OPERATIONS MANUAL
BANK 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* is issued by the Strategy and Policy Department with the approval of the President, and is subject to compliance review. Questions may be directed to the Director, Strategy, Policy and Interagency Relations Division, Strategy and Policy Department.

NONSOVEREIGN OPERATIONS

A. Introduction and Eligibility

1. The Asian Development Bank (ADB) undertakes nonsovereign operations to provide financing to eligible recipients in developing member countries (DMCs). Nonsovereign operations comprise the provision of any loan, guarantee, equity investment, or other financing arrangement to privately held, state-owned, or subsovereign entities, in each case, (i) without a government guarantee (endnote i, ii and iii); or (ii) with a government guarantee, under terms that do not allow ADB, upon default by the guarantor, to accelerate, suspend, or cancel any other loan or guarantee between ADB and the related sovereign (endnote iv and v).

2. To be eligible for ADB nonsovereign financing, the proposed recipient must be:

(i) an entity wholly owned or controlled by one or more private entities (endnote i);

(ii) an entity, wholly owned or controlled by a sovereign, undertaking commercial activities (subsovereign and other public sector entities) (endnote iv and vi);

(iii) an entity, partially owned or controlled by one or more private entities and a sovereign, undertaking commercial activities (endnote i, iv, and vi); or

(iv) a local government or other subsovereign entity (including municipalities and other forms of local government) that can contract and obtain financing independently from the sovereign;[1]

provided, in each case, the proposed recipient is:

(a) established and/or operating in a DMC (endnote i), and

(b) a legal entity that can sue and be sued (endnote ii).

B. Forms of Assistance

3. Financial assistance may be provided in one or more of the following forms:

(i) equity investments (endnote vii);

(ii) loans and other debt instruments[2] (endnote i); and

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[1] Any such entity shall also meet the eligibility criteria outlined in ADB. 2011. *Mainstreaming Nonsovereign Public Sector Financing*. Manila.

(iii) guarantees (including credit guarantees, political risk guarantees, and unfunded risk participations) of loans and other debt obligations.[3]

4. Nonsovereign financing may be denominated in any of the major international currencies and/or in local currencies (endnote viii and ix).

5. Nonsovereign financing can be either (i) financing that uses ADB's own funds or is guaranteed or risk participated by ADB; (ii) co-financing provided by commercial lenders where ADB serves as lender of record (e.g., B-loans) (endnote x); or (iii) financing by ADB that is funded, wholly or in part, by sources that are not ADB funds but is administered by ADB on behalf of fund providers (third-party funds).

6. Consistent with ADB's mandate to enter into financing partnerships as a way to leverage its resources and mobilize public and private capital investment in DMCs,[4] ADB will consider syndications, guarantees, and/or other risk-sharing arrangements with financing partners (such as financial institutions and insurance companies) in connection with its nonsovereign operations.

C. Charter Basis

7. The Agreement Establishing the Asian Development Bank (the Charter) provides the following general mandate and operating principles for nonsovereign operations:

(i) Article 2(i) specifies that one of the functions of ADB is to promote investment in the region of both public and private capital for development purposes.

(ii) Article 11 authorizes ADB to provide or facilitate financing to any entity or enterprise operating in a DMC, as well as to international or regional entities concerned with economic development of the region.

(iii) Article 11 also provides that ADB may carry out its operations by (a) making or participating in direct loans, (b) investing in the equity capital of an institution or enterprise, and (c) guaranteeing loans for economic development participated in by ADB.

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2 Including, by way of example, (i) senior, subordinated, mezzanine, and convertible debt; (ii) project or limited recourse finance; (iii) tier 2 capital raised by banks; (iv) capital market debt instruments including synthetic or structured securities, and the related underwriting and liquidity support arrangements; (v) letters of credit, promissory notes, and bills of exchange (vi) performance, bid, advance, and other payment bonds and forms of bond issuances; and (vii) other forms of financial indebtedness or instruments.

3 *Operations Manual section D9 (Credit Enhancement Operations).*

4 *Operations Manual section D9 (Credit Enhancement Operations).*

(iv) Article 12(4) states that if ADB invests in the equity of an enterprise, it shall not seek to obtain a controlling interest, except where necessary to safeguard its investment.

(v) Article 14 stipulates the operating principles applicable to ADB's operations. In particular, Article 14(xiii) provides that ADB shall not assume any responsibility for managing an entity in which it has invested, except where necessary to safeguard its investment. Article 14(xiv) provides that ADB's operations must be guided by sound banking principles.

D. Policy Objectives

8. Nonsovereign operations aim to catalyze investments and capital flows in DMCs through direct financing or risk-mitigation instruments. The main objective of nonsovereign operations is to promote economic development in DMCs, while allowing ADB to generate sufficient profit to (i) sustain such operations without any cross-subsidy from other ADB activities, and (ii) demonstrate the financial viability of investments in DMCs. Nonsovereign operations include investments in both privately held and state-sponsored companies. Capitalizing on ADB's strengths, nonsovereign operations in the private sector generally focus on (i) infrastructure, and (ii) capital markets and finance (including financial intermediaries, securities firms, and investment funds), while remaining responsive to the changing needs of DMCs and investment opportunities in new sectors (endnote xi and xii). ADB recognizes the importance of expanding and improving infrastructure services and increasing private sector development through public–private initiatives. The financing of public sector entities on nonsovereign terms emphasizes promoting greater efficiencies, spurring economic development, and providing high-quality services in well-managed, commercially operated and financially sustainable entities and bodies (endnote iv). Targeted entities for nonsovereign operations in the public sector are normally involved in providing access to public goods and services that have a high development impact (such as water, wastewater, waste management, power, energy, transport, and telecommunications), or improve business competitiveness.

9. In addition to developmental considerations, credit strength, financial viability, and good corporate governance must play key roles in the selection, analysis, approval, and administration of any nonsovereign financing. Nonsovereign financing may be aimed at refinancing existing debt, including transactions that, although technically and financially sound, may be impaired by problems with their financing structure (endnote ii and vi). Nonsovereign financing is exposed to the full range of commercial and political risks, and managing risk is a priority. Risk analysis consistent with ADB standards and industry practice should be undertaken to determine the acceptability of risks, and related risk exposures must be presented clearly in transaction documents (endnote x).

E. Scope of Operations

1. Development Impacts

10. Nonsovereign operations must have clear development impacts and/or demonstration effects. ADB's assistance must:

(i) attract other financing partners by leveraging ADB's financial resources; and/or

(ii) complement, not substitute for, commercial sources of finance; and/or

(iii) add value by influencing project design or structure to make it more environmentally or socially friendly, create more jobs, improve delivery of services, impart better skills or technology, and/or raise standards of corporate governance (endnote xi and xii).

2. Technical Feasibility, Financial and Economic Viability, Environmental and Social Soundness, and Integrity

11. ADB must evaluate the technical feasibility, market prospects, financial and economic viability, commitment to best practices of corporate governance, and environmental and social soundness of each proposed nonsovereign financing. In addition, for each financing recipient, ADB must evaluate the integrity, experience, success record, financial resources, and competence of the sponsors and/or shareholders and management. Integrity due diligence is carried out in accordance with the Integrity Due Diligence Guidelines for Nonsovereign Operations.[5] All references herein to integrity include issues and/or risks related to money laundering and financing of terrorism.

3. Policy Compliance

12. ADB must assess each proposed financing to ensure that it:

(i) complies with the relevant provisions in ADB's policies on poverty reduction;[6] safeguards (including environment, involuntary resettlement, indigenous peoples);[7] governance;[8] anticorruption;[9] procurement (including consulting services);[10] and enhancing ADB's role in combating money laundering and the financing of terrorism;[11]

(ii) is generally consistent with the applicable country partnership strategy[12] and relevant sector policy;

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5 ADB. 2015. *Integrity Due Diligence Guidelines for Nonsovereign Operations*. Manila.
6 *Operations Manual section C1 (Poverty Reduction).*
7 *Operations Manual section F1 (Safeguard Policy Statement).*
8 *Operations Manual section C4 (Governance).*
9 *Operations Manual section C5 (Anticorruption).*
10 ADB's procurement policies are found in the Procurement Guidelines (2015, as amended from time to time) and the Guidelines on the Use of Consultants (2013, as amended from time to time). In the case of nonsovereign financing made by ADB without government guarantee to entities contemplated in clauses (ii) or (iii) in para. 2 above, section 3.13 of the Procurement Guidelines shall apply.
11 *Operations Manual section C6 (Enhancing the Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism).*
12 *Operations Manual section A2 (Country Partnership Strategy).*

(iii) complies with ADB's credit enhancement policy, [13] if credit enhancement operations are involved;

(iv) complies with the applicable laws and regulations of the host country;

(v) does not involve an industry or activity that does not qualify for ADB financing (i.e., the prohibited investment activities list), as determined by ADB from time to time;[14]

(vi) complies with prudential exposure limits;[15] and

(vii) is reviewed and monitored by an independent risk function in accordance with international best practices and sound banking principles.

F. Approval Authority

13. The Board of Directors considers for approval all nonsovereign transactions, except those described in para. 14. These transactions may be considered by the Board through the no-objection procedure in accordance with *Operations Manual section L4* (*No-Objection Procedure*).

14. The President considers for approval the following:

(i) transactions that qualify for processing under the Faster Approach to Small Nonsovereign Transactions (FAST) (endnote xiii); and B-loans accompanying ADB financial assistance under FAST, subject to the criteria in *Operations Manual section L4* (*No-Objection Procedure*);

(ii) any subsequent increase in a B-loan amount, meeting the relevant financial thresholds;[16]

(iii) the administration of co-financing, subject to the criteria in *Operations Manual section L4* (*No-Objection Procedure*);

(iv) any supplementary equity investment not exceeding $2 million in an existing investee company that is performing and is expected to perform satisfactorily, subject to prompt reporting to the Board (endnote xii and xiv);

(v) loan restructuring proposals where no additional funding is involved and all other recovery alternatives are less advantageous to ADB (endnote xii); and

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13 *Operations Manual section E1 (*Financing Partnerships*)* and *Operations Manual section D9 (Credit Enhancement Operations)*.

14 *Operations Manual section F1 (Safeguard Policy Statement).*

15 *Operations Manual section D13 (Exposure and Investment Limitations on Nonsovereign Operations).*

16 *Operations Manual section L4 (No-Objection Procedure).*

(vi) funding of costs and expenses related to investment recovery operations of nonsovereign transactions, up to a cumulative amount not to exceed $2 million, net of cash proceeds from the related investment recovery operations (endnote xii).

G. Government Assurances

15. In accordance with the requirements of ADB's policy on equity operations (endnote vii) and ADB's nonsovereign operations (endnote i), assurances will be sought from DMC governments to confirm ADB's privileges and immunities as provided in the Charter as a condition for ADB undertaking nonsovereign operations in the concerned DMC. While these assurances may be provided through the execution of framework agreements with DMCs, they may also be obtained through the government's no-objection (para. 16) provided for each nonsovereign operation undertaken in the relevant DMC.

H. Government No-Objection

16. ADB finances an undertaking in a member country only if the government has no objection (endnote xv). Accordingly, the relevant government's no-objection for each financing must be established before the first disbursement by ADB of such financing.

I. Accountability Mechanism

17. Nonsovereign operations are subject to the ADB Accountability Mechanism.[17]

J. Operations Evaluation

18. Nonsovereign operations are subject to performance evaluation by the Independent Evaluation Department.[18]

Basis:

i ADB. 1985. *Lending to the Private Sector without Government Guarantees*. Manila. September (Doc. R93-85).

ii ADB. 2008. *Pilot Financing* Instruments *and Modalities: Extension of Pilot Period for the Sub-sovereign and Nonsovereign Public Sector Financing Facility*. Manila. August (Doc. R177-08).

iii ADB. 2009. *Private Sector Development and Nonsovereign Operations - A Model for Improved Strategic Alignment, Interdepartmental Collaboration, Development Effectiveness, and Risk Management*. Manila. April (IN. 87-09).

17 *Operations Manual section L1 (Accountability Mechanism).*
18 *Operations Manual section K1 (Independent Evaluation).*

[iv] ADB. 2011. *Mainstreaming Nonsovereign Public Sector Financing.* Manila. August (Doc. R133-11).

[v] ADB. 2014. *Review of the Asian Development Bank's Exposure Limits on Nonsovereign Operations.* Manila. December (Doc. R162-14).

[vi] ADB. 2005. *Innovation and Efficiency Initiative: Pilot Financing Instruments and Modalities*. Manila. August (Doc. R194-05).

[vii] ADB. 1983. *Equity Investment Operations by the Bank*. Manila. February (Doc. R38-82).

[viii] ADB. 2005. *Introducing the Local Currency Loan Product*. Manila. August (Doc. R195-05).

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

[x] ADB. 2006. *Review of ADB's Credit Enhancement Operations*. Manila. August (Doc. R168-06).

[xi] ADB. 2000. *Private Sector Development Strategy*. Manila. March (Doc. R78-00).

[xii] ADB. 2001. *Private Sector Operations Strategic Directions and Review*. Manila. August (Doc. R122-01).

[xiii] ADB. 2015. *Faster Approach to Small Nonsovereign Transactions.* Manila. March (Doc. R18-15).

[xiv] ADB. 1995. *Strategy for the Bank's Assistance for Private Sector Development*. Manila. February (Doc. R56-95).

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

[xvi] ADB. 2015. *Enhancing Operational Efficiency of the Asian Development Bank*. Manila. December (Doc. R167-15).

[xvii] ADB. 2015. *Procurement Guidelines*. Manila. April.

[xviii] ADB. 2014. *Review of the Asian Development Bank's Local Currency Operations*. Manila. September. (Doc. R99-14).

[xix] ADB. 2013. *Guidelines on the Use of Consultants*. Manila. March.

[xx] ADB. 2006. *Review of Loss Provisioning Policy for Nonsovereign Operations*. Manila. November (Doc. R263-06).

[xxi] ADB. 2002. *Pricing of Local Currency Loans in Private Sector Operations*. Manila. October (Doc. R215-02).

[xxii] ADB. 1985. *Bank Assistance to the Private Sector*. Manila. June (Doc. R58-85).