OPERATIONS MANUAL
POLICIES AND PROCEDURES

LENDING POLICIES FOR SOVEREIGN AND SOVEREIGN-GUARANTEED BORROWERS (Regular Ordinary Capital Resources)[1]

A. Scope

1. This Operations Manual presents the lending policies including financing terms for sovereign and sovereign-guaranteed borrowers which borrow regular ordinary capital resources (OCR) (endnote i).

B. Introduction

2. The lending operations of the Asian Development Bank (ADB) consist of ordinary and special operations pursuant to Article 9 of the Agreement Establishing the Asian Development Bank (the Charter).[2] Loans under ordinary operations are financed from ADB's OCR described in Article 7 of the Charter. Article 11 specifies to whom ADB may lend and the methods of operation. Article 13 authorizes lending by ADB in local currencies that are not obtained from sales of gold or convertible currencies to finance local expenditures of a project. Article 14 refers to the principles under which ADB's lending operations are conducted.

C. Relending of the Loan

3. Borrowers may choose to relend the loan to a beneficiary that is not the direct borrower of the ADB loan on terms and conditions acceptable to ADB. The terms of relending depend on the nature of the beneficiary and are subject to a financial assessment to confirm that such beneficiary is financially capable of servicing the loan.[3] ADB may allow relending on the same terms as those of the ADB loan if the beneficiary is a government agency or instrumentality entrusted with implementing special social and economic policies of the government. If the beneficiary is a commercially operated state-owned enterprise, relending is generally to be on terms harder than those of the ADB loan, using the comparable terms of ADB's regular ordinary capital resources loans as the minimum acceptable relending terms. If the beneficiary is a private enterprise or an individual, the cost of external capital and the prevailing borrowing terms in the local market as reflected in the interest rate structure of the DMC concerned are the major factors in determining the relending terms. An additional factor in determining relending terms is whether the borrower

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1 Applicable to Flexible Loan Product loans and local currency loans made from ADB's ordinary capital resources (OCR) to sovereign and sovereign-guaranteed borrowers. See *Operations Manual* (OM) section D10 for loans made to nonsovereign borrowers. Policy-based loans referred to in OM section D1 include stand-alone policy-based loans and subprogram loans under the programmatic approach. See OM section D4 (Policy-based Lending) for special policy-based lending and countercyclical support facility lending.

2 ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

3 See OM section G2 (Financial Due Diligence in Sovereign Operations) and its related staff instruction.

or the beneficiary bears the foreign exchange risk involved in the ADB loan.[4] In the case of financial intermediation loans, relending terms should follow Operations Manual section D6.[5] In all these cases, the proceeds of the ADB loan may be provided to the beneficiaries on terms more concessional than those determined on the basis described in this paragraph, or in the form of equity capital or as a grant, in the circumstances to be specifically justified, such as the special economic or social nature of the project and the need to strengthen the financial position of the beneficiary (endnote ii).

D. Expenditures Financed by ADB

4. ADB loans finance the foreign exchange costs and local expenditures of projects, subject to the rules on cost sharing and eligibility of expenditures.[6]

E. Flexible Loan Product Loans

1. Terms of Lending

5. ADB offers its sovereign and sovereign guaranteed borrowers a loan product—the Flexible Loan Product (FLP)—that carries a floating lending rate consisting of a specified standard 6-month floating reference rate and an effective contractual spread fixed over the life of the loan, and a maturity premium, where applicable. A FLP loan has market-based features that provide a transparent basis for borrowers to compare the terms of ADB loan products with those of other lenders and to be amenable to efficient intermediation by ADB on the best possible terms (endnote iii).

6. The FLP provides a high degree of flexibility to borrowers, while providing low intermediation risk to ADB. Borrowers are given (i) the choice of currency and interest rate basis; (ii) various repayment options; (iii) the ability to change certain terms of the original loan agreement at any time during the life of the loan, subject to certain conditions;[7] and (iv) the option to purchase a cap[8] or a collar[9] on the floating lending rate at any time during the life of the loan.

7. With a floating-rate loan, the lending rate is calculated every 6 months and interest paid on each interest payment date. The lending rate is the cost-base rate plus an effective contractual spread (fixed spread less permanent credit) and a maturity premium, where applicable, that is fixed in the loan agreement. The cost-base rate is equal to the "Secured Overnight Financing Rate (SOFR) compounded in arrears" for US dollar denominated loans and the "Tokyo Overnight Average Rate (TONA) compounded in arrears" for yen-denominated loans, and the 6-month euro interbank offered rate (Euribor) for euro denominated loans, or an appropriate floating rate

[4] See OM section H7 (Foreign Exchange Risk).
[5] See OM Section D6 (Financial Intermediation Loans).
[6] See OM section H3 (Cost Sharing and Eligibility of Expenditures for ADB Financing).
[7] Borrowers may change the interest rate basis or currency of the original loan agreement, subject to certain minimum and maximum amounts. However, borrowers may not revise or otherwise amend the term of the loan or the stated grace period for the loan.
[8] A cap is a ceiling that sets an upper limit for a floating interest rate.
[9] A collar is a combination of a cap and a floor, which sets a lower limit, that sets an upper and lower limit for a floating interest rate.

benchmark for nonstandard currencies other than for local currency loans. SOFR and TONA are overnight rates and the daily rates are compounded over the relevant interest period to determine interest in arrears. Euribor is a term rate and is reset every 6 months on each interest payment date.

8. The effective contractual spread is 50 basis points (bps) for FLP loans for which formal loan negotiations were completed on or after 1 January 2014.[10] Borrowers may direct ADB to implement a series of interest rate fixings automatically either by period or by amount. For project loans, borrowers also may capitalize the interest.

9. The maturity premium is diversified by the average loan maturity [11] and by country group[12] for sovereign lending operations approved on or after 1 January 2021 (Table 1).[13] The maturity premium will be applied for the entire life of a loan regardless of changes in country group classifications during the tenor of the loan. The stock of regular OCR sovereign lending operations approved prior to 1 January 2021 will not be amended to reflect the diversified maturity premium presented in Table 1. In group B countries borrowing a blend of concessional OCR and regular OCR, the maturity premium will range from 0 to 20 bps.

[10] A fixed spread of 60 bps net of a permanent credit of 10 bps.

[11] Average loan maturity means the weighted average time to repay a loan, which is calculated as the average of the number of years until each principal repayment amount of the loan is due, weighted by the principal repayment amounts. The method for calculating the average loan maturity is set out below:

$$\text{Average loan maturity} = \frac{\text{Sum of weighted repayments}}{\text{Sum of total repayments}}$$

[12] Each year in July, ADB's Strategy, Policy and Partnerships Department (SPD) will issue a memo to update the country group and effective maturity premium group of all countries accessing regular OCR resources for the following year. Country groups include C1, C2, C3 and C4. Group C1 countries are the regular OCR-only borrowing countries below the World Bank gross national income (GNI) per capita threshold for being classified as an upper-middle-income country (UMIC). Group C2 countries are UMICs with income below the IBRD GNI per capita benchmark for triggering the graduation process. Group C3 countries are the UMICs with per capita income above the IBRD GNI per capita benchmark for triggering the graduation process, but below the World Bank GNI per capita threshold for being classified as high-income countries. Group C3 countries will continue to be eligible for regular OCR support from ADB if they do not fulfill conditions related to access to capital markets and/or the development of institutions. Group C4 countries have per capita income above the World Bank GNI per capita threshold for being classified as high-income countries. Group C4 countries will continue to be eligible for regular OCR support from ADB if they do not fulfill conditions related to access to capital markets and/or the development of institutions. Small island developing states (SIDS) with income below the IBRD GNI per capita benchmark for triggering the graduation process (C1/C2 SIDS) and new regular OCR-only country transitioning from concessional borrowing will not be charged a maturity premium. In group B countries borrowing a blend of concessional OCR and regular OCR, the maturity premium will range from 0 to 20 bps.

[13] The project team should notify the borrowers of the applicability of the maturity premium as early as possible in the loan processing cycle. The maturity premium for a proposed FLP should be agreed with the borrower during the loan fact-finding mission and reflected in the memorandum of understanding or aide-mémoire for the fact-finding mission. The applicable maturity premium should be reconfirmed at the time of loan negotiations.

Table 1: Maturity Premium of Regular Ordinary Capital Resources Sovereign Lending Operations by Average Loan Maturity and by Country Group
(basis points)

	B	**C1 (excluding C1 SIDS) and C3/C4 SIDS**	**C2 (excluding C2 SIDS)**	**C3**	**C4**	**New Group C Countries that Lost COL Access[a] and SIDS with Income below the IBRD GNI per Capita Benchmark for Triggering the Graduation Process (C1 andC2 SIDS)**
<9 years	0	0	0	0	0	0
9–less than 13 years	0	0	10	20	40	
13–less than 16 years	10	10	20	30	50	
16–19 years	20	20	30	50	75	

COL = concessional ordinary capital resources lending, IBRD = International Bank for Reconstruction and Development, GNI = gross national income, OCR = ordinary capital resources, SIDS = small island developing states.
[a] For new group C countries that have lost access to COL, the indicated maturity premium will apply to the entire life of regular OCR sovereign loans approved by the Asian Development Bank Board of Directors or Management within 1 year of graduation from group B. Sri Lanka and Viet Nam graduated from group B to group C, losing access to concessional assistance on 1 January 2019 and will exceptionally get the transitional support for new graduates from group B in 2021.
Source: Asian Development Bank.

10. The maturity premium will apply to all regular OCR lending modalities and regular OCR lending products (including sovereign FLP lending and sovereign local currency lending) (endnote iv).

11. FLP loans provide for rebates and surcharges. Since the principle of automatic cost pass-through pricing is maintained for the FLP, ADB returns the actual sub-benchmark funding cost margin achieved to its FLP loan borrowers through rebates. A surcharge will arise if ADB's funding cost is above the applicable benchmark. The rebate and surcharge are calculated on 1 January and 1 July each year, based on the actual average funding cost margin for the preceding 6 months for each currency. Rebates and surcharges shall be applied to the upcoming interest period.

12. For loans negotiated before 1 October 2007, ADB's Board of Directors may have approved certain waivers applicable to ADB loan charges, including the lending spread, front-end fee, and commitment charge.[14] Waivers will apply only to loans without arrears. The waiver mechanism has been discontinued for loans negotiated on or after 1 October 2007.

13. A commitment charge of 15 bps per year is levied on undisbursed balances of all project and policy-based loans (endnote v), beginning 60 days after the applicable loan agreement is

[14] The waivers that are in effect at any point are available at ADB's website.

signed and accruing when the loan becomes effective.[15] For project loans, borrowers may capitalize the commitment charge.

14. For contingent disaster financing under policy-based lending, a front-end fee of 0.25% is applied to the committed loan amount under the "committed capital" option (Option 1). Under the "unallocated capital" option (Option 2) of the contingent disaster financing, at the time of fund commitment and subsequent to the disaster, the borrower would pay a front-end fee of 0.10% of the committed loan amount. The front-end fee payable under either option may be financed out of the loan proceeds (endnote vi).

15. The repayment term on a FLP loan is based primarily on the economic life of the project. The financial condition of the borrowing entity and the revenue-earning capacity of the project may also be taken into account. Subject to these primary project considerations, the repayment period also takes into account the debt-service capacity of the borrowing developing member country (DMC). The loan term, which comprises the repayment term and the grace period, is subject to an average loan maturity limit of 19 years (endnote vii).[16] The grace period is based mainly on the time needed for the project to become operational but may be modified to reflect country considerations (i.e., the debt-service capacity of the borrowing DMC) and other project considerations (e.g., the social and gender benefits of the project and the revenue-earning capacity of the executing agency). Policy-based loans and project readiness financing have fixed repayment and grace periods that are shorter than those for investment projects (endnote viii). ADB offers two types of repayment schedules for borrowers:[17] (i) commitment-linked repayment schedules in which the loan's repayment schedule starts from the beginning of the interest period following loan signing, and (ii) disbursement-linked repayment schedules in which disbursed amounts have individual repayment schedules that start from the beginning of the interest period following disbursement. In either case, repayment can be made on the basis of any of the following options: (i) annuity-style method, (ii) straight-line repayment, (iii) bullet repayment, and (iv) custom-tailored repayment to match the cash flow projections of the borrower.[18] ADB does not participate in debt rescheduling agreements for sovereign loans.

2. Prepayment and Cancellation of Loan

16. Prepayment refers to the repayment of a loan in advance of the maturity period specified in the loan agreement. Borrowers may prepay in part or in full the disbursed and outstanding loan

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[15] Applicable to project and policy-based loans negotiated on or after 1 October 2007. For contingent disaster financing under policy-based lending, in lieu of a commitment charge, the borrower will pay a front-end fee as described in para. 13. For project readiness financing, no commitment charge is payable.

[16] Applicable to all FLP loans for which formal loan negotiations are completed on or after 1 April 2012.

[17] When loan signing is delayed beyond 1 year because of exceptional circumstances, and ADB consequently approves an extension to the loan signing date, the repayment schedule may, if so requested by the borrower, be revised at the time ADB approves the extension. The grace period and the loan term remain the same as approved by the Board, with the grace period starting from the time ADB approves the extension.

[18] Applicable to project loans negotiated after 1 January 2007. Annuity-style method refers to repayment schedule based on its present-value. Straight-line payment refers to equal repayment schedule over the loan tenor. Bullet repayment refers to one single repayment at the end of the loan term. Custom-tailored repayment refers to an amortization structure that would meet the exact cash-flow structure of the project. However, such customization will be limited to determining the repayment structure in (potentially uneven) percentage terms that cannot be changed after loan signing.

balance at any time during the life of a loan by notifying ADB in writing at least 45 days before the prepayment. Partial prepayments are applied to the amortization schedule in inverse order of maturity, with the most distant maturity being repaid first. Partial prepayment should be at least equal to all of the principal amount of any one or more maturities of the loan. In case of financial intermediation loans, the disbursed amount that has been withdrawn last should be repaid first.

17. For floating-rate loans, borrowers may prepay outstanding amounts on the interest payment date of the loan without a prepayment premium. However, prepayments of floating-rate loans on dates other than interest payment dates are charged a prepayment premium based on the difference, if any, between the rate at which the proceeds from the prepayment can be reinvested and ADB's funding cost for the period up to the next interest payment date. In the event of prepayment of fixed-rate loans or floating-rate loans that involve conversions, and if the corresponding hedge transactions have to be terminated, the borrowers are charged the unwinding costs of the hedge transactions that ADB incurs.

18. With the concurrence of the guarantor (if any), borrowers may cancel all or part of the undisbursed loan balance at any time during the life of the loan without a fee, subject to the same notice period.

3. Loan Conversion Options

19. Borrowers may request a currency conversion of all or a portion of the principal amount of the loan after review of its original currency choice and interest rate structure (endnote ix). At any time after loan effectiveness, borrowers may (i) for conversions to any standard currency, change the loan currency of all or part of the undisbursed or disbursed loan amounts at any time during the life of the loan; (ii) for conversions to any nonstandard currency in which ADB can effectively intermediate (other than for conversions to a local currency), change the loan currency of all or a part of the undisbursed or disbursed loan amounts at any time during the life of the loan, provided that ADB can enter into the necessary hedging transaction; (iii) request an interest rate conversion from floating to fixed or vice versa during the life of the loan; or (iv) establish an interest rate cap (footnote 5) or collar (footnote 6) on a floating rate, subject to relevant swap market opportunities available to ADB. The use of the conversion provisions in the loan agreement is subject to the relevant provisions of the applicable loan regulations and conversion guidelines (endnote x).[19]

20. For conversions to a local currency, borrowers may request a conversion of all or a portion of the withdrawn and outstanding amount of the loan on a case-by-case basis upon the advice of the Treasury Department. Conversions to a local currency are permissible only for fully disbursed loans. An annual fee of 0.02% will be charged on the outstanding principal hedged amount of the loan. Subject to availability in the local market, local currency loans, upon conversion, can be offered at a floating rate or fixed rate.

[19] The currency or the interest rate characteristic of a loan may be changed at any time during the life of the loan in accordance with the conversion provisions in the loan agreement. This is a unilateral document that ADB can change anytime to provide flexibility in executing conversion requests. The guidelines set out the procedures for requesting, accepting, and effecting conversions as specified in the loan agreement.

21. Local currency conversions of withdrawn and outstanding loan balances will be an approximate hedge only. They do not include the lending spread or any potentially applicable rebates, surcharges, or waivers, which will remain in the original loan currency.

22. Before conversion to a local currency can be undertaken, the loan agreement shall be amended to allow for the conversion. The loan regulations applicable to local currency ordinary operations shall apply to that portion of the loan converted to a local currency (endnote xi).

F. Local Currency Loans

1. Terms of Lending

23. In selected DMCs, ADB offers its borrowers local currency loans (LCLs) to finance the local expenditures of a project. An LCL has market-based features that provide a transparent basis for borrowers to compare the terms of ADB loan products with those of other lenders and to be amenable to efficient intermediation by ADB on the best possible terms (endnote x).

24. Loans may be made on a floating rate basis.[20] With a floating rate loan, the lending rate is calculated every 3 or 6 months as applicable and interest paid on each interest payment date. The lending rate is the cost-base rate plus an effective contractual spread (fixed spread less permanent credit) and a maturity premium, where applicable, that is fixed in the loan agreement. The cost-base rate depends on whether financing in a local currency is based on back-to-back funding or the pool-based approach.[21] For back-to-back funding, the cost-base rate comprises ADB's cost of a funding transaction undertaken to finance a specific loan, including related swap costs and negative carry, if any. For a pool-based funding approach, the cost-base rate is based on the local floating-rate benchmark (equivalent to SOFR compounded in arrears for US dollar denominated loans), adjusted by ADB's funding spread over or below the benchmark.

25. The effective contractual spread is 50 bps for loans for which formal loan negotiations are completed on or after 1 January 2014.

26. The maturity premium is diversified by average loan maturity and by country group for regular OCR sovereign lending operations approved on or after 1 January 2021 (Table 1 and footnotes 9, 10 and 11).

27. A commitment fee of 15 bps per year (endnote v) is levied on undisbursed balances of all LCLs, beginning 60 days after signing of the applicable loan agreement and accruing when the loan becomes effective.

28. LCLs funded under the pool-based approach provide for rebates and surcharges. Since the principle of automatic cost pass-through pricing is maintained for LCLs, ADB returns the actual sub-benchmark funding cost margin achieved to its qualifying LCL borrowers through rebates. A surcharge will arise if ADB's funding cost is above the benchmark. The rebate and surcharge are

[20] Borrowers may request an interest rate conversion (para. 31).
[21] The Treasury Department will advise whether funding for a specific project will be undertaken on a back-to-back or pool basis.

calculated on 1 January and 1 July each year based on the actual average funding cost margin for the preceding 6 months.

2. Prepayment and Cancellation of Loan

29. Borrowers may prepay in part or in full the disbursed and outstanding loan balance during the life of a loan by notifying ADB in writing at least 45 days before the prepayment. However, prepayment charges will apply based on the estimated negative carry, if any, that ADB incurs as a result of the prepayment for the remainder of the term of the prepaid loan. As in prepayments of FLP loans, the negative carry would be calculated based on the difference, if any, between the rate at which the proceeds from the prepayment could be reinvested and ADB's funding liability for the prepaid amount. If a fixed-rate loan is prepaid, and the corresponding hedge transactions terminated, the borrowers will be charged the unwinding costs of the hedge transaction, if any. No prepayment charge will apply for floating-rate loans funded under the pool-based funding approach if prepayments occur on interest payment dates.

30. Borrowers may cancel all or part of the undisbursed balance at any time. No cancellation charge will apply if ADB follows a pool-based funding approach for the specific local currency. For back-to-back funding, if ADB has agreed with the borrower to pre-fund the local currency requirement for a particular loan, and the borrower later decides to wholly or partially cancel the loan, a cancellation charge will apply based on the same principle used for prepayments (i.e., to compensate ADB for negative carry costs, if any, resulting from the loan cancellation).

31. Charges for prepayment and cancellation, and their calculation principles, will be included in the loan documents to ensure full transparency for borrowers.

3. Interest Rate Conversion Options

32. Borrowers will be allowed to change the interest rate basis of an LCL at any time during the life of the loan by requesting a conversion to fix or unfix their interest rate, subject to relevant swap market opportunities available to ADB in the local market. The terms and conditions that ADB can achieve by executing the necessary hedging transactions will be passed on to the borrower, plus a transaction fee of 6.25 bps, except for the first series of interest rate conversions for which no fee shall be charged.

4. Currency Substitution

33. The local currency loan agreement includes a currency substitution clause. This will allow ADB to temporarily substitute another currency for the loan currency selected by the borrower if an extraordinary situation arises that prevents ADB from providing the selected currency for funding the loan because of access constraints in the local currency capital market.

Basis

i ADB. 2013. *Enhancing ADB's Lending Capacity*. Manila (R179-13).

ii ADB. 1980. *Lending and Relending Policies*. Manila (R35-80), and ADB. 1979. *A Review of Lending and Relending Policies*. Manila (R124-79).

iii ADB. 2021. *Reference Rate Transition for the Asian Development Bank's Financial Loan Product.* Manila (R61-21); and ADB. 2001. *Revision 1, Final. Review of Asian Development Bank's Financial Loan Products*. Manila (R79-01).

iv ADB. 2019. *Diversification of Financing Terms for Regular Ordinary Capital Resources Sovereign Lending Operations under Strategy 2030.* Manila (R113-19).

v ADB. 2010. *Review of the Asian Development Bank's Loan Charges and Allocation of 2009 Net Income.* Manila (R38-10).

vi ADB. 2019. *Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards.* Manila (R42-19).

vii ADB. 2011. *Review of the Asian Development Bank's Loan Charges and Allocation of 2011 Net Income*. Manila (240-11).

viii ADB. 2018. *Proposal for ADB's New Products and Modalities*. Manila (R56-18).

ix ADB. 2006. *Enhancements for the Asian Development Bank's Loan and Debt Management Products*. Manila (R221-06).

x ADB. 2006. *Enhancements for the Asian Development Bank's Loan and Debt Management Products.* Manila (R221-06).

xi ADB. 2005. *Introducing the Local Currency Loan Product*. Manila (R195-05).