Establishment of the Financial Sector Development Partnership Special Fund
ABBREVIATIONS

ADB – Asian Development Bank
DMC – developing member country
FSD – finance sector development
FSD COP – Financial Sector Development Community of Practice
FSDPSF – Financial Sector Development Partnership Special Fund
FSOP – Financial Sector Operational Plan
OCO – Office of Cofinancing Operations
OREI – Office of Regional Economic Integration
OCR – ordinary capital resources
TA – technical assistance

NOTE

In this report, "$" refers to United States dollars.

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I. INTRODUCTION

1. This report recommends that the Asian Development Bank (ADB) (i) establish the Financial Sector Development Partnership Special Fund (FSDPSF); (ii) accept and administer a contribution of Luxembourg from the Financial Sector Development Partnership Fund to the FSDPSF substantially in accordance with the terms and conditions set forth in this paper including Appendix 1; and (iii) accept and administer contributions to the FSDPSF by bilateral, multilateral, and other sources substantially in accordance with the terms and conditions set out in this paper including Appendix 2.

II. BACKGROUND AND RATIONALE

2. On 13 July 2006, the ADB Board of Directors approved the establishment of the multidonor Financial Sector Development Partnership Fund,1 with an initial contribution of $1.5 million from the Government of Luxembourg, which has now contributed a total of $7.8 million.2

3. Strategy 2020 identifies finance sector development (FSD) as one of the five core areas of ADB operations. To guide ADB operations on FSD, ADB established the Financial Sector Development Community of Practice (FSD COP) in 2009 and issued the Financial Sector Operational Plan (FSOP) in 2011.3 Demand for the Financial Sector Development Partnership Fund gradually accelerated to fund technical assistance in the finance sector. With enhanced access to various financial resources, DMCs are demanding in increasing knowledge support. To respond to this, the existing Financial Sector Development Partnership Fund needs to be expanded.

4. Yet, interested donors awaited ADB’s contribution to the Financial Sector Development Partnership Fund as a sign of ADB commitment to supporting this priority area. A contribution of ADB’s own funds to the initiative requires the establishment of a Special Fund, the proposed FSDPSF. A contribution from ADB is expected to work as catalytic financing to encourage more contributors to participate in the FSDPSF to ensure that this area of ADB’s strategic priorities is adequately financed and supported.

5. Since its inception, the Financial Sector Development Partnership Fund has financed eight technical assistance (TA) projects supporting the strengthening of financial infrastructure, preparation of financial laws, capacity building of financial institutions and treasury functions, and enhancement of financial inclusion. They also supported the development of capital markets and instruments; and strengthened financial regulation, supervision, and stability. Success stories include a 2007 TA project for the Government of Cambodia to support implementation of a comprehensive finance sector program to build foundations for FSD. Specifically, it was instrumental in establishing payment systems, enacting laws and regulations, and strengthening key institutions to encourage growth in financial outreach through banking, microfinance, and insurance industries. Against this background, the program operations are continuing in multiple phases and are expected to request further assistance to be funded by the FSDPSF. Since the issuance of the FSOP, eight new funding applications were submitted

\[2\] Of the total contribution from the Government of Luxembourg of $7.8 million, the fund has used about $3.44 million. The balance is expected to be used for four approved applications and new proposals.
during the first half of 2012, and more applications are expected. The new demand reflects an increasing emphasis on financial inclusion followed by capital markets for infrastructure financing in line with the FSOP.

III. OBJECTIVE AND SCOPE

6. The objective and scope of the FSDPSF will broadly remain the same as that of the Financial Sector Development Partnership Fund. Eligible activities will be closely aligned with the five themes and subsectors under the FSOP, including (i) building the foundation for FSD (policy, legal, regulatory, and supervisory frameworks; financial infrastructure; public debt market; and central bank capacity building); (ii) improving access to financial services for the traditionally excluded (households and small and medium-sized enterprises); (iii) developing capital markets (particularly to support infrastructure financing); (iv) improving financial system stability (prudential regulation, supervision, corporate governance, and international standards and codes); and (v) facilitating the integration of regional financial markets. Activities to improve the general investment climate, such as (i) improving the general legal and regulatory framework, (ii) strengthening governance, and (iii) enhancing administrative capacity, are also eligible as in the original objective and scope of the Financial Sector Development Partnership Fund.

IV. IMPLEMENTATION ARRANGEMENTS

7. A Steering Committee will provide strategic direction for the FSDPSF. ADB’s Office of Regional Economic Integration (OREI) will administer the FSDPSF in consultation with the Review Group of the FSD COP and ADB’s Office of Cofinancing Operations (OCO). OREI will also be the focal point for technical matters related to the FSDPSF. The Review Group will review and make policy and procedural recommendations on project proposals for FSDPSF support. OCO will facilitate contributions to the FSDPSF and act as the official channel of communication for financial aspects between external contributors, ADB, and the FSDPSF. OCO will also lead negotiations and discussions with such contributors on procedural agreements for contributions to the FSDPSF.

8. FSDPSF resources will be used to support projects in ADB’s DMCs and be utilized through relevant ADB departments. Selection of project proposals under the FSDPSF should be consistent with the FSOP objectives and country partnership strategies of the relevant DMCs. The FSDPSF will provide assistance in the form of untied grants for components of investment projects; and TA projects. The FSDPSF can be used in combination with other ADB resources as well as on a stand-alone basis to finance projects or TA. FSDPSF contributors and ADB may agree on specific eligibility criteria for the FSDPSF.

9. Activities to be supported by the FSDPSF will be identified, designed, processed, approved, and implemented in accordance with all applicable ADB policies, procedures, and guidelines, including social and environmental safeguards, financial management and reporting, and anticorruption and governance. FSDPSF grants for investment projects will be governed by the provisions of respective grant agreements which will incorporate by reference the Special

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4 Chair of FSD COP will be chairing the Steering Committee, and the list of members and the terms of reference will be described in the Implementation Guidelines.
5 Under Strategy 2020, ADB intends to strengthen its support for national and regional FSD by helping develop financial infrastructure, institutions, products, and services. FSD also has important links with, or is an integral part of, other strategic agendas under Strategy 2020.
Operations Grant Regulations applicable to grants made by ADB from its Special Funds resources. FSDPSF-financed TA will be governed by ADB’s policies on TA. OREI will develop implementation guidelines in consultation with the FSD COP and other relevant offices.

10. FSDPSF-financed consulting services will follow ADB’s Guidelines on the Use of Consultants (2010, as amended from time to time) and procurement will follow ADB’s Procurement Guidelines (2010, as amended from time to time). Disbursements under TA projects will be made in accordance with ADB’s Technical Assistance Disbursement Handbook (2010, as amended from time to time) and grant projects with ADB’s Loan Disbursement Handbook (2012, as amended from time to time).

11. The contributors and ADB will jointly steer the FSDPSF implementation. They will meet annually to provide strategic guidance, review progress, assess performance, review administrative matters, and endorse the annual work programs. Detailed implementation guidelines to outline the governance structure and implementation arrangements will be developed in close coordination with donors.

V. CONTRIBUTIONS

A. ADB Contribution

12. To demonstrate the importance that ADB accredits to FSD and to help secure commitments from interested donors, ADB Management has already informed the Board of Directors that it will likely recommend that $2.7 million of the ordinary capital resources (OCR) 2012 net income be allocated to the FSDPSF when the allocation of net income will be submitted to the Board of Directors and subsequently to the Board of Governors during the second quarter of 2013.

B. Luxembourg Contribution

13. Luxembourg will make a contribution to FSDPSF by using a portion of its funds in the Financial Sector Development Partnership Fund administered by ADB. For this purpose Luxembourg and ADB will enter into a supplementary agreement to the channel financing agreement establishing the Financial Sector Development Partnership Fund between Luxembourg and ADB dated 30 August 2006 substantially in the form set out in Appendix 1. The amount of Luxembourg’s contribution will be determined as the amount of the Financial Sector Development Partnership Fund which has not been committed and is not required to meet liabilities of the Financial Sector Development Partnership Fund (including liabilities to ADB in respect of administrative expenses). After Luxembourg’s contribution has been transferred from the Financial Sector Development Partnership Fund to the FSDPSF, ADB will have no obligations as administrator of the Financial Sector Development Partnership Fund in relation to such contribution.


C. Other Contributions

14. In addition to contributions from ADB and Luxembourg referred to above, ADB will accept, on an untied grant basis, contributions to the FSDPSF from bilateral, multilateral, and other sources, including companies and foundations. To ensure cost-effective processing and reporting, the minimum contribution will be $5 million for bilateral and multilateral partners, and $1 million for other sources, including companies and foundations.

15. Contributors can make a commitment to the FSDPSF by depositing an “instrument of contribution” substantially in the form set out in Appendix 2, whereby each financing partner agrees to contribute amounts to the FSDPSF substantially in accordance with the terms and conditions in this paper. Commitments by contributors will not be subject to any conditions other than those provided in this paper. By depositing an instrument of contribution, the financing partner will be deemed to have accepted the objectives, terms, and conditions of the FSDPSF as outlined in this paper with respect to the resources contributed under such instrument of contribution.

16. Contributions to the FSDPSF will be made in the form of cash in a freely convertible currency. Contributions will be deposited into a United States (US) dollar interest-bearing account to be specified by ADB. Contributions received in currencies other than US dollars will be converted by ADB’s depository bank upon receipt into US dollars at the prevailing exchange rate.

17. Contributions will be held, administered, and invested at the discretion of ADB. Pending disbursements, ADB may invest and reinvest contributions in any instrument in which ADB is authorized to invest its own funds. Any income earned from such an investment and reinvestment, as well as interest earned and accrued for the account (collectively, the available funds net of expense) will be credited to the account and used for the FSDPSF, including related administrative expenses.

18. ADB will make withdrawals from the account as necessary to meet the expenditures of projects and activities supported by the available funds. If other currencies are required for payments to meet eligible expenditures, ADB may purchase the required currencies with the available funds. Any fees and charges relating to such purchase will be paid out of the account.

VI. ADMINISTRATION ARRANGEMENTS

19. As a multidonor fund, the FSDPSF will commingle all available funds in the account. ADB will maintain records and accounts, in accordance with its standard procedures, that identify the contributions made and the commitments to be financed from the available funds, including eligible activities and administrative expenses. ADB will provide contributors and the ADB Board of Directors with annual financial statements for the FSDPSF. ADB’s external

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8 Under exceptional circumstances, a contribution may be effected through a channel financing agreement or similar agreement substantially in accordance with the terms and conditions in this paper.

9 Under exceptional circumstances, acceptance of objectives, terms, and conditions of the FSDPSF will be formalized through signing a channel financing or similar agreement substantially upon the terms and conditions set forth in this paper.

10 Administrative expenses include service charges, costs of external audits, and finance charges that may be incurred in purchasing required currencies and in remitting funds.
auditors will audit these statements annually; the cost of the audits will be charged to the FSDPSF.

20. In accordance with its standard practices, ADB will use part of the contributions (together with interest and investment income earned thereon) to cover ADB’s service charges for the administration of projects under the FSDPSF. The service fee charges are set at (i) 5% of amounts disbursed for TA projects; and (ii) 5% of amounts disbursed for grant components of investment projects up to $5 million, or 2% of amounts disbursed for grant components of investment projects above $5 million with a minimum of $250,000, whichever is greater. The service charge will be paid from the FSDPSF (and not the disbursed amount) contemporaneously with the disbursement.

21. ADB will submit annual progress reports on the FSDPSF to contributors as well as the ADB Board of Directors. OREI will be the focal point for preparing the progress reports in accordance with ADB’s normal reporting standards and annual work programs. As appropriate, ADB will also provide external contributors and the Board of Directors with reports and information concerning the progress of activities under the FSDPSF. External contributors to the FSDPSF meet once a year to review progress, administrative matters, the work program, and strategic directions of the FSDPSF.

22. ADB will promptly inform contributors and the ADB Board of Directors of any condition that interferes, or threatens to interfere, with ADB’s administration of the FSDPSF.

23. ADB may, from time to time, adopt additional rules for administering the FSDPSF that are substantially based upon the terms and conditions of this paper.

24. Unless otherwise agreed by contributors and ADB, the FSDPSF will terminate when ADB has substantially disbursed the contributions and no replenishment is anticipated. At such time, except for actions necessary for the orderly and expeditious winding up of FSDPSF activities, ADB’s functions in relation to the contributions will be considered terminated.

25. Upon termination of the FSDPSF, and subsequent liquidation of the account, unless otherwise agreed with the contributors, any available funds will be returned to the individual contributors and ADB\textsuperscript{11} in proportion to their respective contributions. Following termination of the FSDPSF, ADB will, as soon as practicable, provide to the contributors and the ADB Board of Directors, a final report on the projects and activities supported by it.

26. With respect to funds provided by contributors, ADB will exercise the same care in the discharge of its functions as it exercises with respect to its own affairs, and will have no further liability in respect of the contributions. The privileges and immunities accorded to ADB under the ADB Charter\textsuperscript{12} will apply to all property, assets, income, and operations of the FSDPSF.

\textsuperscript{11} ADB’s contributions originating from OCR will be returned to OCR.

\textsuperscript{12} ADB. 1965. Agreement Establishing the Asian Development Bank. Manila
VII. RECOMMENDATION

27. The President recommends that the Board approve

(i) the establishment of the Financial Sector Development Partnership Special Fund substantially in accordance with the terms and conditions set forth in this paper;

(ii) the acceptance and administration by ADB of a contribution of Luxembourg from the Financial Sector Development Partnership Fund to the Financial Sector Development Partnership Special Fund substantially in accordance with the terms and conditions set forth in this paper including Appendix 1; and

(iii) the acceptance and administration by ADB of contributions to the Financial Sector Development Partnership Special Fund by bilateral, multilateral, and other sources substantially in accordance with the terms and conditions set for in this paper including Appendix 2.
Supplementary Agreement

To the Channel Financing Agreement

Establishing the Financial Sector Development Partnership Fund

between

the Government of Luxembourg and the Asian Development Bank dated 30 August 2006

(A) WHEREAS the Government of Luxembourg (the “Government”) and the Asian Development Bank (“ADB”) have entered a channel financing agreement establishing the Financial Sector Development Partnership Fund (the “Trust Fund”) dated 30 August 2006 (the “CFA”);

(B) WHEREAS the establishment of the Trust Fund was approved by the Board of Directors of ADB under a Board paper entitled Financial Sector Development Partnership Fund dated July 2006 (the “Trust Fund Board Paper”);

(C) WHEREAS ADB has established a Special Fund called the Financial Sector Development Partnership Special Fund (the “Special Fund”) pursuant to a Board paper entitled Establishment of the Financial Sector Development Partnership Special Fund dated [January] 2013 (the “Special Fund Board Paper”);

(D) WHEREAS the Government wishes that a portion of the funds held in the Trust Fund administered by ADB be used to make a contribution to the Special Fund; and

(E) WHEREAS the Government and ADB (the “Parties”) wish to enter a supplementary arrangement to the CFA in relation to the transfer of funds from the Trust Fund to the Special Fund.

NOW THEREFORE the Government and ADB have agreed as follows:

Section 1. The Government shall make a contribution of $_________ to the Special Fund (the “Contribution”) from its funds in the Trust Fund administered by ADB not later than [insert a date]. ADB, acting in its capacity as administrator of the Trust Fund, shall transfer the Contribution from the Trust Fund to the Special Fund.

Section 2. The Parties agree that, in relation to the Contribution, ADB’s responsibility, as administrator of the Trust Fund, shall be limited to transferring such Contribution from the Trust Fund to the Special Fund. The Parties agree that after ADB has remitted the Contribution to the Special Fund, ADB shall have no further obligations as administrator of the Trust Fund in relation to such Contribution.

Section 3. The Contribution once transferred to the Special Fund shall be subject to the terms and conditions set forth in the Special Fund Board Paper.
Section 4. Any amount remaining in the Trust Fund after the transfer of the Contribution to the Special Fund shall continue to be governed by the provisions of the CFA.

Section 5. This Supplementary Agreement shall become effective when it is signed by the authorized representatives of the Government and ADB.

Section 6. No amendment or modification to this Supplementary Agreement shall be effective unless in writing and executed by each of the Parties.

Section 7. The Parties shall seek amicably to resolve any disputes over the interpretation or application of any provisions of this Supplementary Agreement.

IN WITNESS WHEREOF, the Parties, each acting through its duly authorized representative, have signed this Supplementary Agreement in two counterparts, each of which shall be an original.

Signed in Luxembourg
This ___ of ________ 201_

GOVERNMENT OF LUXEMBOURG

By:
Title:

Signed in Manila
This ___ of ________ 201_

ASIAN DEVELOPMENT BANK

By:
Title:
INSTRUMENT OF CONTRIBUTION

[Date]

Asian Development Bank
6 ADB Avenue
Mandaluyong City
Philippines

[Name and identify of contributor] (hereinafter referred to as the “Contributor”) hereby undertakes to contribute to the Financial Sector Development Partnership Special Fund in an amount of [$ ___ ] in accordance with the provisions of the ADB Board of Directors paper entitled Establishment of the Financial Sector Development Partnership Special Fund of the Asian Development Bank and subject to the terms and conditions set forth in the paper.

The contribution will be paid to the Asian Development Bank in the form of immediately available funds [on or prior to [specify date]] \(^1\) {in accordance with the following schedule [insert disbursement schedule]} \(^2\).

1 This can only be inserted if “in accordance with the following schedule [insert disbursement schedule]” is deleted.

2 This can only be inserted if “on or prior to [specify date]” is deleted.

The contribution will be paid into [ADB to specify account details].

Date this ______________day of ______________201__.

For and on behalf of

__________________________________________