ADB

Policy Paper

October 2020

Concessional Assistance Policy for the ADF 13 Period

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
BFC	–	Blended Finance Committee
CAS	–	country allocation shares
CCPR	–	composite country performance rating
COL	–	concessional ordinary capital resources lending
COVID-19	–	coronavirus disease
CPA	–	country performance assessment
CRW	–	Crisis Response Window
DMC	–	developing member country
DRF+	–	expanded Disaster and Pandemic Response Facility
EVI	–	economic vulnerability index
EVP	–	economic vulnerability premium
FCAS	–	fragile and conflict-affected situations
GNI	–	gross national income
IDA	–	International Development Association
IMF	–	International Monetary Fund
LGS	–	loan guarantee solution
OCR	–	ordinary capital resources
O&M	–	operation and maintenance
PBA	–	performance-based allocation
PCI	–	per capita income
POP	–	population
PSO	–	private sector operations
PSW	–	Private Sector Window
RPG	–	regional public good
SDFP	–	Sustainable Development Finance Policy
SPD	–	Strategy, Policy and Partnerships Department
SIDS	–	small island developing states
WHO	–	World Health Organization
WPBF	–	work program and budget framework

NOTE

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

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I. INTRODUCTION

1. The Asian Development Fund (ADF) was introduced in 1973 to mobilize concessional resources for the poorest and least developed members of the Asian Development Bank (ADB). The ADF was initially a concessional lending facility that did not provide grants. ADF grants were introduced in 2005 to better respond to the needs of heavily indebted developing member countries (DMCs).

2. The ADF became a grant-only facility following the combination of the ADF lending operations and ordinary capital resources (OCR) balance sheet, which took effect on 1 January 2017.[1] Since then, ADB's OCR balance sheet has been financing concessional OCR lending (COL) operations. ADB's Strategy 2030 notes that ADB will direct its concessional finance from COL and ADF grants to support ADB's poorest and most vulnerable DMCs.[2] Many DMCs eligible for concessional assistance are classified as fragile and conflict-affected situations (FCAS)[3] and small island developing states (SIDS).[4]

3. The outbreak of the coronavirus disease (COVID-19), which began in 2019, has severely affected ADB's DMCs. The magnitude of the social and economic losses of DMCs will depend on how the outbreak evolves, which at the time of preparation of this paper remains highly uncertain. The frameworks for grants from the 12th replenishment of the ADF (ADF 13) and COL are assessed to be adequate and sufficiently flexible to respond to the crisis and build the foundations of sustainable and inclusive recovery in ADF- and COL-eligible countries in line with Strategy 2030.

4. The Concessional Assistance Policy (2016) defines the principles and criteria to guide allocations of ADF grants and COL for eligible countries and presents the details of the resource allocation frameworks for ADF grants and COL.[5] It also outlines the specific arrangements for ADF 12 (2017–2020). The Concessional Assistance Policy for the ADF 13 Period (2021-2024) introduces revisions to the resource allocation frameworks to implement the strategic directions and improve the effectiveness and efficiency of the ADF and COL allocation process (Appendix 1), as agreed between ADB Management and ADF donors during the ADF 13 replenishment negotiations. The Concessional Assistance Policy for the ADF 13 Period in conjunction with the ADF 13 Donors Report will guide the implementation of ADF 13.[6]

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[1] ADB. 2015. *Enhancing ADB's Financial Capacity for Reducing Poverty in Asia and the Pacific*. Manila.

[2] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

[3] To categorize FCAS, ADB uses the harmonized multilateral development bank methodology, which averages ADB's country performance assessments (CPAs) and the World Bank's country policy and institutional assessments that are graded on a scale of 0.0–6.0. Countries rated 3.2 or below are classified as FCAS. A country is also classified as a FCAS if during the previous 3 years it had in its territory a United Nations and/or regional peacekeeping or peace-building mission, excluding border-monitoring operations. In 2019, ADB classified 10 DMCs as FCAS: Afghanistan, the Federated States of Micronesia, Kiribati, the Marshall Islands, Myanmar, Nauru, Papua New Guinea, Solomon Islands, Timor-Leste, and Tuvalu.

[4] The United Nations has identified 16 SIDS among ADB's DMCs, of which 13 had access to ADB's concessional assistance as of May 2020: the Federated States of Micronesia, Kiribati, Maldives, the Marshall Islands, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu. United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States. Country Profiles.

[5] ADB. 2016. *Concessional Assistance Policy*. Manila.

[6] ADB. 2020. *Asian Development Fund 13 Donors' Report: Tackling the COVID-19 Pandemic and Building a Sustainable and Inclusive Recovery in line with Strategy 2030*. Manila.

5. This paper seeks the Board of Directors' approval of the Concessional Assistance Policy for the ADF 13 Period. Following approval, the policy will replace the Concessional Assistance Policy (2016) on 1 January 2021.

II. ELIGIBILITY FOR CONCESSIONAL RESOURCES

6. Eligibility for concessional resources is guided by ADB's Graduation Policy[7] and the Concessional Assistance Policy for the ADF 13 Period. Per the Graduation Policy, group A DMCs[8] are eligible for COL and/or ADF grants;[9] group B DMCs are eligible for COL and have access to regular OCR lending, but are not eligible for ADF grants;[10] and group C DMCs have access only to regular OCR lending. Grant-recipient countries generally are restricted from public or publicly guaranteed regular OCR borrowing.[11]

7. Access by group A countries to ADF grants and COL for country allocations is determined by the risk of debt distress: (i) low—no grants; (ii) moderate—an ADF grant allocation equivalent to 50% of performance-based allocation (PBA) share; and (iii) high—100% grants.

8. Country debt distress risk classifications are reviewed at the start of each year, alongside country allocation updates. They are adjusted immediately following a downgrade of the risk of debt distress for a group A country.[12] Classifications are determined by the outcome of the forward-looking debt sustainability analysis, when available, carried out by the International Monetary Fund (IMF) and the World Bank using the debt sustainability framework for low-income countries.[13] When a debt sustainability analysis is not carried out by the IMF and the World Bank, ADB conducts its own assessment consistent with the same methodology.

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[7] ADB's Graduation Policy is presented in two documents: ADB. 1998. *A Graduation Policy for the Bank's DMCs*. Manila; and ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila.

[8] ADB uses a three-tier DMC classification system: groups A, B, and C. Classification is determined by two criteria: gross national income (GNI) per capita (Atlas method) and creditworthiness. Group A countries include DMCs lacking creditworthiness. Group B countries include those with limited creditworthiness. Group C countries have adequate creditworthiness and per capita incomes exceeding the operational cutoff of the World Bank's International Development Association (IDA).

[9] IDA gap countries are not eligible for ADF grants. They are group A countries (except SIDS) that have had GNI per capita above the operational cutoff for IDA eligibility for more than 2 consecutive years and are assessed as a gap country by IDA. The operational cutoff is $1,185 (2019 prices). As of September 2020, the IDA gap countries among ADB's DMCs were Bhutan, the Lao People's Democratic Republic, and Myanmar.

[10] Under the ADF 13 grant and COL frameworks, ADF and COL countries are eligible for grants from the single thematic pool, with group B countries eligible on a very exceptional basis, and through the extended disaster and pandemics response facility.

[11] Under the graduation policy, ADB lending on regular OCR terms can be considered on a case-by-case basis for all group A DMCs for revenue-earning projects that generate net foreign exchange above the foreign debt service requirements and meet other ADB lending criteria. Regular OCR in group A countries can be used for guarantee operations with a sovereign counterindemnity if the project is not expected to undermine the country's debt sustainability. The country should not be classified as being at high risk of debt distress following this policy, and the proposed project is not expected to change the country's debt distress classification. ADB. 2018. *Proposal for ADB's New Products and Modalities*. Manila.

[12] Following a downgrade of the risk of debt distress within the year, COL allocations for that country will be converted to ADF grants for the remaining part of the year following the degree of the downgrade of risk of debt distress. The additional ADF grant resources will be provided from the debt distress reserve, given availability of resources.

[13] IMF. 2018. *Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries*. Washington, DC.

III. ALLOCATION OF ADF GRANTS

9. **Role of ADF grants.** ADF grants are essential in helping ADB's poorest and most vulnerable DMCs facing high or moderate risk of debt distress avoid an increase in their debt burden. Grants play a catalytic role by supporting project investments in areas often underinvested by governments, while generating strong, positive national and regional externalities.

10. **Two-pillar resource allocation framework.** The ADF 13 resource allocation framework adopts a two-pillar approach, consisting of country- and theme-based components. It also includes an ADF grant reserve for changes in debt distress, which is intended to finance increased demand for ADF grants because of deterioration in DMCs' debt distress situation.

A. Country Allocation

11. Country allocations are the sum of PBAs, economic vulnerability premiums (EVPs) for ADF grant-eligible SIDS, and the special allocation for Afghanistan.[14]

1. Performance-Based Allocation

12. The PBA system strengthens the link between allocations, country needs, and country performance. The PBA formula is a weighted geometric function of the composite country performance rating (CCPR), per capita income (PCI),[15] and population (POP). The formula is calibrated to ensure that total allocations equal total available resources. The allocation share for each country is determined by the following formula:

$$S_i = CCPR_i^{2.00} \times PCI_i^{-0.25} \times POP_i^{0.60} \times C$$

13. The scaling factor, C, is a constant term where

$$C = 1 \div \sum_i (CCPR_i^{2.00} \times PCI_i^{-0.25} \times POP_i^{0.60})$$

14. The effect of squaring the CCPR on its component parts highlights the importance of the governance rating in the overall country allocation and is as follows:

$$CCPR_i^{2.00} = (\text{policy and institutional rating})_i^{1.40} \times (\text{governance rating})_i^{2.00} \times (\text{portfolio performance rating})_i^{0.60}$$

15. Each country's indicative allocation is derived by applying its PBA share to the total resources available for PBAs.

[14] SIDS eligible for ADF grants as of September 2020 are the Federated States of Micronesia, Kiribati, Maldives, the Marshall Islands, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

[15] GNI per capita is measured based on the World Bank's Atlas method, which smoothens exchange rate fluctuations by using a 3-year moving average, price-adjusted conversion factor.

2. Economic Vulnerability Premium for Small Island Developing States

16. An EVP calibrated based on the economic vulnerability index (EVI)[16] will complement the PBAs for ADF-eligible SIDS.[17] Based on their EVI scores, ADF-eligible SIDS are assigned premium amounts. ADF-eligible SIDS at high risk of debt distress are allocated the full amount of the EVP as grants, and ADF-eligible SIDS at moderate risk of debt distress are allocated half the amount of the EVP as grants, with the remaining amount allocated as COL. The EVP is discussed in Appendix 2.

3. Special Allocation for Afghanistan

17. Despite important results of ADB operations in energy, transport, and agriculture and natural resources, Afghanistan continues to be classified as a FCAS and has extensive development needs.[18] Continued efforts and investments are needed to face the country's remaining social and economic challenges.

18. Afghanistan will continue to receive an equivalent amount for the special allocation under ADF 13 compared to ADF 12 as agreed with ADF donors.[19] The grant share of the PBA and the special allocation continues to be based on the risk of debt distress of the country. The special allocation for Afghanistan is discussed in Appendix 3.

4. Enhancing Debt Sustainability

19. **Alignment with the International Development Association's Sustainable Development Finance Policy.**[20] Support for debt sustainability in group A countries accessing ADF grant country allocations will be strengthened by aligning with the Sustainable Development Finance Policy (SDFP) principles of the International Development Association (IDA). For IDA gap countries (footnote 9), group A countries at low risk of debt distress and group B countries accessing COL, ADB will monitor IDA's implementation of SDFP, in close collaboration with government, IDA, and IMF, which may trigger adjustments of COL country allocations. The SDFP has two pillars: (i) a debt sustainability enhancement program, which creates additional incentives for countries to move toward sustainable development financing; and (ii) a creditor outreach program to facilitate information sharing and mitigate debt-related risks.

20. **Debt sustainability enhancement program.** The first pillar of the SDFP will incentivize governments to move toward sustainable development financing. The pillar involves defining a set of policy actions to enhance debt sustainability and assessing progress on their implementation. Depending on the country context, policy actions may cover some or all of the following areas: (i) increasing debt transparency, including by improving the coverage, accuracy, and timeliness of debt reporting; (ii) augmenting fiscal sustainability (e.g., through revenue mobilization, public expenditure efficiency, reduction of fiscal arrears, and public investment management); and (iii) strengthening debt management, including by using borrowing limits and

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[16] The EVI was set up by the United Nation's Committee for Development Policy and captures characteristics such as population size, remoteness, size of economic base, and vulnerability to climate change.

[17] ADB. 2019. *A Framework for Addressing the Financing Needs of Small Island Developing States*. Paper prepared for the first ADF 13 replenishment meeting. Philippines. 5–7 November.

[18] ADB. 2019. *Afghanistan: Progress and Remaining Challenges*. Paper prepared for the first ADF 13 replenishment meeting. Philippines. 5–7 November.

[19] ADB. 2020. *Afghanistan: Progress and Remaining Challenges (Supplementary Note)*. Paper prepared for the second ADF 13 replenishment meeting. Philippines. 11–12 February.

[20] IDA. 2020. *Sustainable Development Finance Policy of the International Development Association*. Washington, DC. The SDFP became effective on 1 July 2020 and replaced the Non-Concessional Borrowing Policy.

minimizing collateralization. This process will be implemented in three main steps. First, for all group A countries accessing ADF grant country allocations,[21] ADB will identify a set of policy actions with governments and in close collaboration with other international financial institutions such as IDA and IMF. To a great extent, the policy actions for ADF countries are expected to fully align with IDA's policy actions. This will help reduce administrative costs for both organizations and governments, and maximize synergies of policy reforms through close coordination. In some cases where ADB's operational priorities in an ADF country differ from those of IDA, ADB's policy actions can be partly aligned, subject to policy discussions with governments. IDA will be consulted and informed in these cases. The policy actions can be annual actions, which should be identified before the beginning of the year in which they will be assessed. They can also be programmatic policy actions, including annual milestones, which should be identified before the beginning of the ADF 13 cycle.[22] ADF countries will generally be required to implement three policy actions, and FCAS and SIDS will be required to implement two policy actions. Countries will implement policy actions during the first year of ADF 13 and over the full cycle. [23]

21. Second, progress made by countries in implementing their policy actions will be assessed at the end of each year of the ADF 13 cycle. Third, if progress is unsatisfactory,[24] 20% of the next indicative annual grant country's allocation will be set aside.[25] The country can recover the set-aside if policy actions are implemented before the beginning of the fourth year of ADF 13.[26] Otherwise, the remaining set-aside at the beginning of the fourth year of ADF 13 will be lost. Countries with satisfactory implementation of agreed policy actions will retain their full 4-year country grant allocation over ADF 13. Countries with repeated unsatisfactory implementation of agreed policy actions at the end of years 1, 2, and 3 will lose about 15% of their 4-year grant country allocation. In some cases (severe or repeated breaches of policy actions such as the non-concessional borrowing ceiling), concessional financing terms can be hardened and grants replaced with concessional lending.[27] At the beginning of the fourth year of ADF 13, reductions in grant country allocations that are lost irrevocably will be redistributed to countries demonstrating satisfactory progress in implementing their policy actions through the PBA formula and/or reallocated to the thematic pool.

22. Given the unprecedented crisis of the COVID-19 pandemic at the time of the SDFP's launch, a phased approach will be adopted in implementing the policy. Policy actions for the first year of ADF 13 are expected to focus primarily on debt transparency and, to some extent, on debt

[21] These countries are at high or moderate risk of debt distress. The classification of risk of debt distress is determined by, when available, the outcome of the forward-looking debt sustainability analysis carried out by the IMF and World Bank using the debt sustainability framework for low-income countries.

[22] When ADB's policy actions are aligned with IDA's, ADB country teams will have to adjust the implementation milestones because IDA and ADB have different fiscal years. Programmatic policy actions with annual milestones may be considered if ADB and IDA are already operating programmatic policy-based programs in the country which policy actions can align with. Annual policy actions may be considered if policy measures are more self-contained (for example, borrowing ceilings). ADB's Strategy, Policy and Partnerships Department will exercise quality control over and coordinate policy actions to ensure their consistency across countries, including during the process of identifying policy actions.

[23] The Technical Assistance Special Fund 7 includes a set-aside of about 10% of the overall amount ($52 million) to support public debt sustainability in ADF and COL countries during the ADF 13 period. Technical assistance funded by the set-aside will support implementation of policy measures under the SDFP.

[24] In general, progress will be assessed as unsatisfactory if at least one policy action is not met. Specificities of the country or exceptional events may be taken into consideration to qualify the assessment.

[25] The country allocation includes the EVP and the special allocation for Afghanistan.

[26] If 20% of the indicative annual ADF grant allocation is set aside at the beginning of the second year of ADF 13, the country will have 2 years to recover it. If 20% of the indicative annual ADF grant allocation is set aside at the beginning of the third year, the country will have 1 year to recover it.

[27] This extra sanction will be applied on top of setting aside a portion of the annual country allocation.

management, with less emphasis on structural fiscal sustainability issues. Policy actions will consider the capacity constraints of countries, particularly the specific challenges of FCAS and SIDS. For countries with a borrowing ceiling agreed by the World Bank and the IMF, policy actions will include this borrowing ceiling. Borrowing ceilings under the SDFP will primarily take the form of nominal limits on non-concessional external public and publicly guaranteed debt, which will ensure policy continuity as well as consistency with the IMF's revised debt limit policy.[28] Implementation of the debt sustainability enhancement program under the SDFP is discussed in Appendix 4.

23. **Creditor outreach program.** The second pillar of the SDFP will ease information sharing, dialogue, and coordination; increase transparency and communication with bilateral creditors on the SDFP; promote dialogue on debt transparency with Paris Club, non-Paris Club, and private creditors. ADB will collaborate with the IMF, the World Bank, bilateral creditors (including non-Paris club members), and emerging donors to improve regular dialogue and exchange information.

B. Theme-Based Components

24. The resources for theme-based components are allocated to projects that meet certain criteria.

1. ADF 13 Thematic Pool

25. The thematic pool provides ADF grants to incentivize governments to consider projects with strong national and regional positive externalities and to support the implementation of Strategy 2030 with a focus on the following strategic areas: (i) fostering regional cooperation and integration (RCI), including the provision of regional public goods (RPGs); (ii) supporting disaster risk reduction and climate adaptation; and (iii) achieving Sustainable Development Goal 5's transformative gender agenda. Regional health security will be supported along with RCI and RPGs.

26. The thematic pool employs a unified resource allocation process for the three strategic areas with annual project selection. The indicative shares for strategic areas within the thematic pool are 40% for fostering RCI, including providing RPGs; 40% for supporting disaster risk reduction and climate adaptation; and 20% for achieving the Sustainable Development Goal 5's transformative gender agenda. The indicative shares across the three strategic areas can be adjusted by up to a cumulative amount of $30 million during ADF 13.[29]

27. The thematic pool supports projects in all group A countries, including IDA gap countries (footnote 9), and, on a very selective basis, group B countries. During the ADF cycle, the total amount of allocations to projects in group B countries or involving group B countries in the case of multi-country projects during a cycle is capped at 10% of the total thematic pool size. Allocations follow a project selection and prioritization process based on a scorecard. Priority is given to FCAS and SIDS. Project eligibility criteria will be more stringent for projects in group B countries. Higher leveraging ratios will be required for projects in group B than in group A countries. Countries with prudent or improved fiscal, debt, and budget management will have preferential access to the thematic pool to increase incentives to enhance debt sustainability. The thematic pool is discussed in Appendix 5.

[28] The World Bank and the IMF share on a monthly basis an updated table with a list of IDA-only and Poverty Reduction and Growth Trust- eligible countries subject to IMF/World Bank Group debt limits.
[29] Donors' endorsement will be sought for a higher cumulative adjustment of $30 million, as needed.

2. Pilot Private Sector Window

28. ADF 13 introduces on a pilot basis the Private Sector Window (PSW). The PSW grant resources will contribute to reducing some of the shared financing constraints that hinder private sector operations in group A countries. The need to de-risk private sector investments was very strong before COVID-19, and it has increased more as businesses try to access financing to kick-start and rebuild operations that have been adversely impacted by the pandemic. The PSW includes three solutions: local currency, blended finance, and loan guarantee.

29. The PSW does not provide indicative allocations among the three solutions. The allocation of resources will be flexible, with no ceilings on country, sector, or other limits for any of the solutions proposed. While it is critical that the PSW retain optimal flexibility to respond to the emerging needs of group A countries, ADB will ensure that the PSW maintains a balance across countries, sectors, and products to deploy resources across eligible group A countries for transactions that meet the PSW eligibility criteria.

30. The PSW will be used to encourage and mobilize private sector investment through co-investments and partnerships with other development financial institutions, commercial lenders, and investors for highly developmental projects in group A countries, including FCAS and SIDS. The PSW will focus on transactions in nontraditional sectors, particularly those with higher development impact, including health, education,[30] agribusiness, tourism, and nontraditional energy infrastructure (e.g., water, urban sanitation, information communication and technology, and transport). In addition to the risk framework applied by ADB in assessing all private sector operations transactions, the PSW applies an eligibility assessment framework under the review and guidance of the Blended Finance Committee[31] to ensure that scarce PSW resources are deployed in transactions that, among other things, are consistent with ADB's long-term strategic priorities and country priorities and adhere to the Blended Finance Principles.[32] Additional details of the PSW are provided in Appendix 6.

3. Expanded Disaster and Pandemic Response Facility

31. **Disaster and emergency needs.** The forthcoming Revised Disaster and Emergency Assistance Policy[33] and this Concessional Assistance Policy for the ADF 13 Period will guide allocations and implementation of ADF grants to support disaster and emergency needs. The expanded Disaster and Pandemic Response Facility (DRF+) provides ADF grants for relief, early recovery, and reconstruction following disasters and emergencies. Group A countries can receive grant resources from the DRF+ in case of disasters triggered by natural hazards, large cross-border movements of displaced persons,[34] and public health emergencies, including epidemics

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[30] ADB Private Sector Window (PSW) support should create opportunities for equitable access to education. Potential ADB-PSW projects will specifically address this aspect and will be assessed accordingly in the context of affirming the eligibility criteria.

[31] ADB (Strategy, Policy and Partnerships Department). 2019. Blended Concessional Finance Committee for Nonsovereign Operations—Procedures and Nominations. Memorandum. 11 October (internal).

[32] *Asian Development Bank et al. 2017. DFI Working Group on Blended Concessional Finance for Private Sector Projects: Summary Report*.

[33] ADB. Forthcoming. *Revised Disaster and Emergency Assistance Policy*. Manila.

[34] For cross-border displacement, DRF+ triggers follow the requirements under the IDA19 Window for Host Communities and Refugees, which provides dedicated grant funding to help low-income countries host large numbers of refugees.

and pandemics.[35] For disasters, an eligible country can get up to 100% of its annual country allocation or up to $100 million (whichever is lower) from the DRF+. The risk of debt distress determines grant eligibility and the associated DRF+ grant share.[36]

32. However, for a severe disaster or emergency with estimated damage and losses exceeding 10% of gross domestic product, all group A countries are eligible for ADF grants with full grant share from the DRF+. ADF grant assistance may be offered to group A and B countries when they accommodate significant cross-border inflows of displaced people (footnote 34).

33. Eligible countries can access the DRF+ more than once during ADF 13 in case of multiple disasters and emergencies, depending on available resources. If the available DRF+ allocations are insufficient, any additional country needs will be met, in exceptional cases, through reductions in other countries' ADF grant country allocations. The DRF+ will reduce but not eliminate the need to reallocate resources within programs and to draw on loan cancellations and savings to respond to disasters and emergencies. The expanded Disaster and Pandemic Response Facility is discussed in Appendix 7.

C. Debt Distress Reserve

34. **Debt distress reserve.** Since grant demand can be volatile due to changes in DMCs' debt distress classification, a reserve has been established. The objective of the reserve is to protect the allocations of grant recipients in case additional countries become eligible for grants. With the ADF grant reserve, the indicative ADF grant country allocations could still exceed the available ADF grant resource envelope if the risks of debt distress of more countries deteriorate than predicted and become eligible for ADF grants. In that event, ADB will need to reduce the ADF grant country allocations for eligible countries, prorated according to PBA shares, so that the ADF grant allocations can be met by the available ADF grant resources.

IV. ALLOCATION OF CONCESSIONAL ORDINARY CAPITAL RESOURCES LENDING

35. **Volume of concessional ordinary capital resources lending.** Before a new ADF period begins, ADB seeks consensus among donors on the volume of COL to be delivered over the next 4-year replenishment period based on country eligibility, demand from eligible countries, and ADB's financial capacity. As part of consultations during the ADF 13 replenishment negotiations on the overall COL envelope for 2021–2024, an overall indicative amount for COL similar to the ADF 12 envelope from ADB's ordinary capital resources balance sheet is expected to be made available during ADF 13. The overall COL envelope for ADF 13 will include a reserve of 5% of the overall amount in COL to accommodate additional demand by group A countries that are upgraded to a lower risk of debt distress, and support eligible countries to accommodate additional development needs, particularly those related to disaster and emergency responses.

36. **Separating the allocation of the ADF grants and concessional ordinary capital lending.** Following the combination of ADF lending operations with the OCR balance sheet, the ADF has become a grant-only fund while COL is funded from ADB's ordinary capital resources balance sheet. With ADF grants and COL originating from two different funding sources, the linked

[35] The DRF+ will be triggered for health emergencies when a grant-eligible group A country has (i) declared a public health emergency, and (ii) the World Health Organization has declared a public health emergency of international concern under its global alert and response system.

[36] Group A countries at high risk of debt distress will receive their full allocation in grants, group A countries at moderate risk will receive 50% of their allocation, and group A countries at low risk and IDA gap countries are not eligible for DRF+ grants.

allocation system for ADF grants and COL under ADF 12 has diminished the efficiency of the allocation process. Despite availability of COL resources, their allocation has been restricted by limited ADF resources that are predetermined by donor contributions. Under the ADF 13 period, ADF grants and COL will be allocated separately to increase the efficiency of the allocation frameworks.

37. **Allocation mechanism of concessional ordinary capital lending.** The allocation of COL is based on a combined performance-based allocation (PBA) and a need-based adjustment approach (each accounting for 50% of overall resource allocation under ADF 13). The total COL allocation for an eligible country is the sum of the allocation from a PBA-based component and from a need-based component.[37] COL will be allocated for the 4 years of the ADF 13 cycle with annual updates. For the need-based component, country allocation shares (CAS) for eligible countries for the next year are determined based on a 5-year horizon as an average of actual commitments of the past two years, and rolling pipelines of lending products of the current and next two years, following the most recent work program and budget framework (WPBF).[38] For example, the 2021 CAS of country i, evaluated in 2020 is

$$CAS_i^{2021} = \frac{FP_i^{2022} + FP_i^{2021} + CY_i^{2020} + AC_i^{2019} + AC_i^{2018}}{FP^{2022} + FP^{2021} + CY^{2020} + AC^{2019} + AC^{2018}}$$

where

AC = actual commitments
CY = current year's pipeline
FP = forward-looking pipeline taken from current year's WPBF

and

$$\Sigma_{i=1}^{n} CASi = 100\%$$

The CAS is then applied to the overall available resource envelope for the year to determine the indicative country allocation.

38. Pipelines of lending products are prepared by regional departments as part of the WPBF process. The pipelines will be reviewed and validated by the Strategy, Policy and Partnerships Department (SPD) in cooperation with regional departments, following a combination of bottom-up and top-down approaches. A bottom-up review at the country level will confirm the robustness of country programs versus historical commitments and absorptive capacity constraints, readiness of stand-by projects, and any overprogramming relative to indicative country allocations. Projects and programs not deemed on schedule for commitment may be shifted to the standby pipeline. A top-down review will complement the bottom-up review by validating that overall country programs are aligned with the available COL envelope and fully funded.

[37] COL allocation for country X = PBA component (primarily based on the country performance assessment, gross national income per capita, and population) + need-based component
where
• PBA component = PBA share x 50% of total available COL
• Need-based component = country allocation share x 50% of total available COL

[38] The WPBF defines the parameters and main thrusts of ADB's operations and provides the framework for preparing the budget for the upcoming year.

39. The review and validation of country programs and monitoring of country program implementation by regional departments in cooperation with SPD will reduce risks of inflated project pipelines and reduced quality at entry, aiming at escalating allocations under the need-based component. Increased flexibility of regional departments to reallocate country allocations, in cooperation with SPD, to countries with additional needs from countries that are not in a position to fully utilize their allocations, and to give access to the COL reserve to countries with higher development needs will further increase the effectiveness and efficiency of the allocation process.

40. The need-based allocation mechanism will accommodate changing needs for ADB assistance in eligible DMCs following shifts in country-specific circumstances, which are reflected in validated rolling pipelines. These shifts could include short-term variations in absorptive capacity because of changes in government administration, borrowing policies, government's internal approval processes, and unexpected events such as emergencies and disasters. The need-based allocation mechanism ensures that countries with higher development needs, expeditious commitments, and higher absorptive capacity will receive higher COL allocations. As a transition measure, the need-based allocation mechanism ensures that COL allocation for Myanmar will continue to be at least at a level similar to that under the ADF 12 to meet the country's needs.[39]

41. Group A countries at moderate risk of debt distress receive a blend of ADF grants and COL, which will be allocated separately. Such countries will be allocated grant PBA equivalent to 50% of their PBA share, and COL following the new COL allocation approach.[40] COL allocations for group B countries are prioritized in disaster risk reduction; climate adaptation; environmental sustainability; regional cooperation and integration; regional public goods such as regional health security, biodiversity, ocean health, and environment; gender equality; social sectors; food security; and public sector management.

V. IMPLEMENTATION OF THE CONCESSIONAL ASSISTANCE POLICY FOR THE ADF 13 PERIOD

A. Policy Focal Point

42. The Strategy, Policy and Partnerships Department is the focal point for the Concessional Assistance Policy for the ADF 13 Period and is responsible for its implementation. Management decisions on allocations of ADF and COL resources will be made based on the recommendations of the director general of the Strategy, Policy and Partnerships Department.

43. The focal point will support and coordinate the review of country performance ratings, which are one of the parameters used in the PBA formula. Since these ratings will be disclosed publicly, the focal point will provide independent advice to ADB Management on the credibility of the ratings and of the rating process. The vice-presidents for operations 1, operations 2, and knowledge management and sustainable development will make the final decisions on the ratings.

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[39] Allocation of COL to Myanmar during the ADF 12 period was $1,532 million.

[40] ADF grant-eligible SIDS classified at moderate risk of debt distress will get half of the economic vulnerability premium as concessional ordinary capital resources lending, beside half of the premium as ADF grant.

B. Country Performance Assessment Exercise

44. In principle, country performance assessments (CPAs) are conducted every 2 years for all ADF and COL countries. If country conditions warrant, CPAs may be conducted more frequently on an exceptional basis. The integrity of the Concessional Assistance Policy for the ADF 13 Period and the allocation process will require ADB to carry out independent assessments and determine its own ratings.

45. ADB will base its assessments and ratings on the World Bank's country policy and institutional assessment rating guidelines which will be used because the advantages of aligning country performance criteria outweigh the benefits from customization. The advantages include helping reduce administrative costs for DMCs, support improved performance assessments, and by extension, lead to more effective use of scarce concessional resources. Preliminary CPA narratives and ratings may be discussed with country authorities during the preparation of the first draft of the CPA, and their strategic and operational implications should be discussed thoroughly during country programming.

46. A report on the CPA will be produced every 2 years and made publicly available.[41] The CPA report will present numerical ratings on all performance criteria for all countries that are eligible for and have access to concessional resources. Consistent with the Access to Information Policy (2018), internal documents, including CPA narratives, will remain confidential.[42]

C. Portfolio Performance

47. The measurement of countries' portfolio performance ratings in the CPA is based on countries' average project performance ratings, which are calculated as a proportion of at-risk projects financed with concessional resources.[43] To smooth out anomalies of any single year and ensure more robust average project performance ratings, the average percentage of projects at risk from the previous 3 years will be applied to determine the distribution for portfolio performance ratings. The conversion scale will be periodically reviewed and updated as necessary during ADF 13.

D. Allocation Process of Concessional Resources

48. **Absorptive capacity considerations.** The policy adopts a broad interpretation of absorptive capacity that recognizes macroeconomic (fiscal and debt), sector, and service delivery dimensions. Each area may have constraints to absorbing external resources. These constraints may be institutional, physical, and human; or social, cultural, and political. The country allocations may be reduced where constraints in any of these areas are identified. However, such analysis should also help guide assistance strategies that aim to address constraints and expand absorptive capacity. This approach may be particularly important for FCAS countries. Absorption constraints for the DMC should be carefully differentiated from institutional processing constraints. The resources released will be reallocated to other ADF and COL countries, prorated according to PBA shares.

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[41] ADB. Annual Report on the Country Performance Assessment Exercise.
[42] ADB. 2018. *Access to Information Policy*. Manila.
[43] ADB. 2018. Project Performance Monitoring. *Project Administration Instructions*. PAI 5.08. Manila. The project performance rating (PPR) methodology has been improved by replacing the technical indicator with the output indicator and strengthening financial management and safeguards indicators. The other two indicators (contract awards and disbursements) remain unchanged. The new methodology started to apply to all active projects as of 1 January 2020.

49. **Country allocations.** Country allocations of ADF and COL resources are allocated for the 4-year ADF cycle with annual updates that include annual resource adjustments across countries. The following parameters will guide the annual use of country allocations of concessional resources within the 4-year ADF 13 period, subject to availability of resources:

(i) Uncommitted country allocations at the end of each year will be added to the country allocations of the subsequent year. They can be carried forward for the entire replenishment period.
(ii) Uncommitted allocations at the end of the replenishment cycle will be carried over for reallocations under the subsequent ADF cycle.
(iii) For all countries except SIDS, annual commitments are capped at 125% of the annual country allocation, but within the entire ADF 13 cycle allocation net of potential set-asides under the SDFP.[44]
(iv) For SIDS, annual commitments may go up to 300% of the annual country allocation, but must stay within the entire ADF 13 cycle allocation net of potential set-asides under the SDFP.[45]
(v) Any commitments exceeding country allocations in 1 year will be deducted from the remaining country allocations for the replenishment period.
(vi) Around the middle of the last year of the replenishment cycle, the utilization of country allocations of concessional resources will be assessed.[46] Country allocations for projects and programs that are not on schedule for commitment by the end of the year may be directed, in consultation with regional departments, to DMCs that need additional resources.

50. Proceeds from ADF and COL savings and cancellations will be returned to the originating regional departments and made available for reallocation to new lending and non-lending products during a period of 6 months, in coordination with SPD and subject to approval by the operations group's vice-presidents.

E. Disclosure

51. Greater disclosure of information about the PBA (i) promotes improved public accountability for the use of shareholders' funds, (ii) deepens client involvement in the PBA process, and (iii) helps improve the quality of assessments through increased public scrutiny. From the perspective of clients, greater disclosure should help focus and improve the quality of dialogue, strategies, and operational assistance. More broadly, ratings disclosure serves the public interest in monitoring country results and progress toward internationally agreed development policy objectives.

52. This policy is subject to compliance review under ADB's Accountability Mechanism.[47]

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[44] Non-SIDS countries, which are not satisfactorily implementing their policy actions under the SDFP are not entitled to commit resources above their annual country allocations net of set-asides under the SDFP. A country with a 4-year country allocation of a $100 million grant might lose about $15 million if it consistently failed to implement its policy actions during ADF 13.

[45] Additional flexibility for SIDS is critical because of their small annual country allocations relative size of investment projects. For SIDS, which are not satisfactorily implementing their policy measures under the SDFP, commitments may go up to 150% of the annual country allocation net of any potential set-asides under the SDFP (footnote 44). Annual commitments must stay within the country allocations, including any set-asides under the SDFP for the entire replenishment period.

[46] This assessment may include operations, funded by the thematic pool, which are not on schedule for commitment by the end of the year.

[47] ADB. 2012. *Accountability Mechanism Policy 2012*. Manila.

VI. RECOMMENDATION

53. The President recommends that the Asian Development Bank (ADB) Board of Directors approve the Concessional Assistance Policy for the ADF 13 Period as set out in paras. 6–41 (including related Appendixes), subject to the adoption by the ADB Board of Governors of the proposed resolution for the 12th replenishment of the Asian Development Fund (ADF 13) and the seventh regularized replenishment of the Technical Assistance Special Fund (TASF 7). The policy will take effect on 1 January 2021 and supersede the Concessional Assistance Policy (2016) (footnote 5).

REVISIONS OF THE ASIAN DEVELOPMENT FUND 13 GRANT AND CONCESSIONAL ORDINARY CAPITAL RESOURCES LENDING ALLOCATION FRAMEWORKS

1. The Asian Development Fund (ADF) 13 grant and concessional ordinary capital resources lending (COL) resource allocation frameworks include revisions to the ADF 12 frameworks to improve responsiveness, implementation efficiency, and effectiveness of resource allocation.

2. The ADF 13 grant and COL frameworks will retain the following elements :

(i) the country classification system and debt sustainability assessment to determine country eligibility for grants; and
(ii) the performance-based allocation formula, which comprises country performance assessments; per capita gross national income; and population.

3. Revisions of the ADF 13 grant resource allocation framework include the following elements:

(i) the discontinuation of the base allocation and the introduction of an economic vulnerability premium (EVI);
(ii) the expansion of the thematic use of ADF grants to gender equality and climate adaptation;
(iii) the introduction of a single thematic pool applicable for group A countries and very selectively for group B countries, addressing the following strategic areas: (a) fostering regional cooperation and integration, including the provision of regional public goods; (b) supporting disaster risk reduction and climate adaptation; and (c) achieving Sustainable Development Goal 5's transformative gender agenda;
(iv) the expansion of the scope of the Disaster Response Facility to cover large cross-border movements of displaced persons, health emergencies and additional countries (the expanded Disaster and Pandemic Response Facility);
(v) the introduction of a comprehensive package to enhance debt sustainability under ADF 13, which includes (a) alignment with the International Development Association on the Sustainable Development Finance Policy assessments and incentive system; (b) replacement of the static 20% discount on ADF grants with an interactive incentive scheme; (c) creation of a technical assistance special fund set-aside to support debt sustainability in ADF and COL countries; and (d) preferential access to the thematic pool for countries with prudent or improved performance in fiscal, debt, and budget management to reinforce the performance-based incentive system;
(vi) the pilot of a Private Sector Window for group A countries to help expand private sector operations in frontier markets and new sectors;
(vii) the separation of the allocation mechanisms for ADF and COL; and
(viii) the conversion of the biennial allocation to 4-year allocation with annual updates, which include annual resource adjustments across countries.

4. Revisions of the COL resource allocation framework includes the following elements:

(i) the separation of the allocation mechanisms for ADF and COL: the proposed COL allocation is based on a combined performance-based allocation and need-based adjustment approach (each accounting for 50% of overall resource allocation under ADF 13);

(ii) the conversion of the biennial allocation to 4-year allocation with annual updates, which include annual resource adjustments across countries; and

(iii) the EVP for ADF grant-eligible SIDS at moderate risk of debt distress.

ECONOMIC VULNERABILITY PREMIUM

1. The Asian Development Bank (ADB) Strategy 2030 recognizes that small island developing states (SIDS) require special attention on account of their unique development challenges.[1] Most SIDS have small performance-based allocations (PBAs) mainly because of their small population. Ensuring sufficient allocations to finance their key development programs and building resilience to address the causes of their vulnerability require modification of the PBA system.

2. An economic vulnerability premium (EVP), calibrated based on the economic vulnerability index (EVI), will complement the PBA.[2] The EVP will provide tailored support to Asian Development Fund (ADF) grant–eligible SIDS based on their degree of vulnerability on top of their PBAs. The EVI measures the structural vulnerability of countries to economic and environmental shocks. The EVI covers 145 developing countries worldwide, including all the 10 SIDS that are currently recipients of ADF grants, and is updated every 3 years by the United Nations Committee for Development Policy. The latest update was in 2018.

3. The EVI is composed of two sub-indexes with a total of eight variables: population, remoteness from the world market; merchandise export concentration; share of agriculture, forestry, and fishing in gross domestic product; share of population in low elevated costal zones; instability of exports of goods and services; victims of disasters triggered by natural hazards; and instability of agricultural production. These factors widely reflect the determining factors of structural vulnerability of SIDS. As some of the parameters (e.g., remoteness from the world market, share of population in low elevated costal zones) do not significantly change over time, EVI scores are relatively stable. This means that updates of scores will not cause significant fluctuations in resource allocation from one ADF cycle to the other.

4. Overall, the EVI is deemed to be the most suitable publicly available index for the purpose of reflecting SIDS' vulnerability in the ADF grant allocation system, based on its relevance, country coverage, data availability, simplicity, and comprehensiveness. Table A2 shows the approach of classifying SIDS by their EVI scores and the size of the EVP according to the classification. Each SIDS is classified according to its EVI score (0–100), with a higher score indicating higher vulnerability. The most vulnerable group scores 70–80, with an allocation of amount of $55 million per country under ADF 13, while the least vulnerable group scores 40–50, with an allocation of $40 million per country.

5. ADF grant–eligible SIDS at high risk of debt distress are allocated the full amount of the premium as a grant, and ADF grant–eligible SIDS at moderate risk are allocated half the amount of the premium as a grant, with the remaining amount allocated as concessional ordinary capital resources. The country eligibility and amount of the EVP will not be changed during the ADF 13 cycle to ensure predictability of resource allocations.

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[1] SIDS eligible for ADF grants as of September 2020 are the Federated States of Micronesia, Kiribati, Maldives, the Marshall Islands, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

[2] The EVI was set up by the United Nation's Committee for Development Policy and captures several characteristics such as population size, remoteness, size of economic base, and vulnerability to climate change.

Table A2: Economic Vulnerability Premium for ADF 13

Rounded EVI Score	Country (ADF grant–eligible SIDS)	Amount ($ million)
70–80	Kiribati	55
60–70	Marshall Islands	50
50–60	Federated States of Micronesia, Maldives, Nauru, Solomon Islands, Tonga, and Tuvalu	45
40–50	Samoa[a] and Vanuatu	40

ADF = Asian Development Fund, EVI = economic vulnerability index, SIDS = small island developing states.
Note: Countries classified at moderate risk of debt distress will get half of the premium as a grant and half of the premium as concessional ordinary capital resources lending.
[a] Samoa's score of 39.7 was rounded to 40.
Source: Asian Development Bank.

SPECIAL ALLOCATION FOR AFGHANISTAN

1. Demand for Asian Development Bank (ADB) support remains robust, and continued access to the Asian Development Fund (ADF) special allocation is vital for Afghanistan. The allocation will continue to enable Afghanistan to (i) tackle its development challenges while the country remains at high risk of debt distress, (ii) finance projects, (iii) help restore peace and stability in the country and the region, and (iv) contribute to regional economic cooperation between Central Asia and South Asia to raise the region's prospects of the region. Continued ADF support is essential to catalyze cofinancing from other sources for key infrastructure projects.

2. ADB reengaged with Afghanistan in 2002 and started to provide a special allocation in 2005. Afghanistan's country allocation was—and continues to be—largely determined outside the performance-based allocation because of the country's substantial development needs and fragile and conflict-affected situation (FCAS) status.

3. Afghanistan has made substantial progress since ADB resumed its operations there. The country has harnessed international support to rebuild its political system, institutions, infrastructure, and economy. It has shown improvement on various economic and social indicators. Gross domestic product per capita increased from $364 in 2004 to $601 in 2018. The government has made significant progress in education, health, and the delivery of other public services.[1] Afghanistan has raised its levels of literacy; school enrollment; and access to basic services such as water, sanitation, and electricity. The Human Development Index increased from 0.373 to 0.496 from 2002 to 2019. Life expectancy rose from 56.0 years in 2000 to 64.5 years in 2019.[2]

4. Despite notable progress, Afghanistan still faces many challenges. It is ADB's poorest developing member country and one of the poorest countries in the world. According to official statistics, more than half the population lived below the national poverty line in 2017 (estimated at 55%) and many who were above the line were vulnerable to falling back into poverty.[3] In addition to serious problems caused by violent conflict and political uncertainty, Afghanistan faces risks from disasters, including earthquakes, droughts, and floods. Despite significant improvements in domestic revenue mobilization, about half the national budget is still financed through international development assistance.

5. The overall prospects of Afghanistan have been significantly affected by the coronavirus disease (COVID-19) pandemic, which has resulted in increased unemployment and reduced remittance inflows, regional trade, government revenue, and overall economic activity. The pandemic has significantly affected employment levels and livelihoods, threatened food security, and increased poverty. Preliminary government estimates put the national poverty rate at 70% in 2020.[4]

6. Afghanistan has many development priorities, but the need for infrastructure is especially acute. Only about a third of the population is connected to the power grid. Afghanistan depends heavily on agriculture but has developed only half its potentially irrigated farmland. The country's main highway network is still undeveloped, and a crucial north–south link—the Salang Tunnel—is at the end of its useful life. As the country's infrastructure investment needs greatly exceed the

[1] United Nations Assistance Mission in Afghanistan. Reflections on Key Challenges for Afghanistan. Paper for the Geneva Conference on Afghanistan. Unpublished.
[2] United Nations Development Programme (UNDP). *Human Development Report 2019.* New York.
[3] Central Statistics Organization (Afghanistan). 2018. *Afghanistan Living Conditions Survey 2016–17*. Kabul.
[4] Ministry of Finance (Afghanistan). 2020. *Draft Afghanistan National Peace and Development Framework II*. Kabul.

current level of commitments, higher levels of investment are needed to achieve growth and create jobs.

7. ADB is the major development partner focused on infrastructure development, taking the lead in transport, energy, and agriculture and natural resources. ADF grants enable ADB to play a meaningful role in Afghanistan's development and provide a stable and reliable level of resources. This stability is important for Afghanistan as a FCAS and allows ADB to make a long-term commitment to the country's development.

8. ADB has been working to improve its operations in Afghanistan. Considering the unique and challenging operating environment, ADB has developed a FCAS-sensitive operational approach adapted to the country's situation. To improve project performance, ADB has been strongly engaged in building the capacity of line ministries through multiple technical assistance packages. ADB has taken actions to increase efficiency and reduce bottlenecks in procurement, including (i) strengthening the National Procurement Authority, (ii) reducing the size of procurement packages to widen the pool of eligible contractors and achieve more competitive bidding, (iii) allowing pre-bid site visits so that contractors can assess security costs in insecure areas, and (iv) conducting training in contract management.

9. Ensuring sustainability of outputs and outcomes of ADB operations has been a key concern. ADB has been prioritizing innovative financing methods to improve sustainability and reduce the overall life-cycle costs to the country of the assets provided. The designs and technical solutions for new projects will consider the actual capacity for effective post-completion operation and maintenance (O&M) (of particular infrastructure and equipment, for example); the overall life-cycle costs (compared with the likely future ability to finance them); and all other relevant hard realities on the ground. ADB co-chairs the O&M Executive Committee (OMEC) of Afghanistan, which was set up to recommend O&M policies to the government. ADB has funded a team of consultants to work with OMEC to help prepare O&M policy recommendations. ADB efforts in OMEC focus on transport, energy, and agriculture.

IMPLEMENTATION OF THE DEBT SUSTAINABILITY ENHANCEMENT PROGRAM UNDER THE SUSTAINABLE DEVELOPMENT FINANCING POLICY

1. The Debt Sustainability Enhancement Program is a pillar of the Sustainable Development Financing Policy (SDFP), approved in June 2020 by the International Development Association (IDA).[1] The program will enhance incentives for countries to move toward transparent and sustainable financing. Under the program, which covers all IDA-eligible countries, countries will implement policy actions to enhance debt sustainability. Performance against these actions will have implications for IDA allocations. For allocation of ADF grants, for group A countries at high or moderate risk of debt distress, ADB will align with the SDFP, as described below. For allocation of concessional ordinary capital resources lending (COL) for group A countries at low risk of debt distress, IDA gap countries[2], and group B countries, ADB will monitor IDA's SDFP implementation, in close collaboration with the government, IDA and IMF, which may trigger adjustments to COL allocations.

2. **Policy actions.** Depending on country context, policy actions may cover some or all of the following areas:
   (i) enhancing debt transparency, including by improving the coverage, accuracy, and timeliness of debt reporting;
   (ii) enhancing fiscal sustainability (e.g., through revenue mobilization, public expenditure efficiency, reduction of fiscal arrears, public investment management); and
   (iii) strengthening debt management, including by using borrowing limits and minimizing collateralization.

3. Policy actions could take various forms, depending on the country context and the underlying factors that contribute to debt vulnerabilities. Examples of policy actions to foster debt transparency include disclosure of loan contract terms and payment schedules; full disclosure of the stock of public and publicly guaranteed debt, state-owned enterprise liabilities, and debt-like instruments; steps by borrowers to request relief from excessive confidentiality clauses to proceed with transparent data reporting; measures to ensure effective and prudent use of collateral and liens in sovereign borrowing; compliance with legal requirements of other creditors, such as negative pledge clauses; and improved reporting of external debt.

4. Examples of policy actions to strengthen fiscal sustainability include measures to (i) enhance domestic resource mobilization through tax reforms (i.e., by broadening the base and changes to rates and rationalizing tax expenditures); (ii) improve the efficiency and effectiveness of spending while protecting the poor and vulnerable (e.g., by reforming public procurement, implementing a medium-term fiscal strategy, strengthening oversight of state-owned enterprises); and (iii) improve public investment management (e.g., by enhancing the quality of the evaluation framework and selection and execution of public investment projects, and integrating the public investment plan into the annual budget).

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[1] IDA. 2020. *Sustainable Development Finance Policy of the International Development Association.* Washington, DC. The SDFP became effective on 1 July 2020 and replaced the Non-Concessional Borrowing Policy (NDSP).

[2] IDA gap countries are not eligible for ADF grants. They are group A countries (except SIDS) that have had GNI per capita above the operational cutoff for IDA eligibility for more than 2 consecutive years and are assessed as a gap country by IDA. The operational cutoff is $1,185 (2019 prices). As of September 2020, the IDA gap countries among ADB's DMCs were Bhutan, the Lao People's Democratic Republic, and Myanmar.

5. Examples of policy actions to improve debt management include measures to (i) enhance the legal and regulatory framework for public debt, (ii) adopt and publish a medium-term debt management strategy, and (iii) improve debt recording.

6. For countries with a borrowing ceiling agreed by the World Bank and the International Monetary Fund (IMF), policy actions will include this borrowing ceiling.[3] Like other policy actions, borrowing ceilings aim to support countries to meet their financing needs in a sustainable manner. They are important tools to help governments make informed borrowing decisions and promote efficient use of financing, while avoiding unsustainable debt buildup. In addition to being an important performance target, borrowing ceilings can also help creditors make informed lending decisions. Borrowing ceilings under the SDFP will primarily take the form of nominal limits on non-concessional external public and publicly guaranteed debt, which will ensure continuity with the implementation of the Non-Concessional Borrowing Policy[4] as well as consistency with the International Monetary Fund's revised Debt Limit Policy. The framework for establishing borrowing ceilings by the World Bank and the IMF is presented in the IDA SDFP policy paper (Annex 3) (footnote 1).

7. **Identifying a set of policy actions designed to enhance debt sustainability and assessing progress on their implementation.** First, three policy actions will be identified for ADF countries during the ADF 13 cycle to enhance debt sustainability. Fragile and conflict-affected situations and small island developing states will require two policy actions. Policy actions should depend on the country context and underlying factors that contribute to debt vulnerabilities. Policy actions should consider the capacity constraints of ADF countries and the specific challenges of small island developing states and fragile and conflict-affected situations. The Asian Development Bank (ADB) will identify a set of policy actions with governments and in close collaboration with other international financial institutions such as IDA and IMF. To a great extent, the policy actions for ADF countries are expected to fully align with IDA's policy actions. This will help reduce administrative costs for both organizations and governments and maximize synergies of policy reforms through close coordination. In some cases, where ADB's operational priorities in an ADF country differ from those of IDA, ADB's policy actions can be partly aligned, subject to policy discussions with governments. IDA will be informed and consulted in these cases. The policy actions can be annual actions, which should be identified before the beginning of the year in which they will be assessed. They can also be programmatic policy actions, including annual milestones, which should be identified before the beginning of the ADF 13 cycle.[5]

8. Key diagnostic and analytical tools that will help identify the policy actions will include debt sustainability assessments,[6] debt management performance assessments,[7] existing systematic country diagnostics and ongoing policy-based loans, and IMF programs. The policy actions should be simple and easily measurable.

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[3] The World Bank and the IMF share on a monthly basis an updated table with a list of IDA-only and Poverty Reduction and Growth Trust- eligible countries subject to IMF/ World Bank Group debt limits.

[4] Under the Non-Concessional Borrowing Policy, IDA implemented mechanisms to deter grant-eligible countries from acquiring or expanding their non-concessional debt by reducing allocations or hardening terms. ADB adopted a similar mechanism under ADF 12 for grant recipients which accumulated non-concessional debt.

[5] When ADB's policy actions are aligned with IDA's, ADB country teams will have to adjust the implementation milestones because IDA and ADB have different fiscal years. Programmatic policy actions with annual milestones may be considered if ADB and IDA are already operating programmatic policy-based programs in the country which policy actions can align with. Annual policy actions may be considered if policy measures are more self-contained (for example, borrowing ceilings).

[6] IMF. 2018. *Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries*. Washington, DC.

[7] World Bank Group (2015). Debt Management Performance Assessment (DeMPA) Methodology. Washington, DC.

9. Second, the progress made by countries in implementing their policy actions will be assessed relative to their defined milestones at the end of each of the first 3 years of the ADF cycle. The final assessment will be submitted to the SDFP review panel during the fourth quarter of the year.[8] Assessments agreed upon by the SDFP review panel will be forwarded to the vice-presidents of the concerned regional departments and to the vice-president, knowledge management and sustainable development, for final approval by the end of the fourth quarter.

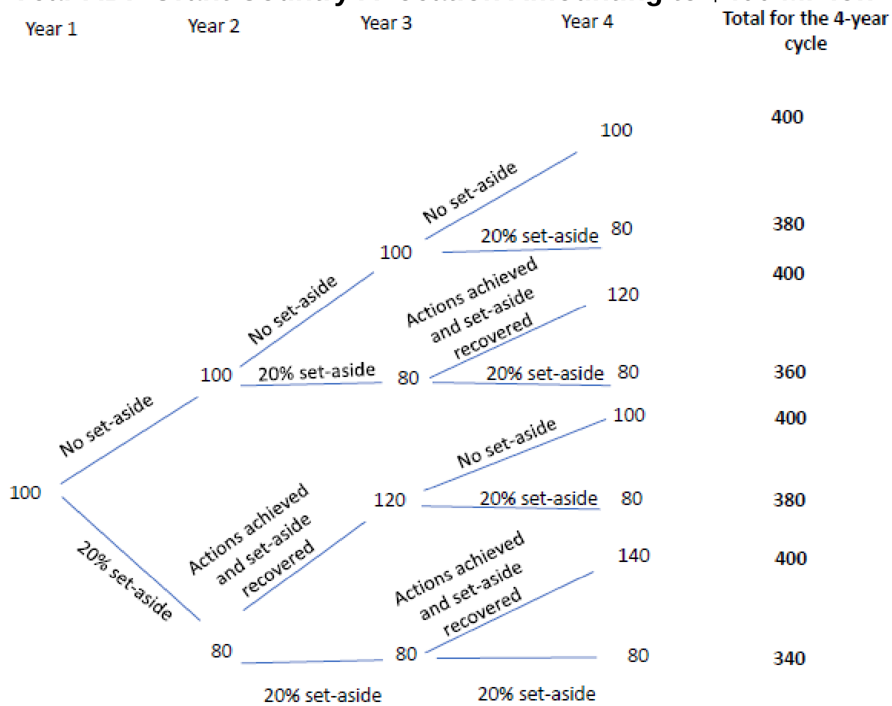
10. Finally, performance against the policy actions will have implications for ADF country allocations. ADF countries that do not satisfactorily implement their policy actions will not be able to access 20% of the next indicative annual grant allocation. In general, progress will be assessed as unsatisfactory if at least one policy action is not met. Specificities of the country or exceptional events may be taken into consideration to qualify the assessment. The grant resources set aside can be recovered if policy actions are eventually achieved at the end of the third year of ADF 13. Countries with repeated unsatisfactory implementation of agreed policy actions at the end of years 1, 2, and 3 will lose a total of about 15% of their total 4-year grant country allocation. In some cases (severe or repeated breaches of policy actions such as going over the non-concessional borrowing ceiling), the terms of concessional financing can be hardened and grants replaced with concessional lending.[9] At the beginning of the fourth year of the ADF 13 cycle, reductions in grant country allocations that are lost irrevocably will be redistributed to countries demonstrating satisfactory progress in implementing their policy actions through the performance-based allocation formula and/or reallocated to the thematic pool.

11. Performance against the policy actions may also have implications for COL allocations for IDA gap countries (footnote 2), group A countries at low risk of debt distress, and group B countries. The COL-eligible countries that do not satisfactorily implement their policy actions may also not be able to access 20% of the next indicative annual COL allocation, but these allocations can be recovered if policy actions are eventually achieved in the following years.

[8] The SDFP review panel is chaired by the director general of SPD. Its members include the directors general of regional departments and the Sustainable Development and Climate Change Department and the chief economist and director general of the Economic Research and Regional Cooperation Department.

[9] This extra sanction will be applied on top of setting aside a portion of the annual country allocation.

Figure A4: System of Sustainable Development Finance Policy Set-Asides during a 4-Year ADF Cycle. Example of a Group A Country at High Risk of Debt Distress with a 4-Year ADF Grant Country Allocation Amounting to $400 Million



ADF = Asian Development Fund.
Asian Development Bank

IMPLEMENTATION OF THE ASIAN DEVELOPMENT FUND THEMATIC POOL OF GRANT RESOURCES

1. The thematic pool responds to the main challenges in the poorest and most vulnerable developing member countries, in alignment with Strategy 2030, with a focus on the following strategic areas: (i) fostering regional cooperation and integration, including the provision of regional public goods;[1] (ii) supporting disaster risk reduction and climate adaptation; and (iii) achieving Sustainable Development Goal 5's transformative gender agenda.

2. The provision of Asian Development Fund (ADF) grants from the thematic pool aims to incentivize governments to consider projects that otherwise would not take place. Project eligibility criteria target projects with large development impact (even if financial returns are low) and underinvested activities with positive externalities. Activities and projects supported by the ADF 13 thematic pool go beyond gender mainstreaming and climate change mainstreaming that will continue to be implemented without additional incentives.

3. The thematic pool supports projects in ADF and concessional ordinary capital resources lending countries: group A countries, including International Development Association–gap countries and, on a very selective basis, group B countries. Priority is given to fragile and conflict-affected situations (FCAS) and small island developing states. During a cycle, support for projects in group B countries or involving group B countries in the case of multi-country projects is capped at 10% of the total thematic pool size. Project eligibility criteria are more stringent for projects in group B countries. A maximum of two-thirds of the project cost can come from the ADF 13 thematic pool for projects in group A countries and a maximum of one quarter of the project cost for projects in group B countries. There is no absolute cap per country but, as ADF grant resources are scarce, requests for ADF grants should be strongly justified by the project's scope and outputs. All project and program modalities are eligible for accessing grant resources from the thematic pool.

4. ADF 13 thematic pool grant resources will be programmed through annual calls for proposals, organized in May–June. Regional departments will submit project proposals, which can be at the pre-concept or later stage. Resources from the thematic pool will be allocated following a two-step process. First, the proposals will be screened based on a set of eligibility criteria (Tables A5.1–A5.4). Second, eligible projects will be selected and prioritized based on a scorecard (Table A5.5). Each project meeting the eligibility criteria will be scored by an Asian Development Bank (ADB) internal committee composed of staff members from ADB's Sustainable Development and Climate Change Department, including gender and FCAS experts, and from ADB's Strategy, Policy and Partnerships Department. The assessment and scoring will be informed by cross technical peer reviews from regional departments. The eligible projects will be assigned scores based on (i) the project's development impact in the strategic area(s), (ii) the quality (improved or prudent) of fiscal, debt and budget management in the country(ies) where the project will take place, (iii) the portfolio performance in the country(ies) where the project will take place, (iv) the multi-country and multi-thematic aspects of the project, (v) the ability of the project to leverage other financing sources, and (vi) innovativeness. A weighted bonus point will be given for projects in FCAS and a weighted bonus point will be given for projects in small island developing states. Projects with the highest scores will receive funds from the thematic pool. Projects with a score below 1 will be excluded. A regional project will be assessed using the weighted average of the scores given to each country subcomponent of the project. Regional

[1] Regional health security, with attention to universal health coverage, and environmental preservation such as ocean health, and biodiversity and ecosystems services.

projects with more participating group A countries will be prioritized.[2] While these allocation principles (criteria and weights) will be maintained during the ADF cycle, the rating scale may be adjusted during the cycle to better reflect the quality of projects.

5. Projects will have about 2 years to be committed. If projects selected to be supported by the thematic pool drop out of the pipeline, ADF grants from the thematic pool will be returned to the thematic pool for reallocation during the cycle. If a project initially selected and prioritized in July of year 1 is not committed by the end of year 3, the ADF grant resources allocated to the project will be returned to the thematic pool for further allocation, together with remaining funds, based on project selection and prioritization.

Table A5.1: Project Eligibility Criteria for Projects on Regional Cooperation and Integration and Regional Public Goods

In Group A Countries	In Group B Countries
Stand-alone projects and discrete project components and/or outputs are eligible if they pertain to the three strategic priorities outlined in the RCI Operational Plan for 2019–2024: (i) greater and higher-quality connectivity between economies; (ii) expanded global and regional trade and investment opportunities; and (iii) increased and diversified regional public goods, focusing on environmental protection and sustainable management of shared natural resources, which include ocean health, and biodiversity and ecosystem services, and on regional health security. All projects must have been classified as RCI following assessment using the RCI scorecard. It considers (i) the relevance of the project to regional agreements and strategies; (ii) the existence of cross-border economic spillovers; and (iii) wider benefits such as regional harmonization of standards, technology transfer, and knowledge sharing.	Stand-alone projects and discrete project components and/or outputs pertaining only to increased and diversified RPGs are eligible. Focus is on environmental protection and sustainable management of shared natural resources, which include ocean health, and biodiversity and ecosystem services, and on regional health security. Only projects in group B countries with prudent (average score of the latest relevant CPA criteria is above 3 out of 6) or improved (average score of the latest relevant CPA criteria has increased from the previous assessment) fiscal, debt, and budget management are eligible.

CPA = country performance assessment, RCI = regional cooperation and integration, RPG = regional public good.
Source: Asian Development Bank.

[2] The criteria will be updated, if necessary, during the ADF 13 midterm review, based on actual experience of implementation and donors' feedback.

Table A5.2: Project Eligibility Criteria for Projects Supporting the Provision of Regional Public Goods

Criteria for Regional Health Security	Criteria for Environmental Protection and Sustainable Management of Shared Natural Resources (which include ocean health, and biodiversity and ecosystem services)
Eligible stand-alone projects and discrete project components and/or outputs support one or more of the following: (i) Strengthen capacity to prevent, detect, and respond to human and animal disease outbreaks before they become pandemics. (ii) Develop a robust health system and financing for moving toward universal health coverage, thereby contributing to containing outbreaks before they become pandemics. (iii) Support region-wide universal health coverage schemes that will strengthen financing and delivery of region-wide prevention, detection, and treatment of communicable and other diseases of migrant workers and other nonnationals. (iv) Strengthen capacities for transparent and timely information sharing with regional and global partners during outbreaks, which is critical to mitigate their spread and impact. (v) Support regional health cooperation, including region-wide training of the health workforce; pooled procurement of and logistic systems for medicines, diagnostics, and vaccines; and region-wide tele-medicine, tele-radiology, and tele-pathology systems, which help address communicable diseases. (vi) Address country-level and region-wide anti-microbial resistance and inappropriate use of antibiotics in humans and animals. (vii) Strengthen health infrastructure facilities that focus on addressing communicable diseases in border areas. (viii) Enhance laboratory capacities that support surveillance and management of communicable diseases. (ix) Help increase collaboration among sectors (e.g., human and animal health, finance, agriculture, security, defense, law enforcement, development, foreign affairs, research) and nongovernment partners. This includes helping prevent transmission of diseases from animals to humans, and from humans to animals, and other region-wide OneHealth interventions that jointly address human and animal health concerns. (x) Sustain programs on vaccine-preventable diseases, malaria, tuberculosis, and HIV/AIDS, particularly after the reduction of Global Fund financing support.	Eligible stand-alone projects and discrete project components and/or outputs support one or more of the following: (i) protection, restoration, and/or enhancement of terrestrial, coastal, and marine ecosystems and biodiversity; (ii) sustainable management of land, forest, water, and marine resources; and (iii) enhanced resource efficiency and/or pollution control. **Examples:** The project (i) protects or restores critical ecosystems such as coral reefs, seagrass beds, or mangrove forests, especially if planned to restore ecological connectivity; (ii) uses nature-based or integrated solutions to protect atolls, small island developing states, and vulnerable coastal cities against climate impacts by combining eco-sensitive engineering with mangrove forest or coral reef rehabilitation; (iii) rehabilitates island, coastal, or riverside landfills leaking chemicals and wastes into the ocean; (iv) keeps plastics out of the ocean; (v) supports ecosystem-based fisheries management to improve food security for coastal communities; (vi) integrates biodiversity management into urban and rural development strategies; (vii) supports reforestation or riparian planting to reduce soil erosion and the sedimentation of coastal ecosystems; or (viii) reverses the spread of invasive species, particularly in small island states, where this issue is more prevalent.

Source: Asian Development Bank.

Table A5.3: Project Eligibility Criteria for Projects Supporting Disaster Risk Reduction and Climate Adaptation

In Group A Countries	In Group B Countries
Eligible stand-alone projects are those that have (i) disaster risk reduction as their primary objective (e.g., school seismic retrofitting); discrete components and/or outputs that reduce disaster risk (e.g., development of a flood early warning system as part of urban development projects); and/or incremental costs of strengthening the resilience of infrastructure investments in case of geophysical events; or (ii) climate adaptation as the primary objective (e.g., climate smart agriculture); and discrete adaptation components and/or outputs of projects (e.g., integrating climate adaptation considerations into road asset management systems). Incremental costs of strengthening climate resilience of infrastructure investments are not eligible as these costs are met through climate mainstreaming efforts.	Eligible stand-alone projects must meet the same criteria as those in group A. In addition, because a large proportion of the poor and vulnerable in group B countries live in high-risk areas and are dependent on climate-sensitive sectors for their livelihoods, additional ADF grants from the thematic pool will support only eligible projects that focus explicitly on building resilience of the poorest and most vulnerable by (i) piloting innovative solutions to build resilience (e.g., use of ecosystem-based solutions for coastal defense, use of high-level technology to improve early warning systems, use of traditional earthquake-resistant construction techniques to retrofit schools and hospitals); or (ii) leveraging additional climate and/or disaster finance (including from the private sector) to strengthen resilience. Only projects in group B countries with prudent (average score of the latest relevant CPA criteria is above 3 out of 6) or improved (average score of the latest relevant CPA criteria has increased from the previous assessment) fiscal, debt, and budget management are eligible.

ADF = Asian Development Fund, CPA = country performance assessment.
Source: Asian Development Bank.

Table A5.4: Project Eligibility Criteria for Projects Achieving the Sustainable Development Goal 5's Transformative Gender Agenda

In Group A Countries	In Group B Countries
Stand-alone projects or distinct outputs of projects targeting one or more of the following strategic areas are eligible: (i) elimination of violence against women and girls (e.g., building a gender-based violence survivors' shelter; building a country system to deal with sexual harassment, exploitation, and abuse, following the principles of the joint MDB heads' statement); (ii) reduction and rebalance of unpaid care and domestic work (e.g., building and operating affordable and sustainable childcare facilities and services in urban and rural areas); (iii) women's participation in decision-making and leadership (e.g., supporting women's "meaningful" participation in decision-making that results in changes in public sector and corporate behavior); (iv) sexual and reproductive health and rights (e.g., supporting menstrual hygiene education and facilities at school); (v) access to economic and productive resources and information and communication technology (e.g., promoting agriculture and housing land and other assets); and (vi) legal or institutional reforms to protect women's rights and change gendered social norms (e.g., supporting legal, institutional, and governance reforms to remove gender-discriminatory provisions and gender stereotypes). Standard activities mainstreamed into projects are not eligible.	Criteria are the same as for group A countries, and projects should take place in countries in the bottom tier (33%) of the OECD Social Institution and Gender Index or the World Economic Forum Global Gender Gap Report. In case of lack of data, CPA scores and country gender assessments are used. Only projects in group B countries with prudent (average score of the latest relevant CPA criteria is above 3 out of 6) or improved (average score of the latest relevant CPA criteria has increased from the previous assessment) fiscal, debt, and budget management are eligible.

CPA = country performance assessment, MDB = multilateral development bank, OECD = Organisation for Economic Co-operation and Development.
Source: Asian Development Bank.

Table A5.5: Selection and Prioritization Criteria and Corresponding Scorecard

Criterion	Source of the Score	Weight	Scale (0–3 points)
1. Located in countries with prudent or improved fiscal, debt, and budget management	Aggregate of criteria 2 and 3 (fiscal policy and debt policy and management) and criteria 13 and 14 (quality of budgetary and financial management budget and revenue and efficiency of revenue mobilization) of the existing CPA	30%	**3 points** if average score has improved and if the score is above 3 **2 points** if average score has improved **2 points** if average score is stable and above 3 **1 point** if average score has decreased and is above 3 **1 point** if average score is stable and below 3 **0 points** if average score has decreased and below 3
2. Development impact in the relevant strategic area(s)	Rated by the committee based on qualitative assessment informed by the project proposal	20%	**3 points** for projects with relatively higher development impact **2 points** for projects with medium development impact **1 point** for projects with relatively lower development impact
3. Located in countries with higher country portfolio performance	Criterion 17 of the CPA	10%	**3 points** if portfolio performance indicator is 4.5 **2 points** if portfolio performance indicator is 4.0 **1 point** if portfolio performance indicator is 3.5 **0 points** if portfolio performance indicator is 3.0
4. Multicountry projects and multi-thematic projects	Assessed based on proposal	10%	**3 points** for multicountry projects addressing more than 1 strategic area **2 points** for multi-country projects addressing 1 strategic area **2 points** for single country project addressing more than 1 strategic area **0 points** otherwise

Criterion	Source of the Score	Weight	Scale (0–3 points)
5. Leveraging external funding or with enhanced government buy-in	Calculated based on proposal	10%	**3 points** if country allocation and other sources,[a] including commercial sources, represent more than 50% of the project cost in group A countries and more than 83% of the project cost for a project in group B **2 points** if country allocation and other sources, including commercial sources, represent 33%–50% of the project cost in group A countries and 75%–83% of the project cost in group B **1 point** if country allocation and other sources, including commercial sources, represent 33% of the project cost in group A countries and 75% in group B **0 points** if the country allocation funds 33% of the project cost in group A countries and 75% in group B and no other sources are leveraged
6. Innovativeness	Rated by the committee	10%	**3 points** for projects pilot testing innovative solutions in at least two of the following areas: financing solutions, technical design, implementation arrangements, and collaboration and knowledge partnerships **2 points** for projects pilot testing innovative solutions in technical design **1 point** for projects pilot testing innovative solutions in implementation arrangements **0 points** otherwise
7. FCAS and SIDS		10%	**1 point** if the project takes place in an FCAS or a SIDS **2 points** if the project takes place in a FCAS that is also SIDS

CPA = country performance assessment, FCAS = fragile and conflict-affected situations, SIDS = small island developing states.
[a] Other sources include government contribution and cofinancing.
Source: Asian Development Bank.

PILOT PRIVATE SECTOR WINDOW TO PROMOTE PRIVATE SECTOR OPERATIONS IN GROUP A COUNTRIES

A. Introduction

1. Asian Development Fund (ADF) resources will be allocated to support the Private Sector Window (PSW) on a pilot basis to promote private sector growth, expand investment, and mobilize private finance in group A countries.

2. Financial markets in group A countries can be inefficient in supporting private sector development and growth as they are often perceived as high risk, which drives high-risk pricing, and precedents are insufficient to counter these risks. The need for de-risking private sector investments has increased since the outbreak of the coronavirus disease (COVID-19) pandemic as businesses try to access financing to kick-start and rebuild operations that have been adversely impacted by the pandemic. The PSW addresses the financing constraints that prevail in many group A countries, including (i) lack of access to local currency financing, (ii) limited capacity to carry foreign currency risk, (iii) prohibitive cost of debt capital, (iv) collateral requirements that prevent investors from accessing finance, and (v) limited access to de-risking solutions offered in the market that can improve bankability of borrowers and projects.

B. Scope

3. The PSW promotes and supports private sector operations (PSO) in group A countries by helping mobilize, catalyze, and encourage private sector investments through (i) local currency, (ii) blended finance, and (iii) loan guarantee solutions. The PSW will be provided for transactions that aim to mobilize additional capital from the private sector to contribute to private sector development in the targeted economies. The PSW will offer additional grant resources through the three solutions to reduce common financing constraints that hinder many private sector transactions in group A countries.

C. Objective

4. The primary objective of the PSW is to increase access to finance and lower the cost of high-risk (actual and perceived) financing in group A countries. The PSW is a source of funding that will enable the expansion of the scope and range of PSO in group A countries, including fragile and conflict-affected situations and small island developing states, through co-investments and partnerships with commercial lenders and investors in these countries.

5. The Private Sector Operations Department will lead the implementation of the PSW by pursuing a coordinated approach across Asian Development Bank (ADB) operations to expand its support in frontier markets and/or new sectors, particularly those that demonstrate strong development impact. The PSW builds on ADB's existing blended concessional finance platforms (i.e., where concessional finance is used to support PSO), which have been in operation since 2012.

D. Governance

6. Implementation of the PSW will adhere to ADB's established governance procedures for the use of concessional resources for PSO, which are consistent with the Development Financial Institutions Principles for Blended Concessional Finance in Private Sector Operations (Blended Concessional Finance Principles). These principles include additionality, crowding-in

private finance, commercial sustainability, reinforcing markets, and promoting high standards. All transactions utilizing PSW resources will be assessed by ADB's Blended Finance Committee (BFC).

7. The BFC is an independent decision-making body that will safeguard the allocation and deployment of PSW resources to ensure that they are being utilized only for transactions that meet the PSW eligibility criteria, in addition to the Blended Finance Principles. The BFC will review each proposed PSW transaction at the concept and final review stages to determine the transaction's adherence to the Blended Concessional Finance Principles. The BFC ensures consistent application of the Blended Concessional Finance Principles across all funds and transactions and the PSW will be subject to the same assessment procedures implemented for other concessional resources.

E. Eligibility Criteria

8. An eligibility assessment framework will be applied to filter prospective transactions before they go through the standard ADB credit assessment and approval processes for PSO transactions. Compliance with the eligibility assessment framework will be determined as part of the decision-making process to determine whether a transaction is suitable for PSW resources. This analysis will ensure that scarce PSW resources are deployed in transactions that, among other things, are consistent with ADB's long-term strategic priorities, relevant country priorities, and adhere to the Blended Finance Principles.

9. The following are the indicative criteria for assessing eligibility of transactions for PSW support:

- i. Country and/or solutions applicability
  - a) Is the transaction located in a group A country?
  - b) Is the economic rationale consistent with the intended purpose of PSW solutions?
- ii. Strategic alignment
  - a) Are the transaction parameters consistent with Strategy 2030?
  - b) Is the transaction consistent with the Operational Plan for Private Sector Operations?[1]
- iii. Adherence to the Blended Concessional Finance Principles
  - a) Does the transaction meet the requirements of the Blended Concessional Finance Principles, including the following?
    1. Additionality
    2. Crowding-in private sector and minimum concessionality
    3. Commercial sustainability
    4. Reinforcing markets
    5. Promoting high standards (in corporate governance, environmental impact, social inclusion, integrity, among others)
- iv. Risk considerations for the ADF
  - a) Are the potential transaction risks outweighed by the anticipated development impacts?
  - b) What are the risk mitigation strategies?

[1] ADB. 2019. *Operational Plan for Private Sector Operations, 2019–2024*. Manila

F. Private Sector Window Solutions

10. The PSW offers the following three financing solutions: (i) local currency, (ii) blended finance, and (iii) loan guarantee. These solutions may be combined to maximize impact while maintaining minimum concessionality and adhering to the Blended Finance Principles.

11. The local currency solution will help mitigate and protect against potential losses caused by local currency exposure, which will encourage and enable local currency lending, which is critical for group A countries. Potential transactions to be considered include the provision of credit lines and facilities to local commercial lenders and financial institutions (including local development banks) to support local currency lending to small and medium-sized enterprises or other projects, as well as a structured solution to provide local currency support directly to borrowers in ADB-led transactions.

12. The blended finance solution is designed to improve the commercial viability of projects by reducing the cost of financing, which is often extremely high or prohibitive in group A countries. The blended finance solution will be considered for private sector projects and activities that are well-designed and reasonably expected to service financing and/or deliver capital returns but face financial viability gaps. The solution is expected to focus on support to transactions in renewable energy; agribusiness (e.g., processing and storage facilities); and social infrastructure (e.g., university facilities, healthcare facilities, and pharmacies).

13. The loan guarantee solution (LGS) intends to improve the risk profile of a project or a financial intermediary. The LGS will back-stop first-loss call, caused by credit loss or default, to improve the risk profile of transactions, enabling better pricing and access to affordable financing. The LGS can also be applied to help ADB crowd in co-lenders to finance underlying funding that locally domiciled banks require to provide local currency loans at extended loan tenors to ADB-led projects. The assistance will expedite longer-term financing required in critical sectors such as infrastructure and financial institutions. Often, local banks are constrained from lending for longer durations by regulatory limitations on their capital use, or by their own lack of access to long-term funding in their domestic market.

G. Transparency and Information

14. ADB has developed a disclosure framework for PSW transactions that considers its current disclosure practices and those of peer institutions. ADB will disclose the following information for PSW transactions: (i) the nominal grant element of PSW support, (ii) the total project cost and/or total ADB loan (or equity) committed for the individual PSW blended finance solution, (iii) the rationale for supporting the transaction with concessional resources, (iv) the additionality that the PSW offers, (v) the development impact the transaction is expected to deliver, and (vi) arguments used to estimate the minimum amount of subsidy needed to catalyze the transaction (minimum concessionality). For each local currency solution and LGS, ADB will disclose an upper nominal limit to the total ADB loan committed and the total project cost.

15. ADB's approach to disclosure will demonstrate to donors and the public that ADB is deploying grant resources to private sector projects that not only meet the Blended Finance Principles but also contribute high development impacts.

H. Development Coordination

16. An outreach program during the first year of the pilot will target ADB staff and select group A countries to market and create awareness of the availability and the types of solutions offered under the PSW initiative. The outreach will assist in project identification and subsequently help build a pipeline of transactions. Consultations during the formulation of the PSW have already created some awareness within ADB and the outreach program will build on this momentum. At the same time, ADB will engage with prospective local and regional sponsors (including local financial institutions) to gauge their risk and/or return requirements, which will be critical in the structuring of PSO transactions seeking PSW support.

EXPANDED DISASTER AND PANDEMIC RESPONSE FACILITY

A. Introduction

1. The expanded Disaster and Pandemic Response Facility (DRF+) follows the Asian Development Bank's (ADB) policy frameworks on disaster management. The Disaster and Emergency Assistance Policy[1] will be replaced by the Revised Disaster and Emergency Assistance Policy (draft).[2] When ADB uses specific modalities for disaster responses (e.g., emergency assistance loans), the DRF+ assistance will comply with the policies and procedures as appropriate under such modalities.

B. Objective

2. The objective of the DRF+ is to provide timely and effective assistance to eligible countries through a more predictable financing source to cover the costs of disaster and emergency assistance, early recovery, and reconstruction after a disaster. The DRF+ complements the disaster risk reduction and regional heath security activities supported by the thematic pool.

C. Scope of the Expanded Disaster and Pandemic Response Facility

3. The scope of the DRF+ for group A countries covers disasters triggered by natural hazards; large cross-border movements of displaced persons; and public health emergencies, including epidemics and pandemics. The risk of debt distress determines eligibility for grants and associated grant share from the DRF+.[3]

4. However, in the case of a severe disaster or emergency with estimated damage and losses exceeding 10% of gross domestic product, all group A countries are eligible for Asian Development Fund (ADF) grants with full grant share from the DRF+. ADF grant assistance may also be offered to group B countries when they accommodate significant cross-border inflows of displaced people in full alignment with the criteria developed by the International Development Association (IDA) 19 Window for Host Communities and Refugees.

D. Resources

5. In case of a disaster or emergency, an eligible country can get up to 100% of its annual country allocation or up to $100 million (whichever is lower) from the DRF+, depending on resource availability. Because of its limited size, the DRF+ will reduce but not eliminate the need to use portfolio restructuring and savings and cancellations for disaster and emergency response. Reprogramming or other means are likely to be used in parallel in most cases. Eligible countries can access the DRF+ more than once during the ADF 13 period in case of multiple disasters and emergencies. Access to the DRF+ does not disqualify group A countries from accessing other ADB resources, such as the Asia Pacific Disaster Response Fund.[4] ADB seeks to attract cofinancing, wherever possible, to complement DRF+ resources.

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[1] ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila.
[2] ADB. 2020. *Revised Disaster and Emergency Assistance Policy (draft)*. Manila.
[3] Group A countries at high risk of debt distress will receive their full allocation in grants, group A countries at moderate risk will receive 50% of their allocation, and group A countries at low risk and IDA gap countries are not eligible for grants from the DRF+.
[4] ADB. 2009. *Establishment of the Asia Pacific Disaster Response Fund*. Manila.

E. Terms and Conditions

6. The terms follow the terms for ADF grants,[5] and/or other relevant provisions (e.g., the forthcoming policy on emergency assistance loans).

F. Eligibility Criteria

7. The principal criterion for accessing the DRF+ is the severity of a disaster or emergency.[6] In case of disasters triggered by natural hazards, the DRF+ is triggered when a grant-eligible group A country satisfies an assessment based on multiple sources, in line with the approach adopted by the IDA Crises Response Window (CRW). The assessment of eligibility includes quantitative data on impact of the disaster to corroborate its intensity.[7] Disaster impact assessments look at aspects such as direct physical damage, environmental damage, people affected, and loss of lives. Data sources, including the government's initial assessment, international assessment, media reports, and satellite images may be used.

8. In case of cross-border displacement, triggers for the DRF+ follow the requirements adopted under the proposed IDA19 Window for Host Communities and Refugees, which provides dedicated grant funding to help low-income countries host large numbers of refugees. To be eligible for DRF+ resources, ADF countries will need to demonstrate that they

(i) host at least 25,000 refugees or that refugees make up at least 0.1% of the population;
(ii) have an adequate framework for the protection of refugees; and
(iii) have an action plan or a strategy with concrete steps, including possible policy reforms, for long-term solutions that benefit refugees and host communities.

9. To be eligible for DRF+ resources and 100% grants, group A and B countries that are not eligible for ADF grant country allocations will need to demonstrate that they are experiencing a sudden massive inflow of refugees, defined as receiving at least 250,000 new refugees or at least a number equivalent to 1% of its population within the last 12 months from the beginning of or during the ADF 13 cycle, in addition to having an adequate framework for the protection of refugees; and an action plan or a strategy with concrete steps, including possible policy reforms, for long-term solutions that benefit refugees and host communities. Other IDA19 provisions for the Window for Host Communities and Refugees will apply.

10. In case of public health emergencies, the DRF+ will be triggered when a grant-eligible group A country has (i) declared a public health emergency through the relevant government department (e.g., office of the President or Prime Minister); and (ii) the World Health Organization (WHO) has declared a public health emergency of international concern under WHO's global alert and response system in accordance with the International Health Regulations (2005).[8] These triggers for early response to disease outbreaks are aligned with those used by IDA for its CRW.

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[5] ADB. 2017. *Regulations of the Asian Development Fund*. Manila.

[6] This includes loss and damages caused by the disaster.

[7] This is also the approach adopted under the World Bank's CRW. Parametric data (e.g., the magnitude of an earthquake on the Richter scale) may not always adequately reflect the severity of a disaster. In the case of an earthquake, for example, disaster preparedness and proximity to human settlements are just as important in determining the severity of a disaster. This information may be drawn from government or other sources, considering that information immediately after a disaster may be preliminary or not be readily available.

[8] WHO. 2016. *International Health Regulations (2005).* 3rd edition. Geneva.

11. To determine whether DRF+ resources should be allocated to respond to a particular disaster, and to determine the size of any allocation, ADB may also consider (i) ADB's delivery capacity, including its presence and/or expertise in the country; (ii) the availability of resources, including the DRF+, ADB's headroom, domestic resources, and other external financing; and (iii) the country's needs and response capacity.

G. Processing Assistance Funded by the Expanded Disaster and Pandemic Response Facility

12. The DRF+ can cover all aspects of disaster and emergency assistance, early recovery, and reconstruction costs that arise after a disaster that is determined to be eligible for the DRF+.[9]

13. The proposed DRF+ is a mechanism for setting aside resources from the ADF to support disaster and emergency response and does not establish an independent business process. If initial information indicates sufficiently severe impact, and the concerned regional department determines that accessing the DRF+ is necessary, the regional department, in consultation with other departments, will process and implement the DRF+ assistance following established business processes as defined by ADB policies. ADB's Strategy, Policy, and Partnerships Department will ensure that all criteria necessary to access DRF+ funds are met. Typically, DRF+ processing will be expected to follow the requirements for emergency assistance lending. However, in case modalities such as additional financing or policy-based lending are used to deliver post-disaster support, then specific provisions related to those instruments will apply as defined by ADB policies.

14. Disasters and emergencies may highlight weaknesses in development processes and investments, such as insufficient consideration of potential disaster, pandemic, and other emergency risks in their design and implementation. The DRF+ will prioritize support for operations to build back better, taking measures to reduce disaster risks, including through new adaptation technologies and approaches.

H. Development Coordination

15. As in other emergency and disaster response operations, ADB will coordinate with the developing member countries and other development partners. DRF+ support will be limited to areas where ADB has a comparative advantage (e.g., where it has an established role or expertise or can add significant value). ADB will involve civil society and bring in private sector partners where it sees suitable opportunities. ADB will share its assessments with other partners, undertake assessments with them, or make use of assessments by other agencies.

16. Effective development coordination helps augment resources. Equally important, it helps reduce duplication or conflicting assistance from different development agencies and improves the efficiency and effectiveness of resource utilization. Consistent with the forthcoming Revised Disaster and Emergency Assistance Policy and ADB's established practices, ADB will proactively coordinate with other development partners to improve disaster risk and emergency management, including risk reduction, as well as post-disaster and emergency response. Such coordination is especially important in developing member countries with high disaster risks.

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[9] For example, the DRF+ can be used to support post-disaster technical assistance.