidential according to exception no. 97(viii) of ADB’s Public Communications Policy.)
INDICATIVE PIPELINE OF SMALL NONSOVEREIGN TRANSACTIONS
(as of 28 February 2015)

(This information was deemed confidential according to exception no. 97(viii) of ADB’s Public Communications Policy.)