These policies and procedures were prepared for use by Asian Development Bank staff and are not necessarily a complete treatment of the subject. This Operations Manual is issued by 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 SPD’s Strategy, Policy and Business Process Division.

# POLICY-BASED LENDING

## A. Scope

1. The Asian Development Bank (ADB) provides policy-based lending (PBL) in the form of sovereign budget support or a sovereign guarantee to support policy reforms and development expenditure programs of a developing member country (DMC). Under certain circumstances, it may also be used to provide balance of payments (BOP) assistance or countercyclical fiscal support. PBL may come from ADB’s regular ordinary capital resources (OCR), concessional OCR, or the Asian Development Fund (ADF).

2. PBL supports sector and inter-sector reform programs in a DMC. This may include introduction or revisions to laws, regulations, and policies to address structural bottlenecks; and measures to strengthen the capacity of institutions. The reform program addresses underlying constraints that are sector-wide or inter-sector or have a bearing on links between sectors and the macroeconomy. PBL and sector development programs must be targeted at sectors that the government is firmly committed to reform. Strong government ownership of the reform program is essential. PBL should also be limited to areas where ADB has or can readily acquire the requisite experience to provide well-founded advice on formulating and implementing reform programs (endnote i). In general, PBL (i) is linked to the implementation of policy reforms and is disbursed quickly, and (ii) has sector-wide and economy-wide impacts.

## B. Policy-Based Lending Operations

3. ADB has four types of PBL operations, each catering to a different situation in a DMC, and are generally categorized as conventional PBL and crisis response PBL. Conventional PBL

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1. In this Operations Manual, “PBL” refers to policy-based lending, a policy-based loan, or the policy-based component of a sector development program, as the context requires.
2. In this Operations Manual, “sovereign guarantee” refers to a partial credit guarantee (PCG) provided by ADB that is backed by a sovereign counter-guarantee and indemnity.
3. Structural reforms seek to improve the amount and efficiency of investment in an economy or sector through three interrelated efforts: (i) enhancing resource mobilization by increasing the cost recovery of utilities and state-owned enterprises, eliminating or reducing subsidies, and raising real interest rates; (ii) improving resource allocation by adjusting relative prices, lowering trade barriers, limiting directed credit, and rationalizing public investment; and (iii) promoting efficient resource use by enhancing domestic and external competition and the role of the private sector.
4. The terms “lending” and “loan(s)” include ADF grant(s) and guarantee(s), except that ADB’s policy-based guarantee (PBG), special PBL (SPBL), and Countercyclical Support Facility (CSF) lending are financed only from regular OCR.
5. The term “sector” in the context of PBL is to be understood in the broad sense of the word. In addition to the traditional concept of a sector characterized by the production of particular goods or services (such as agriculture, industry, and service), the term may cover subsectors of more limited scope or relate to a crosscutting sector addressing economy-wide themes, ownership, or a specific area of policy coverage (such as private, public, or external sectors) with possible macroeconomic implications.
comprises (i) stand-alone and (ii) programmatic approach, with financing options such as contingent disaster financing (CDF) and policy-based guarantee (PBG). Crisis response PBL comprises (i) special PBL (SPBL) and (ii) the Countercyclical Support Facility (CSF).

4. **Stand-alone policy-based lending.** Stand-alone PBL provides budget support and is packaged as a single or multitranche loan to support structural reforms in a particular sector. Reform programs can be short or medium term. Where relevant, links to other programs financed by ADB or other development partners should be clearly established. PBLs should normally be used to improve the policy and institutional environment for enhanced sector efficiency and for higher returns on investment (footnote 3). Where policy adjustments are required in a particular sector over an extended period, a succession of stand-alone PBLs may be considered to sustain the reform process (endnote i).

5. Multitranche and single-tranche PBLs are allowed (endnote ii). A PBL may be divided into multiple tranches if major elements of the structural reforms remain after the loan agreement becomes effective. Multiple tranches enable ADB to monitor and expedite phased program implementation. The program period and number of tranches are determined on a case-by-case basis. Single-tranche loans may be considered if the most important reforms can be implemented before the circulation of the report and recommendation of the President (RRP) to the Board of Directors.7

6. **Programmatic approach.** The programmatic approach is ADB’s primary mode of PBL to support structural reforms over a medium-term time frame. Programmatic budget support finances a series of subprograms, each designed as a fully front-loaded single-tranche intervention (footnote 7). The programmatic approach is designed to provide more effective and flexible ways of translating complex objectives of structural reforms into implementable policy actions. It recognizes imperfections in information and its availability, and allows for flexibility in designing policy packages. The logical links between the subprograms and the broad objectives are captured in a programmatic approach concept paper (endnote iii). A sound policy and institutional setting of a recipient country is a prerequisite for receiving budget support under the programmatic approach (endnote ii).

7. The programmatic approach can take the form of (i) chronologically sequenced packaging (over time), (ii) vertical packaging (across levels of government), and (iii) horizontal packaging (inter-sector) (endnote iii).

8. **Contingent disaster financing.** CDF is designed as a contingent financing option, whereby loan processing and essential DMC policy dialogue and reforms are completed before a natural hazard8 occurs, with disbursements made upon the satisfaction of the pre-agreed

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8 CDF covers disasters triggered by natural hazards as defined in the Disaster and Emergency Assistance Policy (ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila), such as typhoons, tropical cyclones, floods, earthquakes, droughts, and tsunamis. The program and policy matrix, as part of the policy design and monitoring framework (PDMF), should clearly demonstrate how policy reforms will enhance preparedness for and response to disasters triggered by these natural hazards. The PDMF combines the policy matrix and the design and monitoring framework and presents outcome indicators in a specific, measurable, achievable, relevant, and time-bound (SMART) format. The PDMF is described in ADB. 2020. *Staff Instruction on Business Processes for Policy-Based Lending*. Manila.
9. Unlike other forms of conventional PBL operations that involve broader structural reforms, the policy framework required for CDF focuses on legal, institutional, and policy constraints for more effective disaster preparedness and response programs. In principle, PBL conditions should be designated as prior actions to ensure that funding is available if a disaster is triggered by a natural hazard. Full or partial disbursements are triggered after a disaster is confirmed by the DMC’s declaration of a state of emergency or its equivalent, depending on the DMC’s legislation or practice. The criteria and process for declaring a state of emergency, or its equivalent, should be discussed with ADB as part of the policy dialogue, mutually agreed during the fact-finding mission, and recorded in the memorandum of understanding or aide-mémoire of the fact-finding mission. Where necessary, CDF disbursements can be succeeded by follow-up assistance through an emergency assistance loan or regular investment lending for longer-term reconstruction. Having met all the requirements for conventional PBL, CDF allows for deferred disbursement. If no disaster occurs or if funds are not fully disbursed, the DMC may elect to have the approved CDF amount disbursed at the conclusion of the availability period. The deferred disbursement option is available only at the conclusion of the standard availability period and may be extended as part of the CDF renewal process (endnote iv).

10. **Policy-based guarantee.** PBG follows the general policy and requirements of conventional PBL. The financial instrument will be a partial credit guarantee (PCG) for sovereign borrowings backed by a sovereign counter-guarantee and indemnity. Financial support will cover the credit risk of government borrowing from private lenders in lieu of a direct loan to the government. This type of guarantee would also be suitable for PCGs on sovereign bonds or other sovereign financing. In general, a PBG will be offered in parallel with a conventional PBL to facilitate the monitoring of the policy conditions. However, a PBG may also offer support entirely in the form of a sovereign guarantee. It will be provided with a sovereign counter-guarantee and indemnity, and the guarantee fee will be equivalent to the sovereign loan spread for regular OCR following ADB’s policy on credit enhancement operations (endnotes v and vi). Further, following the same policy, ADB may charge administrative and other fees that are specific to PBG processing and implementation, such as commitment fees and maturity premiums, consistent with industry practice. Such fees will be charged on a cost recovery principle while maintaining the competitiveness of ADB products (endnote vi).

11. ADB’s financial support will be subject to compliance with policy conditions agreed with the government. In formulating the policy conditions, ADB must take into account the link between the program and the macroeconomic conditions, and the direction of macroeconomic policies must be deemed satisfactory. ADB should closely coordinate with the International Monetary Fund (IMF), the World Bank, and other agencies (endnote v). The procedures for proposing a PBG by the operations departments should follow the updated guidelines for sovereign credit

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9 Endnote ii. Conventional PBL comprises all types of PBL, except crisis response PBL (CSF and SPBL).

10 Even after the completion of prior actions, policy dialogue between ADB and the DMC government should continue and be guided by the priorities established in a post-program partnership framework (PPPF). Implementation of the agreed PPPF should be monitored regularly during the extended loan availability period to ensure its quality and continuity. Following a DMC’s request for loan renewal, a progress report should be prepared by ADB and a revised PPPF should be agreed to cover the extended period of up to 3 years.
enhancement products (endnote v, Appendix 4).\textsuperscript{11} Commitment of PBGs will be subject to the PBL ceiling for regular OCR operations (endnote v and para. 51).

12. \textbf{Special policy-based lending.} SPBL is designed to address external and internal payments crises by providing large-scale support as part of an international rescue effort, led by the IMF and supported by other international financial institutions (IFIs), including the World Bank. SPBL should be provided as part of a wider financial burden sharing across IFIs in providing large-scale support to DMCs during a crisis.

13. A crisis is defined as a situation in which a DMC faces unanticipated difficulties meeting its external and internal payment obligations. In practice, the approval of an IMF rescue program is used to verify the existence of BOP difficulty, and SPBL is not expected to be used for domestic payment difficulties alone. To justify the use of SPBL, the crisis should have significant structural dimensions and be likely to have significant negative social impact.\textsuperscript{12} DMCs must be eligible for regular OCR to avail of SPBL assistance.\textsuperscript{13} Countries that have graduated from regular ADB assistance are also eligible for SPBLs (endnote iii).

14. Overloading reforms in a program could undermine support for actions that are essential for addressing a crisis. Measures that have broad and immediate impact or that signal the government’s commitment to reform should form the basis for the initial phase of crisis management assistance under SPBL.

15. \textbf{Countercyclical Support Facility.} The CSF provides budget support to DMCs undertaking fiscal stimulus for growth following an exogenous shock in the form of countercyclical development expenditures.\textsuperscript{14} CSF lending has similar features to SPBL, such as accessibility to regular OCR-eligible or graduate countries. However, because its purpose is to provide budget support for fiscal stimulus rather than BOP support to DMCs with payment difficulties and an international rescue package, the CSF requires a DMC to have a countercyclical development expenditure program and to commit to its implementation. The program should include social safety nets targeting the poor and vulnerable groups. Countries that have graduated from regular ADB assistance are eligible for CSF lending (endnotes vii and viii).

16. \textbf{Precautionary Financing Option.} Although CSF lending takes the form of a single-tranche operation, disbursement may be immediate or deferred under certain conditions, such as deteriorating market conditions, through exercising the precautionary financing option (PFO). The PFO may be exercised when it is highly likely that the impacts of the exogenous shock will reach the recipient country but have not fully materialized at the time of ADB’s financing commitment. The PFO enables a borrower to postpone drawing down the funds once the loan agreement has been declared effective until such time that the prescribed drawdown conditions have been satisfied (endnotes ii and viii). Primarily intended to be used with the CSF, the PFO may be applied

\textsuperscript{12} However, not all structural reforms that are eventually beneficial should be undertaken amid the crisis addressed by SPBL. Examples of negative social impact include increased poverty rate, increased unemployment rate, increased income inequality, and reduced access and affordability to basic services for the poor and vulnerable groups.
\textsuperscript{13} SPBL and CSF lending are not proposed for concessional assistance-only countries.
\textsuperscript{14} A loan from the CSF is aimed at making up for lost aggregate demand at the time of economic crisis and containing its adverse impacts on growth.
to all types of PBL if there is a strong development impact rationale (endnote ii). In all cases, conditions for drawing down under the PFO are articulated in the RRP of individual operations.

17. **Subnational policy-based lending.** Conventional PBL (including subprogram loans) at the state or provincial levels may be considered selectively in DMCs where sufficient policy autonomy exists at these levels of government, and where there are no legal or administrative impediments to such loans. This approach requires the ability of all levels of government to address all relevant sector issues and the full concurrence of the national government and the state or provincial government.

C. **Key Access Criteria**

18. **Conventional policy-based loans.** Stand-alone PBL and the programmatic approach, including CDF and PBG, should form part of the programming package in a country partnership strategy (CPS) or indicative rolling country operations business plan (COBP) for a DMC. Technical assistance (TA) may also be attached to all PBL products to diagnose major policy constraints, support implementation of reforms, and strengthen key sector institutions.\(^{15}\)

19. Stand-alone PBL and the programmatic approach, including CDF and PBG,\(^{16}\) should be based on a comprehensive sector or thematic analysis that identifies structural constraints to sector development and on policy dialogue with the government to determine the means to address these constraints (paras. 8–11 and endnote i). The program resulting from the diagnostics and policy dialogue must have the full commitment of the government, be consistent with ADB’s CPS for the DMC concerned, support the DMC’s development plans and priorities, and be closely coordinated with other major development agencies (endnote i).

20. **Crisis response policy-based loans.** SPBL and CSF lending are not expected to be planned in advance\(^{17}\) and do not form part of the programming package in the CPS and COBP for a DMC. An SPBL and a CSF loan can lead to subsequent planned stand-alone PBL and/or programmatic approach operations during the recovery phase following a crisis.

21. **Special policy-based loans.** Exceptional assistance under SPBL would typically be provided in a crisis situation in which a DMC is facing unanticipated difficulties meeting its external and internal payment obligations, and where a large international rescue package led by the IMF is being mounted in one or more DMCs to help restore stability. A further necessary dimension to justify the use of SPBL is when the crisis has significant structural dimensions and is likely to have significant negative social impact. Comprehensive diagnostics include a detailed assessment of the coverage, depth, and impact of the reforms undertaken as part of the IMF-led rescue program. The diagnostics (i) distinguish between the presence of structural weaknesses and immediate causes of the crisis, (ii) explain how proposed reform actions will contribute to recovery and build resilience to withstand future crises, and (iii) assess the time frame required to implement the

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\(^{16}\) Endnote v. When a PBG is considered, the possible impact of ADB’s PBG should be assessed carefully made through close interaction with market participants. To assess the advantage of a PBG over a PBL, information and analysis should be disclosed and discussed with the government.

\(^{17}\) Incremental resource mobilization for SPBL and CSF lending should be permitted exceptionally during a crisis and only to the extent that it does not hinder ADB’s risk-bearing capacity, which is assessed by the Treasury Department and the Office of Risk Management.
reform measures under the IMF rescue program. The time required to resolve the weaknesses contributing to the crisis determines how reforms are packaged and sequenced (endnote iii).

22. **Countercyclical Support Facility.** The CSF is an exceptional instrument reserved for addressing severe crises at the macroeconomic level.¹⁸ Macroeconomic policy dialogue and assessment are essential for CSF operations. To be eligible for CSF assistance, DMCs must meet the following criteria (endnote viii):

(i) **Adverse impact of exogenous shocks.**¹⁹ The DMC should have experienced or will likely experience a severe decline in growth.²⁰ While it is difficult to specify a strict threshold for this decline, experience from earlier crises may be referenced to determine eligibility for CSF operations. Although a severe decline in growth would be the main criterion for CSF lending, the following additional indicators tailored to specific country contexts could also be part of the justification: (a) the DMC may be facing or is likely to face substantial fiscal stress, such as actual or projected fiscal deficit and lower revenue collections; (b) for DMCs relying on international capital markets to finance public expenditures, a rise in the spread on government bonds could disrupt their access at favorable terms;²¹ and (c) for DMCs relying on exports and/or remittances, exogenous factors could cause a sharp decline in those inflows.

(ii) **Countercyclical development expenditures.** The government should have an effective countercyclical development expenditure program for CSF support and be committed to its implementation. The program should include social protection measures targeting the poor or vulnerable groups.

(iii) **Pre-shock record of generally sound macroeconomic management.** The government’s monetary policy should address price stability as one of its core objectives, and the country’s inflation should be under control. The overall institutional budgetary framework and public finances should be sound, as shown by recent fiscal balances in relation to the economy’s cyclical position, and all planned adjustment measures must be of high quality.

(iv) **Structural reforms.** Where structural weaknesses substantially increase vulnerability to exogenous shocks, there should be assurances that the country is taking credible steps to address the underlying structural issues. To enhance the effectiveness of such reforms, the country may engage with ADB to negotiate conventional PBL to address these weaknesses.

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¹⁸ In most cases, the use of the stand-alone PBL and the programmatic approach should be the default form of ADB budget support.

¹⁹ Because these broader exogenous shocks can disrupt growth, mitigating such adverse impacts is in line with ADB’s institutional mandate. If such shocks lead to a serious BOP crisis requiring the IMF’s intervention, ADB should mobilize SPBL under the IMF’s leadership. However, when such impacts are limited primarily to slower growth, the CSF would be the right instrument.

²⁰ In addition to data from relevant national authorities and ADB data and publications, such as the *Asian Development Outlook*, its update, and its supplement, macroeconomic analysis should be sourced from the IMF’s staff report on Article IV consultation and other IMF reports.

²¹ Alternatively, the credit default swap spread could be referenced.
(v) **Debt sustainability.** The borrower’s debt sustainability, including potential impacts of the prospective CSF assistance, should be confirmed. International reserves should be determined to be adequate, taking into account the imports coverage ratio and the short-term external debt financing requirement. The relevant indicators may be based on the debt sustainability analysis of the IMF and the World Bank or, when a joint analysis is not conducted, a similar assessment.

(vi) **Coordination with the International Monetary Fund.** If the IMF is not involved in crisis response, ADB should ensure that the country has had constructive consultations with the IMF, such as recently completed or ongoing Article IV consultations. ADB should secure an assessment letter from the IMF confirming the soundness of the government’s macroeconomic management and other policies before the Board considers the proposed assistance. ADB should work closely with its IMF counterparts to determine the appropriateness of the CSF and the related conventional PBL despite the absence of an IMF program.²²

23. Assessing the access criteria may involve a degree of judgment, and flexibility might be needed. The assessment should take into account the diversity in DMCs’ circumstances and the uncertainties underpinning economic projections (endnote viii).

**D. Procedures and Requirements**

24. **Identification.** Identifying stand-alone PBL and the programmatic approach, including CDF and PBG, is done in the context of ADB’s CPS for the DMC concerned to achieve medium-term objectives in one or across sectors. SPBL and CSF lending can be identified only when a crisis arises. The decision to initiate PBL preparation requires a comprehensive diagnostic of sector or thematic issues to identify binding legal, regulatory, or institutional constraints. Full government commitment to institute a reform program is required for PBL, as is the ability and political will to implement the needed reforms. The reform program must also merit ADB support because of its scope and strength, and the PBL must facilitate and accelerate the implementation of the reform program (endnotes iii, iv, and v; and footnote 7).

25. **Sector analysis.** Comprehensive sector, inter-sector, or thematic diagnostics are required for considering stand-alone PBL, programmatic approach (including CDF and PBG), and SPBL, where applicable.²³ A problem analysis diagram (problem tree) should be prepared as part of the summary sector assessment linked to the concept paper and the RRP. The analysis is expected to help DMCs identify the most binding constraints to development and streamline the conditions attached to PBL. The RRP should briefly explain how ADB contributed to the design and implementation of the government-owned reform package, including TA support (if applicable), and present a summary of the envisaged reform impacts. In addition to policy issues,

²² Consultation with the IMF and other IFIs is important for the CSF, beyond securing the IMF assessment letter, especially when the IMF is not involved in the crisis response. ADB should involve IMF staff through regular and active policy dialogue during the preparation of the CSF operation. ADB should routinely attend the Article IV consultations or other IMF missions. Similar engagement with other IFIs should also be adopted, as needed.

²³ This does not mean that ADB needs to conduct a formal sector study. If the necessary information is already available, for example through ongoing sector work by ADB or studies carried out by other institutions, then such information may serve as a foundation for PBL formulation.
the sector or inter-sector studies must address social and environmental issues, the relative
roles of the public and private sectors, and institutional development needs. TA may be processed
with the PBL to study unresolved policy issues or strengthen the capacity of key sector institutions.
For CSF operations, the assessment should cover the appropriateness of the countercyclical
development expenditures and present ADB’s value addition (endnotes i, ii, iii, iv, and viii; and
footnote 16).

26. The impact of the proposed sector reforms on the poor and other vulnerable groups must
be assessed by ADB. Where a reform program entails adverse short-term impacts on the poor or
other vulnerable groups, the PBL should seek to include mitigating or offsetting measures to the
extent feasible. When applicable, counterpart funds generated by the foreign currency disbursed
under the loan may be used for this purpose (endnote i).

27. **Macroeconomic link and aid coordination.** A PBL must take into account the link
between the program and the macroeconomic conditions in the DMC. The general direction of
the macroeconomic conditions and policies in the borrowing country must be deemed satisfactory
by ADB before a PBL can be considered. The effects of untied capital inflows on the money supply
and exchange rate must also be considered. ADB will systematically consult and closely
coordinate with the IMF, the World Bank, and, where applicable, other multilateral development
banks and major bilateral funding agencies in formulating and implementing PBLs. Aid
coordination must particularly address the interface of the ADB-supported program with
macroeconomic aspects, including the adequacy of the macroeconomic framework for successful
program implementation, and the potential impact of the PBL on macroeconomic variables. There
should also be simultaneous efforts to mobilize cofinancing (endnote i).25

28. **Development policy letter and policy actions.** Policy reforms that improve growth and
development prospects are the basis for PBL to a DMC. The policy reform26 along with the
development expenditure program is set by the DMC government concerned in a policy statement
letter to the ADB President. The program outlined in the development policy letter is the focus of
ADB’s support (endnotes i and ii).27

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links between disaster resilience, environmental management, and social vulnerability, particularly close attention
should be given to the potential impact of the program on the poor and other vulnerable groups, including women
and girls. Where possible, prior actions that help reduce the impact of natural hazards on vulnerable groups should
be emphasized in the policy matrix (in the PDMF) and program description.

25 Macroeconomic and debt sustainability are key access criteria for CDF. The soundness of the macroeconomic policy,
including an updated IMF assessment letter, should be reconfirmed every 3 years during loan renewal. The
borrower’s debt sustainability, including potential impacts of the prospective CDF assistance, should also be
confirmed. Relevant indicators may be based on the debt sustainability analysis of the IMF and the World Bank, or
a similar assessment where such joint analysis is not conducted.

26 The term “policy reform” covers (i) structural reform required under stand-alone PBL and the programmatic approach,
including CDF as well as PBG and SPBL; and (ii) fiscal policy under the CSF.

27 All types of conventional PBL and PBGs will use a policy matrix (in the PDMF), which presents actions that are crucial
for policy reforms and addresses constraints identified in the program’s problem analysis diagram (problem tree). It
also presents conditions that need to be satisfied and actions that need to be taken before the release of each tranche
in a single-tranche or multitranche stand-alone PBL, subprograms for a programmatic approach, or the single tranche
or multitranche PBL component of a PBG; or when there is no PBL component to a PBG, the signing of the PCG.
Given their crisis response nature, CSF and SPBL operations may flexibly adopt a stand-alone design and monitoring
framework in lieu of a PDMF to be prepared in close coordination with SPD.
29. Considerable importance in PBL is attached to the proper timing and sequencing of reforms. The policy matrix must be formulated to optimize the sequencing of reform steps and minimize the short-term costs of adjustment. The policy matrix should be used as a flexible implementation guide for assessing whether the intended objectives were substantively achieved, and conditions should be streamlined (endnote ii). Staff should adopt a flexible approach to the conditions in PBLs and apply the following good practice principles in their design and implementation: (i) conditions should reinforce country ownership, (ii) the conditions should be agreed with the government and other financial development partners and linked closely to national development strategies, (iii) only actions critical for achieving program outputs and outcomes should be selected as disbursement conditions, and (iv) transparent progress reviews that contribute to predictable and performance-based financial support should be conducted regularly (footnote 7).

30. Specific to CDF operations, the policy matrix, should include a post-program partnership framework (PPPF), which presents medium-term reform objectives that will be supported by ADB. The PPPF will be used to monitor program performance during the CDF availability period and justify loan renewal. ADB should clearly demonstrate its value addition in supporting the reforms (endnote iv).

31. In principle, CSF operations should focus on short-term fiscal responses at the macroeconomic level; and the policy matrix is not required to include conditions for structural reform at the microeconomic level (endnotes ii and vii). However, where structural weaknesses substantially increase the vulnerability to an external shock, CSF operations might be accompanied by, and integrated with, complementary conventional PBL operations addressing the underlying structural issues connected with the crisis (endnote viii).

32. Considering the dislocations often caused by drastic policy changes and the sometimes adverse, short-term impact of reform on specific groups, ADB can, where justified, support an incremental pace of reform. This may be done through a succession of PBLs in a sector or through the adoption of a longer time frame together with multiple tranches (endnote i).

33. **Fiduciary requirements.** Since general budget support under stand-alone PBL and the programmatic approach are absorbed into a DMC’s public expenditures in the form of counterpart funds of loan proceeds, fiduciary arrangements need to be in place to ensure the efficient use of overall resources through sound public financial management (PFM). Hence, up-to-date diagnostic work should support the knowledge of the PFM environment in the country. Risk assessments, as mandated by the Second Governance and Anticorruption Action Plan, will be

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28 The CSF does not require structural reform conditions. Only where structural weaknesses substantially increased vulnerability to exogenous shocks, there needs to be assurances that the country is taking credible steps toward addressing them in the near future, if not earlier. For instance, DMCs suffering from a collapse of international commodity prices may wish to advance reforms to diversify their economies to reduce dependence on commodity exports, provided that such measures also enhance economic efficiency and welfare. However, these do not need to take the form of negotiating stand-alone PBL or a PBL under a programmatic approach with ADB. The DMC concerned may request such conventional PBL from ADB only if it wishes to do so at its discretion, either in parallel or subsequent to the CSF operation.

29 In such cases of structural weaknesses, during loan negotiations, the requesting country must commit to a robust structural reform program to be defined within a short time frame. The RRP seeking Board approval of CSF support should include the mechanism for monitoring and reporting of such a reform program.

carried out at the country, priority sector, and program levels to evaluate PFM, procurement, and corruption risks. The country-level assessments can serve as important evaluations of country systems, and the CPS needs to describe the extent of fiduciary risks to budget support.\(^{31}\) When the available analysis identifies weaknesses in the borrower’s budget management system, ADB should identify the additional steps needed to secure sound fiduciary arrangements for PBL. The risks and actions taken to address the weaknesses should be identified in the risk assessment and risk management plan and may, to the extent feasible, be integrated in the policy matrix as prior actions (endnote ii).

34. Under all PBLs, an audit of the use of loan proceeds will be undertaken only upon ADB’s request, provided that ADB retains the right to audit any accounts (endnote ix).

35. **Environmental and social safeguards.** ADB’s Safeguard Policy Statement (2009) applies to PBL (referred to as program lending in the policy). The borrower will evaluate potential direct or indirect environmental or involuntary resettlement impacts or impacts on indigenous peoples associated with policy actions to be supported by a PBL, identify appropriate mitigation measures to address these impacts, and integrate the mitigation measures into the program’s design. A matrix of potential impacts of each policy action, together with appropriate mitigation measures, will be prepared, with a qualitative indication of the likely order of magnitude of each impact and brief reasons for the proposed safeguard categorization. A strategic environmental assessment may be applied where appropriate (endnotes ii and x).

36. **Concept clearance.** ADB prepares a concept paper for the PBL. To enhance Board oversight early in loan processing,\(^{32}\) the Management-cleared concept paper\(^{33}\) should be circulated to the Board as a formal information paper for comments within 10 working days (endnote ii).

37. **Approval of policy-based loan.** PBL proposals follow the procedures for sovereign operations and are submitted to the Board for approval. The Board will consider PBL proposals that meet the following criteria on a no-objection basis: (i) the loan amount does not exceed $50 million; and (ii) the operation does not (a) require any major exception to an ADB policy, as determined by Management; (b) have the potential for significant adverse environmental, economic, and/or social impacts, particularly on vulnerable groups that may be unable to absorb

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\(^{31}\) The public expenditure and financial accountability assessment could be a good point of reference where available. The public expenditure and financial accountability program was founded in December 2001 as a multi-donor partnership to strengthen recipient and donor ability to (i) assess the condition of country public expenditure, procurement, and financial accountability systems; and (ii) develop a practical sequence of reform and capacity building actions.

\(^{32}\) The Board circulation requirement does not apply to PBLs for which a concept paper is not prepared (i.e., CSF and SPBL). Early information will be provided to the Board when a DMC has requested CSF lending. An informal Board seminar should be conducted as soon as Management receives sufficient information. The rationale for mobilizing the CSF, especially the existence of economic stress, should be clearly presented in the informal Board seminar. This also applies to SPBL.

\(^{33}\) For low-risk loan proposals, the director general approves the project concept paper and submits it to the concerned vice-president of operations for information. The concerned vice-president of operations approves complex loan proposals.
such impacts;\textsuperscript{34} (c) involve the use of a novel financing arrangement;\textsuperscript{35} and (d) involve significant financial assistance relative to the size of the DMC concerned, as determined by Management.\textsuperscript{36}

38. **Capacity development and institution building.** TA attached to a PBL must be carefully targeted to meet key capacity building needs in the sector and/or address major policy issues that have a bearing on strategy decisions. The number and design of attached TA projects must be geared to the absorptive capacity of the executing and implementing agencies involved. Close ADB supervision of TA execution and the incorporation of TA findings in ongoing policy dialogue are essential for administering PBL (endnote i and footnote 7).

39. **Counterpart funds.** Counterpart funds will be used for general budget purposes, and a fiduciary arrangement needs to be in place to ensure effective use of overall resources through sound PFM (endnote ii).

40. **Procurement and disbursement.** The approach to procurement and disbursement under PBL is different from that under project loans. There is considerable flexibility in using PBL proceeds to meet a DMC's development needs. Following declaration of loan effectiveness, loan proceeds will be disbursed against economy-wide import requirements on the basis of a negative import list or, where necessary and appropriate, sector-specific import requirements on the basis of a positive import list, upon receiving a disbursement request from the DMC concerned (endnote ix). For CDF operations, disbursement is available only if the prespecified condition(s) linked to a disaster caused by natural hazards—typically the DMC’s declaration of a state of emergency or its equivalent—has been met. Additional disbursement conditions are mutually agreed at the time of negotiation and reflected in legal agreements.\textsuperscript{37} Up to the full allocated amount is available for disbursement at any time within 3 years of signing the legal agreement(s) (endnote iv). The RRP should also specify the likely loan disbursement date (endnote viii).

41. For multitranche stand-alone PBL, following PBL approval and disbursement of the first tranche, to accelerate disbursement for second (or subsequent) tranches in cases where policy actions have been completed, the following are undertaken: (i) authorize the President to delegate authority for tranche release to the relevant vice-president, and (ii) disburse the tranche and submit a progress report immediately after tranche release\textsuperscript{38} unless the Board requires a 10-day waiting period at the time of PBL approval (endnote xi).\textsuperscript{39}

\textsuperscript{34} Management may apply a liberal interpretation of these criteria in determining whether to submit a loan proposal to the Board for discussion.

\textsuperscript{35} A novel financing arrangement means (i) an innovative approach in resource mobilization or (ii) an innovative financing modality for which a policy paper has not yet been prepared. A PBG operation is not automatically considered a novel financing arrangement.


\textsuperscript{37} As the scope and procedures for declarations of emergency vary from country to country, the disbursement condition(s) would be defined on a case-by-case basis, taking into consideration the borrower's legal and policy framework for national hazard risk management. The program team, in consultation with the Office of the General Counsel, needs to carefully study the borrower's legal and regulatory framework for emergencies before formulating the disbursement condition(s).

\textsuperscript{38} This superseded para. 8(i) of ADB. 1992. *Procedure for Release of Second or Subsequent Tranches under Program.* Manila (R127-92).

\textsuperscript{39} Management is authorized to release the tranche upon completion of the agreed policy actions. A progress report is submitted to the Board for information thereafter. If the Board believes at the time of approval that the PBL merits
42. Where the foreign exchange provided by ADB is used for procurement by public sector entities rather than private, commercial importers, ADB must review the standard public sector procurement procedures used in the DMC as part of its due diligence and risk assessment. Where exchange controls are in effect, ADB will review the general foreign exchange allocation mechanism in the DMC with regard to its efficiency and transparency; where these cannot be guaranteed, remedial steps should be adopted as an integral part of program design. ADB must always ensure that the standard exclusion negative list applies in economy-wide imports (endnote i).

43. To improve the efficiency of PBL operations, the Board grants a blanket waiver of member country procurement eligibility restrictions for PBLs for which a negative list of ineligible items is applied (endnote xi).40

E. Monitoring and Reporting

44. ADB uses a two-tier approach to evaluate individual operations. For public sector operations, the first tier involves self-evaluation through the preparation of completion reports. The second tier involves independent evaluation by the Independent Evaluation Department.41

F. Terms and Conditions

45. Loan amount. A clear basis for determining the loan amount based on the overall and sector-specific requirements of the DMC should be presented (endnote ii). The overall loan size should be determined based on the development financing needs of a country (endnote ii) with reference to specific elements of the development expenditure programs supported by the budget support.43 Where relevant, support provided by other development partners should be explained.44 Costs of adjustment directly related to the implementation of reforms may be additional Board scrutiny before the release of the second (or subsequent) tranche, then Management will circulate the progress report to the Board and wait for 10 days before releasing that tranche. If any of the policy actions have not been complied with, the Board would continue to approve any waiver of the policy action on a no-objection basis.40 This eliminates the need for DMCs to submit a certification confirming the borrower's compliance with the formula (endnote xi, para. 29; and endnote ix, para. 11.a(i)). In addition to saving time for ADB and borrowers, the blanket waiver would recognize that PBL proceeds are fungible, and therefore linking such disbursements to imports provides few benefits.41


42 The loan amount should be determined individually to accommodate country-specific circumstances, including overall projected budgetary (or BOP-related) financing requirements, the availability of alternative financing, and debt sustainability at the macroeconomic level. As appropriate, development financing needs in the key macroeconomic indicators, such as budget or current account deficit, should be referenced. For CDF operations, the discussion on overall development financing needs may also include an explanation of the past fiscal costs of major natural hazards and any forecasts of expected future fiscal or economic costs as a result of climate change or other factors.

43 This may include external financing requirements needed to generate counterpart funds for economy-wide or sector-specific development expenditure programs.

44 Each PBL’s RRP should take into account country-specific circumstances, particularly the budget mechanism and accounting environment. Where relevant, the costs of adjustment directly related to the implementation of the envisaged reforms can still be included in a development expenditure program supported by the budget support, but it is not regarded as a prime determinant of loan size.
referred but may not be used as the basis for determining loan amounts.\(^{45}\) Due consideration should be given to the DMC’s borrowing capacity and debt sustainability.

46. For CDF operations, DMCs can mobilize an amount equal to 0.5% of their gross domestic product, up to a maximum of $500 million if financed by regular OCR or $250 million if financed by concessional OCR or the ADF. Small DMCs whose 0.5% of gross domestic product is less than $20 million may avail of up to $20 million, subject to available resources. CDF allocations are counted against each DMC’s regular resource allocation (endnote iv). Under the CSF, total lending to each country is capped at $500 million per exogenous shock or crisis episode (endnote viii). For SPBL, the justification for ADB’s loan amount should demonstrate an acceptable level of financial burden sharing across the IFIs relevant to the total rescue package being provided. The burden-sharing arrangements among the IFIs should be satisfactory to ADB (endnote iii).\(^{46}\)

47. **Loan terms.** Standalone PBLs and loans under the programmatic approach from regular OCR have a 15-year term, including a 3-year grace period. ADB’s London interbank offered rate (LIBOR)-based loan lending terms\(^{47}\) apply. Standalone PBLs and loans under the programmatic approach financed by ADB’s concessional resources follow the applicable PBL terms.\(^{48}\)

48. For CDF, standard PBL lending terms and conditions will apply.\(^{49}\) For the ADF-financed CDF operations, ADB will fully commit the CDF amount and make it available for disbursement immediately after a disaster occurs. For regular and concessional OCR-financed operations, DMCs may avail of one of two resource commitment and pricing options: committed capital (option 1) and unallocated capital (option 2).\(^{50}\) The selected option will initially be agreed during fact-finding and be incorporated into the legal agreements. The selected option will be fixed during the life of the loan, including any renewal periods. The initial availability period of CDF financed by regular OCR, concessional OCR, and ADF is 3 years. Regular OCR-financed CDF can be renewed up to four times for a maximum of 15 years, while concessional OCR- and ADF-financed CDF can be renewed once for a maximum of 6 years. Each renewal is for a period of up to 3 years. Upon renewal of CDF operations, ADB may approve a closing extension request at the

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\(^{45}\) The countercyclical expenditure program supported by the CSF is primarily aimed at stimulating the aggregate demand to restore growth. ADB support through the CSF is expected to ensure that pro-poor fiscal measures are preserved—and possibly expanded—despite the crisis. The development expenditure program supported by other forms of budget support (stand-alone, programmatic approach, CDF, and PBG) has broader objectives of contributing to the acceleration of the economic development.

\(^{46}\) SPD will confirm resource availability for SPBL and CSF operations in consultation with the Treasury Department. The Office of Risk Management will be consulted to assess ADB’s risk-bearing capacity.


\(^{49}\) The pricing of conventional PBL, which may be updated from time to time, should be applicable to CDF. Conventional PBL from regular OCR has a 15-year term, including a 3-year grace period; ADB’s LIBOR-based lending terms; and a commitment charge of 15 basis points per year. PBL financed by concessional OCR for group A countries has a fixed 24-year term (including a grace period of 8 years), a 1.0% interest charge during the grace period, and a 1.5% interest charge during the amortization period. PBL financed by concessional OCR for group B countries has a fixed 25-year term (including a grace period of 5 years) and a 2.0% interest charge throughout loan maturity. There is no commitment charge for CDF loans, but a front-end fee is required for each of the two resource commitment and pricing options (footnote 50).

\(^{50}\) The two options and their applicable terms and fees are outlined in ADB. 2019. *Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards*. Manila (para. 28 and Appendix 6).
end of the 3-year period. Approval of the CDF extension is based on the submission of a progress report that (i) reconfirms the adequacy of the macroeconomic environment, including an updated IMF assessment letter; (ii) demonstrates continued progress toward the PPPF; (iii) updates the PPPF with mutually agreed objectives for the subsequent CDF availability period; and (iv) attaches a CDF extension request from the DMC government (endnote iv).

49. For PBG, the guarantee fee will be equivalent to the standard interest spread for PBL under regular OCR. A guarantee fee may be adjusted if the guarantee takes a certain structure that has significant implications on effective risk exposure for ADB (e.g., first loss cover). Specific conditions are applicable for PBGs as follows (endnote v):

(i) **Policy-based guarantee incentives.** ADB will more flexibly allocate regular OCR for sovereign guarantee operations on top of the regular country allocation. The additional allocation will create an incentive to develop projects and help country programming. Because ADB needs to capture business opportunities as they emerge, it is difficult to fully incorporate guarantee projects and assign resources through the regular country programming cycle. In cases where PBG is not included in the CPS or COBP, or an additional allocation is requested, ADB will consider additional allocations for groups B and C countries and also for group A countries, subject to the condition that the program is not expected to undermine the debt sustainability of the country as described in para. 49(ii). The allocation of concessional OCR will not be affected by the additional allocation of regular OCR and will continue to follow the performance-based allocation.

(ii) **Use of policy-based guarantee in group A countries.** Using regular OCR to provide a PBG in group A countries for sovereign guarantee operations is allowed on the condition that the project is not expected to undermine the country’s debt sustainability. The country should not be classified as being in high risk of debt distress following the Concessional Assistance Policy, and the proposed program should not be expected to change the country’s debt distress classification. The debt distress risk classification is based on debt sustainability analyses using the IMF–World Bank debt sustainability framework for low-income countries. Because group A countries do not have regular OCR allocation, the required resource will be allocated on a case-by-case basis by assessing the development impact of the proposed project (e.g., catalyzing private financing in challenging markets), as well as the potential impact on ADB’s capital requirement.

50. For SPBL and CSF, the pricing and terms of lending comprise interest rates set at a minimum spread of 200 basis points over LIBOR or an applicable funding source, a rebate or surcharge reflecting the cost of funds, a loan term of 5–8 years (including a grace period of up to 3 years), and a commitment charge at 75 basis points per year on the undisbursed loan balance. The terms of SPBL and CSF lending should be determined by the crisis situation (including its

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51 On repayment terms, standard PBL terms and conditions for regular OCR, concessional OCR, and the ADF apply, unless stated otherwise. Repayment schedules will be calculated on a disbursement-linked basis for regular and concessional OCR-financed CDF.

52 ADB. 2016. *Concessional Assistance Policy*. Manila. Countries with high risk of debt distress have access only to ADF grants.
severity and market conditions), country-specific considerations (including the borrower’s debt repayment capacity), and ADB’s risk-bearing capacity (endnote ii). Given that the provision of SPBLs could impose a strain on ADB’s risk-bearing capacity and that such assistance is meant for crisis support, prepayment, if permitted by a DMC’s circumstances, is encouraged through a waiver of the prepayment penalty. Prepayment of an SPBL on a pro rata basis would be triggered if a DMC prepaid a concurrent World Bank equivalent of an SPBL (endnote iii).

51. **Ceilings.** There are no individual country ceilings for PBL. Total annual stand-alone PBLs, loans under the programmatic approach, the policy-based component of sector development programs, and PBGs are not to exceed 20.0% of total public sector lending on a 3-year moving average basis under normal circumstances. Similar lending from ADB’s concessional resources is subject to a ceiling of 22.5% of total concessional lending (endnotes ii and iii). CDF operations financed by concessional OCR or the ADF will remain within the 22.5% ADB-wide cap. Regular OCR-financed CDF operations will fall outside the PBL cap of 20.0%. An ADB-wide ceiling of $3 billion in regular OCR-financed CDF and $1 billion in concessional OCR- or ADF-financed CDF will initially be applied, subject to review 3 years after Board approval of the policy (endnote iv). Loans under SPBL and the CSF will not be counted toward the regular PBL ceiling but should be managed within ADB’s risk-bearing capacity (endnotes ii, iii, and viii). The ceilings are applied on a commitment basis (endnote xii).

G. **Disclosure**

52. ADB’s Access to Information Policy should be complied with in the public disclosure of documents (endnote xiii).

**Basis**


iv. ADB. 2019. *Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards.* Manila.


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53 As a preliminary benchmark, a spread of 200 basis points above LIBOR should be regarded as an initial default pricing basis for loans up to $500 million with the 5-year maturity (including the 3-year grace period), while case-by-case adjustments in the spread and maturity may be made within the permissible range prescribed herein. Repayment terms of equal installments or the annuity method with the general practice of a 10% discount rate are applicable. A complete analysis of the impact on ADB’s relevant financial indicators and discussion on the measures to ensure consistency with ADB’s financial policy should be undertaken.


**Other background information and references**


This *Operations Manual* section is to be read with ADB. 2020. *Staff Instruction on Business Processes for Policy-Based Lending*. Manila.