

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 Office of the General Counsel (OGC) and issued by the Strategy, Policy, and Partnerships Department with the approval of the President and is subject to compliance review. Questions may be directed to the OGC.

LOAN COVENANTS

A. Introduction

1. The *Agreement Establishing the Asian Development Bank* (the Charter) provides that ADB shall take necessary measures to ensure that proceeds of any loan made, guaranteed, or participated in by ADB are used only for the purposes for which the loan was granted and with due attention to considerations of economy and efficiency (Article 14 [xi]). Thus, ADB's legal agreements¹ and loan² regulations set out loan covenants that are considered necessary to ensure smooth and efficient implementation of, and full realization of benefits from, ADB-financed projects.³

B. Compliance with the Loan Covenants

2. Loan covenants are primarily obligations to be performed by the borrower.⁴ At the same time, ADB has a duty to monitor and follow up on compliance by the borrower with the obligations under the loan covenants. ADB's general approach with noncompliance with loan covenants is to seek corrective measures to attain the original development objectives of the ADB-financed project and achieve compliance with ADB requirements. ADB's legal remedies on noncompliance with loan covenants include loan suspension, cancellation, or acceleration of maturity, which are available under the loan agreement and the loan regulations made applicable thereto. However, resorting to legal remedies in the event of noncompliance is not automatic or mandatory (endnotes ii, iii, iv, v, and vi). Before utilizing such measures, ADB uses available means to help the borrower rectify the situation in a manner that is satisfactory to all parties to the legal agreement and meet ADB requirements.⁵

¹ In this *Operations Manual* (OM) section, the term "legal agreements" refers to all or any of the project-related legal agreements, including the loan agreement, grant agreement, guarantee agreement, and project agreement.

² In this OM section, the term "loan" includes grants (other than technical assistance grants), unless the context requires otherwise. This OM section also applies to loans and grants from a trust fund and other external sources that are administered by ADB, unless agreed otherwise between ADB and the applicable cofinanciers.

³ In this OM section, the term "project" includes projects or programs under the OM section on Sector Lending (OM D3), OM section on Policy-Based Lending (OM D4), OM section on Sector Development Programs (OM D5), OM section on Financial Intermediation Lending (OM D6), OM section on Disaster and Emergency Assistance (OM D7), OM section on Sovereign and Sovereign-Guaranteed Financing (OM D11), OM section on Multitranchise Financing Facility (OM D14), OM section on Additional Financing (OM H5), OM section on Results-Based Lending for Programs (OM D18), OM section on Project Readiness Financing (OM D16), OM section on Small Expenditure Financing Facility (OM D17), OM section on Emergency Assistance Loan (OM D19), and other modalities financed by a sovereign loan, except where indicated otherwise.

⁴ In this OM section, the term "borrower" also refers to guarantors, recipients of grants, executing agencies, and/or implementing agencies, unless the context requires otherwise.

⁵ In the case of an externally financed loan or grant, requirements of the applicable cofinancier should be confirmed.

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C. Formulation of Covenants

3. ADB's legal agreements and loan regulations include loan covenants that specify actions important for smooth and efficient project implementation and for the realization of the expected objectives and benefits of the project. These covenants may be broadly divided into two categories: general and project-specific covenants.

4. General covenants are standard assurances and undertakings that ADB obtains from all borrowers in respect of ADB-financed projects. They include obligations to repay the loan and assurances that specific ADB policies are adhered to, such as ADB policies on anticorruption and procurement. Project-specific covenants are those assurances and undertakings that ADB considers necessary or desirable to obtain from the borrower for a specific project, taking into account particular features of the project. Such covenants may cover matters such as environmental and social safeguards, procurement, gender and development,⁶ sector performance, financial measures, and mitigation of project-specific risks.⁷

5. Both general and project-specific covenants provide a basis for ADB to monitor project implementation and performance. Accordingly, such covenants should be realistic, monitorable, and measurable. Moreover, loan covenants should be compatible with the socioeconomic conditions of developing member countries, and local laws, regulations, and administrative procedures, except where ADB and the borrower agree to appropriate changes to the existing local laws, regulations, or administrative procedures. Covenants must also satisfy ADB's sectoral and/or subsectoral and other policy requirements. Project teams should work closely with staff from relevant departments in formulating loan covenants, in consultation with the Office of the General Counsel.⁸

Bases

- i. ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.
- ii. ADB. 2021. *Revised Ordinary Operations Loan Regulations*. Manila (R75-21).
- iii. ADB. 2022. *Ordinary Operations Loan Regulations*. Manila.
- iv. ADB. 2022. *Ordinary Operations (Concessional) Loan Regulations*. Manila.
- v. ADB. 2022. *Special Operations Grant Regulations*. Manila.
- vi. ADB. 2022. *Externally Financed Grant Regulations*. Manila.
- vii. ADB. 1987. *Study of Compliance with Special Loan Covenants*. Manila (IN.300-87).

⁶ Standard covenants for matters such as safeguards, procurement, and gender and development, among others, are maintained by the Office of the General Counsel and are included in the legal agreements, as appropriate, depending on the particular features of the individual project (e.g., safeguards and gender categorization). These covenants may be tailored, or supplemented by additional covenants, depending on the project-specific requirements.

⁷ Cofinanciers may also require certain covenants to be included in the applicable legal agreements.

⁸ The operational procedures for this OM section are contained in the project administration instructions (PAI 5.01–5.09) and internal procedures and reports (PAI 6.01–6.08), as well as the documents cited therein.