**OPERATIONS MANUAL**
**POLICIES AND PROCEDURES**

These policies and procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject. This Operations Manual was prepared by the Treasury Department (TD) and the Strategy, Policy, and Partnerships Department (SPD) with the approval of the President and is subject to compliance review. Questions may be directed to the director of the Operations Planning and Coordination Division of SPD and the Assistant Treasurer of the Financial Policy and Planning Division or the Assistant Treasurer of the Client Solutions Division of TD.

# LENDING POLICIES FOR SOVEREIGN AND SOVEREIGN-GUARANTEED BORROWERS (Regular Ordinary Capital Resources)

## 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).[1]

## 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 as 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 the sale 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. The 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 OCR 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 concerned developing member country (DMC) are

---

[1] Applicable to Flexible Loan Product loans and local currency loans made from ADB’s OCR to sovereign and sovereign-guaranteed borrowers. Refer to ADB. 2016. Nonsovereign Operations. *Operations Manual*. OM D10. Manila. Policy-based loans referred to in this *Operations Manual* section include stand-alone policy-based loans and subprogram loans under the programmatic approach. Refer to the *Operations Manual* section on policy-based lending (ADB. 2022. Policy-Based Lending. *Operations Manual*. OM D4. Manila) for special policy-based lending and countercyclical support facility lending.

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

[3] Refer to the *Operations Manual* section OM G2 (ADB. 2023. Financial Due Diligence in Sovereign Operations. *Operations Manual*. OM G2. Manila) and its related staff instruction (ADB. 2023. *Staff Instruction on Business Processes for Financial Due Diligence in Sovereign Operations*. Manila).

the major factors in determining the relending terms. An additional factor in determining relending terms is whether the borrower 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 the *Operations Manual* section on financial intermediation loans (OM 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. The FLP has market-based features that provide a transparent basis for the 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. The 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

---

[4] Refer to ADB. 2023. Foreign Exchange Risk. *Operations Manual*. OM H7. Manila.
[5] Refer to ADB. 2023. Financial Intermediation Lending. *Operations Manual*. OM D6. Manila.
[6] Refer to ADB. 2023. Cost Sharing and Eligibility of Expenditures for ADB Financing. *Operations Manual*. OM H3. Manila.
[7] The borrowers may change the interest rate basis or currency of the original loan agreement, subject to certain minimum and maximum amounts. However, the 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.

(SOFR) compounded in arrears for United States 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 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 FLPs for which formal loan negotiations were completed on or after 1 January 2014.[10] The borrowers may direct ADB to implement a series of interest rate fixings automatically either by period or by amount. For project loans, the borrowers may also 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 as shown in the table.[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 the table. 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 as follows:

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

[12] Each year in July, ADB's Strategy, Policy, and Partnerships Department (SPD) issues 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's 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 International Bank for Reconstruction and Development (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 countries 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.

**Maturity Premium of Regular Ordinary Capital Resources Sovereign Lending Operations by Average Loan Maturity and by Country Group**
(basis point)

| Item | 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 and C2 SIDS) |
|---|---|---|---|---|---|---|
| **< 9 years** | 0 | 0 | 0 | 0 | 0 | 0 |
| **9 years to 13 years** | 0 | 0 | 10 | 20 | 40 | |
| **> 13 years to 16 years** | 10 | 10 | 20 | 30 | 50 | |
| **> 16 years to 19 years** | 20 | 20 | 30 | 50 | 75 | |

< = less than, > = more than, COL = concessional ordinary capital resources lending, GNI = gross national income, IBRD = International Bank for Reconstruction and Development, 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.
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. FLPs 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 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 signed and accruing when the loan becomes effective.[15] For project loans, the borrowers may capitalize the commitment charge.

[14] The waivers that are in effect at any point are available on ADB's website.
[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. 14. For project readiness financing, no commitment charge is payable.

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. Under the unallocated capital option of the contingent disaster financing, at the time of fund commitment and after 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 of an FLP 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 considered. Subject to these primary project considerations, the repayment period also considers the debt-service capacity of the borrowing 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 iv and 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 the 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 based on 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. The borrowers may prepay in part or in full the disbursed and outstanding loan 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.

[16] Applicable to all FLPs 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 the repayment schedule based on its present value. "Straight-line repayment" refers to the 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.

17. For floating-rate loans, the 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 must be terminated, the borrowers are charged the unwinding costs of the hedge transactions that ADB incurs. Conversely, if ADB receives unwinding amounts from the terminated hedge transactions, such amounts are credited to the borrowers.[19]

18. With the concurrence of the guarantor (if any), the 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. The borrowers may request a conversion of all or a portion of the principal amount of the loan at any time after loan effectiveness (endnote ix). The Flexible Loan Product provides that the borrowers may request the following:

(i) conversions to any standard currency or changes to the loan currency of all or part of the disbursed or undisbursed loan amounts;
(ii) conversions to any nonstandard currency in which ADB can effectively intermediate (other than for conversions to a local currency) or changes to the loan currency of all or a part of the disbursed or undisbursed loan amounts, provided that ADB can enter into the necessary hedging transaction;
(iii) an interest rate conversion from floating to fixed or vice versa of all or part of the disbursed or undisbursed loan amounts at the time of disbursement; and/or
(iv) the establishment of an interest rate cap (footnote 8) or collar (footnote 9) 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 ix).[20]

20. For conversions to a local currency, the 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% is currently charged on the outstanding principal hedged amount of the loan (footnote 19). Subject to availability in the local market, local currency loans, upon conversion, can be offered at a floating rate or fixed rate.

---

[19] ADB. 2022. *Guidelines for Conversion of Loan Terms for ADB's Flexible Loan Product*. Manila.

[20] 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. The conversion guidelines set out the procedures for requesting, accepting, and effecting conversions as specified in the loan agreement. This is a unilateral document that ADB can change anytime to provide flexibility in executing conversion requests.

21. Local currency conversions of withdrawn and outstanding loan balances will be a partial 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, if necessary, 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. LCLs have market-based features that provide a transparent basis for the 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 ix).

24. Loans may be made on a fixed or floating rate basis.[21] Floating rate LCLs typically reset every 3 or 6 months. 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.[22] For back-to-back funding, the cost-base rate comprises the cost of the funding transaction entered into by ADB to finance a specific loan, including related arranger, legal, depositary, and other costs associated with implementing the funding transaction and negative carry, if any. For a pool-based funding approach, the cost-base rate is based on the local floating-rate benchmark, adjusted by ADB's respective local currency 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 and footnotes 11, 12, and 13).

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 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

---

[21] The borrowers may request an interest rate conversion (para. 32).
[22] 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. Subject to the financing source, borrowers may prepay in part or in full the disbursed and outstanding loan balance during the life of the LCL by notifying ADB in writing at least 45 days before the prepayment. However, unwinding costs may apply as a result of the prepayment for the remainder of the term of the prepaid loan, depending on the financing source. As in prepayments of FLPs, 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 borrower will be charged the unwinding costs of the hedge transaction, if any. Conversely, if ADB receives unwinding amounts from the terminated hedge transactions, such amounts are credited to the borrowers (footnote 19).

30. Subject to any fees and charges in the loan agreement, borrowers may cancel all or part of the undisbursed balance of the LCL at any time.

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 the LCL on any interest payment date 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, 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 for LCLs with refinancing provisions. 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

**Bases**

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