Enhancing the Asian Development Bank’s Multitranche Financing Facility

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Asian Development Bank
ABBREVIATIONS

ADB – Asian Development Bank
DMC – developing member country
DMF – design and monitoring framework
FFA – framework financing agreement
IBS – informal Board seminar
IED – Independent Evaluation Department
MFF – multitranche financing facility
PCR – project completion report
PFR – periodic financing request
RRP – report and recommendation of the President
SPD – Strategy, Policy and Partnerships Department

NOTE

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

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I. INTRODUCTION

1. The Asian Development Bank (ADB) introduced the multitranche financing facility (MFF) in 2005.\(^1\) After 3 years of pilot implementation, ADB mainstreamed the MFF in 2008.\(^2\)

2. In 2012, the Independent Evaluation Department (IED) completed a real-time special evaluation study of the MFF,\(^3\) which prompted ADB to introduce several changes to the modality through the related operational documents.\(^4\) IED completed a corporate evaluation of MFF performance and results in 2019. One of the evaluation’s key findings was that the increasingly tight MFF requirements introduced over the years had depressed the use of the modality.\(^5\) The evaluation also provided four recommendations to improve the MFF’s design, operational practice, and development results.

3. ADB developed an enhancement plan to address the issues identified in the 2019 IED evaluation, its findings and feedback from internal and external stakeholders, and lessons learned from ADB’s MFF implementation experience.\(^6\) This paper presents the proposed enhancements to the MFF modality, including where appropriate, proposed amendments to the 2008 MFF policy (footnote 2) to incorporate them.

II. PROPOSED ENHANCEMENTS TO THE MULTITRANCHE FINANCING FACILITY

4. Five areas for improvement are proposed.

A. Maximizing Potential to Deliver Transformational Changes

5. **Issues.** An MFF needs a clear strategic context and thorough understanding of the sector to be designed properly and implemented effectively. Because the MFF sets out a long-term partnership for the chosen sectors or thematic areas, the government’s long-term commitment is critical. Past MFF operations have largely focused on delivering physical investment outputs; the potential for MFFs to deliver more transformational changes within the supported sectors has not been fully realized (footnote 5, para. 165).

6. The IED evaluation noted that capacity development under MFFs largely focused on project implementation (compliance with procurement, financial management, safeguards, and other ADB requirements). Insufficient attention was paid to enhancing the ability of institutions to plan and manage sector improvements (footnote 5, para. 153).
7. **Proposed enhancements.** Strengthening the sector assessments is proposed to ensure deep understanding on the policy and institutional environment for effective MFF operations. The assessments will cover the sector issues holistically to deliver results beyond physical investments directly funded with the MFF by leveraging long-term programmatic engagement. The MFF will increase assistance for a wide range of institutional capacity building and will integrate infrastructure investments with support for transformational changes. To achieve this, the following actions are proposed, and implementation details are further provided in paras. 20 and 21:

(i) **Strengthen sector assessments.** The MFF requires a road map and a clear strategic context based on detailed assessments of the sector. The summary sector assessments included as a linked document to the RRP will be strengthened to help develop better insights into the challenges and opportunities to maximize the potential of an MFF. Stronger assessments will help determine the suitability of the MFF modality, improve the quality of MFF design, and identify opportunities to build institutional capacity.

(ii) **Ensure suitability of multitranche financing facility as modality of engagement.** For many developing member countries (DMCs), the main reason for using MFFs instead of stand-alone projects has been engagement with ADB for large-scale and long-term programmatic financing in priority sectors. Based on the enhanced sector assessment, the project team will examine the best modality of the planned engagements and justify the suitability of an MFF. Illustrative guidance will be provided in the MFF operational documents on the types of projects that are suitable for MFF. Reflecting the long-term engagement under the MFF, the assessment will cover government commitments to sector development and the country’s underlying political economy.

(iii) **Use multitranche financing facility to build sector-wide institutional capacity.** ADB will increase support for the development of institutional capacity and sector reforms by leveraging the longer-term engagement of MFFs. Based on the enhanced sector assessments, project teams will confirm that agencies have the absorptive and implementation capacity commensurate with the design and scope of the MFF. When such capacity is not sufficient but can be effectively enhanced, Project teams will prepare a capacity development action plan and integrate it into the MFF (i.e., as part of a facility-level output). Project teams will also monitor the progress on capacity development throughout MFF implementation and discuss such progress in the periodic financing request (PFR) report for subsequent tranches.

B. **Improving Operational Performance**

8. **Issues.** The IED evaluation found that MFFs tended to encounter implementation issues when preparation of the initial tranche was inadequate (footnote 5, para. 161). The design and implementation of succeeding tranches can be improved by reflecting lessons and experiences of earlier tranches. The IED evaluation and stakeholder consultations by the Strategy, Policy and Partnerships Department (SPD) indicate that government commitment is essential to ensure

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7 MFF choices are dictated by project-specific circumstances and efficiency considerations. For smaller countries and fragile situations, the combination of larger projects under the MFF and a longer period to implement them allows governments to pursue investment on a scale not previously attempted (footnote 5, para. 84). The IED evaluation found that commitment fee savings were marginal, and most client countries did not consider the savings to be important (footnote 5, para. 152).

8 In the past, MFFs have been used to support institutional reforms in social sectors, such as education and health.
successful implementation of a large, long-term program. Changes in government priorities during MFF implementation were found to cause delays. Careful risk assessment and risk management plans are essential to mitigate risks during MFF implementation.

9. **Proposed enhancements.** To increase the readiness of tranche preparation and implementation, minimize delays and scope changes, and ensure that the envisaged development outputs are delivered, the following actions are proposed, and implementation details are further provided in paras. 20 and 21:

   (i) **Improve tranche preparation.** The preparation of tranches will be improved to enhance readiness and ensure timely implementation. Lessons learned from the previous tranches will be incorporated as part of the MFF quality assurance process. While preceding tranches are usually used to prepare subsequent tranches, technical assistance and project readiness financing can be used too. If ADB technical assistance is needed for the preparation of subsequent tranches, justifications will be provided in the report and recommendation of the President (RRP).

   (ii) **Strengthen link between multitranche financing facility undertakings and tranches.** MFF policies mandate that a breach of facility-level undertakings will trigger ADB’s right to hold back financing and to suspend or terminate the MFF. Consideration of subsequent tranches will be more strongly linked to compliance with the MFF undertakings and sufficient progress of earlier tranches. If sufficient progress has not been made, the ADB team processing the MFF will be required to provide additional justification for subsequent tranche approvals in the PFR report. To support timely completion, it is proposed that MFFs rated potential problem for more than 3 consecutive years be reviewed to consider the cancellation of future tranches.\(^9\)

   (iii) **Enhance risk assessment and management.** To maximize development outcomes and minimize implementation risks, the risk assessment and management plan will be enhanced. It will assess any risk during MFF implementation of (a) a substantial and material change in the strategic direction of the road map; (b) a change in the policy framework that undermines the viability or sustainability of the investment program; (c) a change in the sectors covered by the investment program; (d) a substantial and material change in the type of the investments contemplated under the investment program; (e) external shocks that could result in significant change or disruption, such as disasters; and (f) other changes relevant to the particular MFF. These will be updated at the time of approval of each subsequent tranche to reflect the latest developments.

   (iv) **Ensure government commitment.** Discussions to ensure strong government commitment for a planned MFF should start early, for example during the diagnostic phase of the country partnership strategy and will be revisited during the annual country programming missions. During MFF preparation, the government commitment will be confirmed to determine (a) if policy changes or new policy initiatives might affect the facility, (b) whether the MFF design needs to be updated or adjusted because of policy changes or unforeseen developments, and (c) the impacts of new information on the overall feasibility of the facility. The

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\(^9\) Currently, the MFF Annual Report contains description of the performance rating methodology to comply with MFF policy para. 90. If an at risk rating is assigned to an MFF, it may lead to its suspension and possible cancellation. A potential problem rating requires the regional department concerned to create an action plan to rectify MFF performance.
RRP will mention how the commitment of the government and executing agency has been confirmed; for subsequent tranches, this will be discussed in the PFR report.

C. Streamlining Processing and Implementation

10. **Issues.** Tightening MFF requirements and procedures have reduced the processing efficiency of the modality over the years. The IED evaluation noted that staff time requirements to process an MFF increased by 85% from 2012 to 2016 (footnote 5, para. 103). The additional requirements and procedures have also caused redundancies in templates and documentation. For example, MFFs supporting large-scale projects are fully assessed before submission for approval, with subsequent tranches typically structured as time-sliced disbursements. However, current business processes require the same due diligence and same documentation as with regular tranches when seeking PFR approval.

11. Similarly, upon Board approval of an MFF, the President approves the PFR for the first tranche through a separate process. This procedure has been adopted for subsequent tranches categorized as A for environmental impact. The IED evaluation noted the considerable staff time required to prepare project completion reports (PCRs). As more MFFs mature (and when many tranches are involved), the burden of preparing tranche PCRs has increased significantly (footnote 5, para. 115).

12. **Proposed enhancements.** To improve efficiencies in MFF processing and implementation, the following enhancements are proposed, and implementation details are further provided in paras. 20 and 21:

   (i) **Review processing documents and templates to reduce redundancies and simplify requirements.** The IED evaluation suggested that some MFF documentation can be streamlined to improve the efficiency of processing and implementation (footnote 5, para. 174). Templates and required documents will be reviewed and simplified where possible with any redundancies removed, including the concept paper, RRP, PFR report and linked documents, and framework financing agreement (FFA). The RRP template will be revised to better clarify that the Board’s approval of an MFF is directly linked to the terms and conditions of the MFF as described in the FFA included as part of the RRP package.

   (ii) **Simplify documentation requirements for multitranche financing facilities supporting large-scale projects.** Documentation for subsequent MFF tranches supporting large-scale projects will be simplified because the facility and tranche design and monitoring frameworks (DMFs) are the same. Separate tranche DMFs will not be required as the facility DMF will report on the progress of all outputs. Because all due diligence requirements for large-scale projects are completed at MFF approval, the PFR reports for subsequent tranches and their linked

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10 A proposed project is categorized A if it is likely to have significant adverse environmental impacts that are irreversible, diverse, or unprecedented. These impacts may affect an area larger than the sites or facilities subject to physical works. ADB. 2013. Safeguard Policy Statement. Operations Manual. OM F1/OP. Manila (para. 6[i]).

11 The MFF policy requires that a PCR be prepared for each tranche financing and a facility completion report be prepared for the whole facility.

12 While the current standard “Recommendation” paragraph for MFF RRPs already includes language providing that the Board approves the MFF subject to the terms and conditions as are substantially set forth in the FFA, the main bodies of MFF RRPs do not always include a clear reference to such FFA as being included as a linked document to the RRP. The RRP template will be revised to require that the main body of the RRP for each new MFF include such a reference to the FFA.
documents will be streamlined by focusing on the review of implementation progress of the MFF and compliance with facility-level undertakings.

(iii) **Remove redundant process for Management approval.** To simplify the internal process for approval of the first tranche, the President will be deemed to have approved the first tranche following the Board’s approval of the facility. This will remove the need for submission of a separate memo to the President requesting approval for the tranche. Similarly, the President will be deemed to have approved subsequent tranches categorized as A for environmental impact once the Board provides its no objection to converting the tranche.

(iv) **Streamlining of project completion reports.** The preparation of tranche PCRs and facility completion reports will be reviewed for efficiency while ensuring the quality. Streamlining will be achieved by (a) removing redundancies, (b) using a simplified format, or (c) introducing a midterm review instead of tranche-specific PCRs for some MFFs (i.e., for MFFs supporting large-scale projects and time-sliced design\(^\text{13}\)).

D. **Increasing Board Engagement**

13. **Issues.** An informal Board seminar (IBS) is not mandatory for new MFF proposals; Board engagement usually begins when the RRP is circulated to the Board for consideration. Since ADB builds a long-term engagement with the DMC through MFFs, it will be important to have Board’s feedback at an earlier stage to ensure that this can be incorporated as appropriate as part of the design of each MFF.

14. Management informs the Board of proposed new tranches through tranche-at-a-glance reports and of the progress of MFF implementation through MFF annual reports. While substantial information is provided, the formats can be improved to present the information in a clearer and more concise manner.

15. **Proposed enhancements.** To address Board concerns regarding oversight of MFFs, the following enhancements are proposed, and implementation details are further provided in paras. 20 and 21:

   (i) **Make informal Board seminar a requirement.** Where they have been carried out in the past, IBSs for proposed new MFFs have proven to be beneficial. Among other things, such IBSs have provided teams with the opportunity to present the proposed MFF, including the rationale for using the MFF over other modalities, and obtain feedback from Board members early in the process. Accordingly, it is proposed to require an IBS before seeking Board approval of all MFFs.\(^\text{14}\)

   (ii) **Continue improving format and content.** SPD and regional departments will hold briefings to update the Board on MFF and tranche implementation status.\(^\text{15}\) The content and presentation of the tranche-at-a-glance report and the annual report will be reviewed and streamlined to ensure that it clearly and concisely conveys pertinent information to the Board.

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\(^{13}\) Through the time-slice financing approach of MFFs, ADB finances slices of a long-term contract packaged under the investment program. In this case, each tranche would typically finance parts of a contract or groups of contracts which require disbursements over a time period. Each contract is sliced according to the indicative tranche schedules.

\(^{14}\) Management is reviewing the IBS process to reduce the burden on staff.

\(^{15}\) Updates will include progress on implementation of ongoing tranches, subsequent tranches, and possible changes to the MFF scope. These briefings may cover other modalities, if needed.
E. Reviewing the 10-Year Availability Period

16. The maximum availability period for an MFF is 10 years from the date of Board approval of the facility. The availability period is the utilization period for the MFF that the borrower and ADB agree upon. An extension of the availability period is generally not considered. However, if an extension is warranted, it must be approved by the Board.

17. **Issues.** The IED evaluation noted that the strict application of the 10-year limit was a major constraint on completing planned investments, which reduces the attainment of envisaged development benefits (footnote 5, para. 154). SPD received the same feedback in consultations with project teams and executing and implementing agencies.

18. **Proposed enhancements.** To increase the likelihood of completing the MFF within the maximum availability period, the following enhancements are proposed:

   (i) **Board approval of the proposed deadline for last tranche approval.** Instead of having a maximum 10-year utilization period, it is proposed that the Board approve the date by which the last tranche under an MFF must be approved. Teams will indicate and justify this date as part of the RRP requesting approval for the MFF. Management will approve all tranches before that date. The 10-year limit will no longer apply, but tranche implementation will be closely monitored and reported to the Board. All tranches under an MFF are expected to be approved within 8 years from Board approval of the facility. To support timely completion, cancellation of future tranches will be considered if the MFF is rated a potential problem for more than 3 consecutive years.

   (ii) **Improved monitoring of tranches.** To promote high readiness of the MFF design and timely completion of MFFs, information on tranche sequencing and the indicative processing schedule (i.e., approval year, scope, and target completion date) for each envisaged tranche will be part of the MFF proposal. The Board will approve the addition of a new tranche or other changes if they result in a change to the MFF as specified in para. 86 of the 2008 MFF Policy (footnote 2). The MFF Staff Instruction will further elaborate the application of para. 86 of the 2008 MFF Policy. Monitoring and reporting arrangements will be enhanced to include progress on non-physical investments. The methodology to rate overall facility performance will be reviewed to improve monitoring and align with the new project performance rating system that was rolled out in 2019.

III. PROPOSED AMENDMENTS TO MFF POLICY AND OPERATIONAL DOCUMENTS

19. The proposed enhancements will be operationalized in two ways: (i) through amendments to select provisions of the 2008 MFF policy (footnote 2), and (ii) through revisions to operational

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16 While the pilot policy (footnote 1) mandated that each MFF have a "sunset" clause or maximum utilization period, the MFF staff instruction issued for the pilot phase introduced the "availability period." When the modality was mainstreamed in 2008, the operational procedures section of *Operations Manual* (section D14) provided the definition and key considerations regarding the maximum availability period. This definition was formulated in the context of traditional loan- and grant-financed MFFs; for MFFs comprising guarantees, because of the nature of guarantees and the operations they support, disbursements of MFF proceeds may be required after the 10-year anniversary of MFF approval. In such cases, disbursement arrangement will be described in the RRP.

17 Changes in MFFs that would require Board approval will include (i) a substantial and material change in the strategic direction of the road map, (ii) a change in the policy framework that negatively affects the viability or sustainability of the investment program or plan, (iii) a change in the sectors covered by the investment program, or (iv) substantial and material change in the type of the investments contemplated under the investment program or plan.
documents, including *Operations Manual* (section D14) and the related staff instruction for the MFF.

20. Amendments to the MFF policy require approval by the Board of Directors. Based on the envisaged enhancements, the following provisions of the policy are proposed to be amended. The amendments will be effective upon Board approval for new MFFs unless stated otherwise below:

(i) To emphasize the need for institutional capacity development, para. 68 of the 2008 MFF Policy will be revised as follows:

> "68. Given the substantial capacity constraints in most sectors, as well as in the institutions overseeing them, Operational teams should incorporate financing for institutional capacity development into individual MFF tranches. Exceptions to this should be clearly justified in the RRP. Assessment of institutional capacity constraints, at the level of both MFF and individual tranches, should follow ADB’s Capacity Development Medium Term Framework and Action Plan. Depending on the specific capacity constraints identified, capacity development could focus on three parts: (i) assistance with the implementation of a project approved under the first tranche; (ii) due diligence advisory services to help prepare investments or projects for the second and other tranches; and (iii) special advisory services to work on policy framework refinements, planning assistance, institutional change management, monitoring and evaluation of the overall investment program, results measurement, and reporting to the authorities and ADB. The first of these capacity development components can be structured to include technical and nontechnical expertise, such as project design and supervision, safeguards, governance, procurement, and financial management. The second component can cover standard ADB project finance requirements, including technical, financial, commercial, legal, regulatory, social, safeguards, operational, governance, implementation, and disbursement. The third component can focus on planning; policy reformulations; results measurement; and overall MFF monitoring, evaluating, and reporting."

(ii) Para. 74 of the 2008 MFF policy will be amended to clarify the process for preparing DMFs for MFFs supporting large-scale projects, as well as to add the requirement to provide updates on progress on the facility undertakings and incorporate lessons from prior tranches. This will also be applicable for new tranches of existing MFFs that finance large-scale projects:

> "74. Each MFF will include a facility DMF, and if each tranche will have its own unique outputs, a tranche DMF will also be prepared. Otherwise, the facility DMF will be used to monitor tranche implementation and will be updated as needed with the approval of each new tranche. During implementation, the DMF for the overall facility will track the direction of the road map, policy framework, safeguards framework, financing plan and broad investment program, inputs, outcomes-activities, and results. Review mission reports will update this information. MFF teams will use this material in the annual reports submitted to the Board on each MFF. The tranches will be monitored in the

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18 To provide a convenient reference document, the Appendix to this paper sets out the MFF policy provisions from the 2008 MFF policy (footnote 2) in their entirety after incorporating the proposed amendments.

19 This is noted as para. 13 in the Appendix.

20 This is noted as para. 18 in the Appendix.
same way as stand-alone projects. A tranche DMF will track inputs, outcomes activities, and results. Review mission reports will cover the design, commercial and operational matters, status of policy actions, undertakings, covenants, compliance with ADB policies and procedures (including safeguard requirements), capacity development actions, procurement, fiduciary oversight, anticorruption measures, and governance. Noncompliance in these areas may trigger decisions by Management leading to termination or suspension of MFF, or rejection of the PFRs, or suspension or cancellation of the related tranche. PFR reports will provide the status of progress on the facility undertakings and describe how lessons from implementation of prior tranches are incorporated into the proposed subsequent tranche design.

(iii) Para. 81 of the 2008 MFF policy will be revised to remove redundant text and add MFF-related risk management measures as follows:

“81. All MFF concept papers will be cleared in accordance with the prevailing ADB’s business processes for stand-alone loan projects (currently they require the relevant vice-president to approve). The format for the papers will be similar to the one used for stand-alone loan projects. However, it will include variations to accommodate the additional information needs of the overall facility: sector road map, strategic context, policy framework, matrix to justify the modality vis-à-vis others, investment program (divided between physical and nonphysical investments), and financing plan. Other information to be provided will include the indicative size of the MFF and the first PFR. Ideally, the concept paper will be backed by a problem tree analysis to highlight key issues or root causes of problems and consequences. Each MFF will include risk mitigation measures to better manage the implementation risks and minimize the need for changes to an MFF. Appendix 5 illustrates the methodology involved in a problem tree analysis.”

(iv) The provision requiring individual PCRs for each tranche will be removed from Para. 90 of the 2008 MFF policy, as follows. This will also be applicable for tranches under ongoings MFFs:

“90. A project performance monitoring system will be established for the entire MFF, as well as for its individual tranches. In addition to individual project completion reports for each financing, once the MFF has been mainstreamed, a facility completion report will be prepared for the facility as a whole; project completion reports for tranches will be prepared following applicable operational guidance. Post-evaluation reviews may be undertaken of the overall MFF or any of its tranches.”

(v) A provision will be added to para. 92 of the 2008 MFF policy to include (i) the proposed cutoff date for last tranche approval for all new MFF proposals, (ii) submission of environmental impact category A tranches to the Board for its decision on whether to authorize the President to convert the tranche, and (iii) the requirement to respond to Board questions in relation to subsequent tranches not categorized A for environmental impact before their approval. Other than the

21 This is noted as para. 25 in the Appendix.
22 This is noted as para. 34 in the Appendix.
23 This is noted as para. 36 in the Appendix.
change relating to the cut-off date for approval of the last tranche, these changes will also be applicable for new tranches under ongoing MFFs:

"92. All MFF proposals will be submitted to the Board for approval, following standard ADB rules and procedures for sovereign project processing. Proposals will indicate the cutoff date for approval of the last tranche under the proposed MFF. All tranches under an MFF are expected to be approved within 8 years from Board approval of the facility. MFFs will be subjected to Management review meetings and staff review committee meetings. The FFA and first PFR will be attached to the RRP for an MFF. Management will convert the facility amount approved by the Board into financings for individual tranches. Tranches will be processed by the regional departments and approved by the President. The Board will be notified of subsequent tranches before submission to the President. Projects categorized as A for environmental impact in a subsequent tranche will be submitted to the Board for its decision on whether to authorize the President to convert the tranche. The Board will approve addition of a new tranche or other changes if they result in a change in the MFF, as specified in para. 86 of this policy paper. In deciding whether to approve the second and subsequent tranches, Management will consider, among other things, compliance with the MFF undertakings, as well as the status of the road map, investment program, and policy considerations. Any surplus under an individual tranche that is canceled will replenish the overall facility by an equivalent amount. Management review meetings for the second and subsequent tranches will be held at the discretion of the concerned vice-president."

21. Management will approve revisions to operational guidelines and process-related actions. As proposed in the enhancements in para. 20, these will include the following:

(i) revise Operations Manual (section D14) to reflect (a) updates and amendments to the MFF policy as proposed in para. 20; and (b) the provision that deems the President has approved the first tranche of an MFF following approval of the facility by the Board, and subsequent tranches categorized as A for environmental impact following the Board’s no-objection to converting the tranche;

(ii) issue revised staff instructions on the MFF to provide clearer guidance on (a) presenting strong justification for selecting MFF as the modality, (b) developing robust sector assessments to strengthen MFF quality at entry, (c) requiring an IBS before approval of all new MFF proposals, (d) including information on tranche sequencing and the indicative process schedule, (e) encouraging the use of project readiness financing to strengthen the readiness of tranches, (f) providing updates on progress on undertakings when processing subsequent PFRs, (g) incorporating lessons from prior tranches, (h) reporting on the commitment of the government and executing agency during implementation, (i) application of para. 86 of the 2008 MFF policy, and (j) building institutional capacity. The MFF operational documents will include illustrative guidance on types of projects that are suitable for MFFs;

(iii) review MFF processing documents and issue revised and streamlined templates and documentation requirements; and

(iv) review MFF performance monitoring and reporting, including (a) implementing improved formats of the MFF annual report and progress reports; (b) improving information shared with the Board regarding subsequent tranches not categorized as A for environmental impact (e.g., tranche-at-a-glance report); and (c) developing procedures for periodic Board briefings on MFF implementation updates.
22. All items in para. 21 will become effective upon issuance of the revised Operations Manual (section D14) and related instructional documents. While operations departments are responsible for designing and implementing MFFs in line with the revised operational guidelines, SPD and other corporate departments will support them to ensure the effective application of the new procedures. ADB will provide training and outreach activities to staff and concerned DMC officials. ADB will report the progress of actions to improve MFF implementation will be reported as part of MFF Board briefings.

IV. RECOMMENDATION

23. The President recommends that the Board of Directors approve the proposed amendments to the 2008 Multitranche Financing Facility policy as described in para. 20 of this paper.
A. MFF

1. While the CPS captures broad strategic directions that ADB and a DMC have agreed upon, including priority sectors and themes for coverage, the MFF establishes a partnership in a chosen sector. For an MFF to work well, it has to be flexible. The Board needs to approve a maximum amount for each MFF under clear terms and conditions. Without this feature, the MFF is not attractive. Board approval of MFFs, on the other hand, requires the eligibility criteria, decision-making filters, and reporting arrangements to be streamlined and clear.

B. Preconditions

2. The following are the main preconditions for the use of MFF.

1. Road Map

3. The MFF requires a road map, which can be developed at the CPS stage or at any other time. The road map should define (i) the strategic directions for a sector, service, or industry; (ii) the importance it has to growth, poverty reduction, and inclusiveness (or the extent to which it is a binding constraint); and (iii) the list of success factors for better performance. The road map needs detailed assessments of physical and nonphysical investments. These assessments highlight the main investment and non-investment bottlenecks, risks, and mitigation measures. Such information then informs the strategic context, policy framework, and investment programs (the so-called enablers), as well as the interventions needed and their sequencing.

4. Operational teams will provide information on the road map in the FFA.

2. Strategic Context

5. An MFF needs a clear strategic context. The most obvious one comes from the relevant CPS, which is developed based on macroeconomic reviews, detailed sector diagnostics, and crosscutting theme assessments. The CPS articulates the areas where ADB is to deliver financing and ideas. The MFF sets out a long-term partnership for the chosen sector or sectors, and thematic areas. The strategic context should include key quantitative and qualitative principles, as well as targets.

6. Operational teams will be required to describe the strategic context for the MFF. This information will appear first in the concept paper for the MFFs, one of the first decision-making filters by Management.

3. Policy Framework

7. The MFF requires a policy framework that focuses on the main challenges and operating conditions in the relevant sectors to ensure efficiency, cost recovery, sustainability, and competition. Where none is available, or its content is considered unsatisfactory, other modalities should be used instead—program lending, sector development programs, advisory mandates financed through technical assistance loans/grants, sector loans, or stand-alone projects. The MFF finances physical and nonphysical investments. Although nonphysical investments can
include policy changes, these should occur only within an existing policy platform. This “work in progress” approach also needs to be applied to crosscutting themes such as governance and safeguards.

8. A policy framework must cover more than technical or operational aspects. It needs to summarize the strategic vision for the sector (the road map), and then the principles and targets for change. This information leads to reform actions over the short, medium, and long term. A policy framework aims to create the right environment for public and private investment. The changes or reforms address financial, economic, commercial, legal, regulatory, and institutional matters. The main principles and outcomes include cost recovery, optimal use of resources, sustainability, efficiency, competition, and transparency.

9. The policy framework will be part of the FFA. This information will appear first in the concept paper, to be considered by Management in determining whether the MFF is the most appropriate modality.

4. Investment Program

10. An MFF will require a detailed investment program, which should specify the physical and nonphysical investments required, as well as the corresponding resources needed. Where there is no investment program, large stand-alone projects will still be eligible for financing under MFFs, provided they have substantial and related individual components with long term implementation plans. In such cases, the MFF will require a detailed investment plan instead of an investment program.

11. The physical part of an investment program can be split into long-term and medium-term investments. National planning commissions often prepare or coordinate the preparation of longer-term plans (e.g., 2030 Vision in Pakistan). A medium-term investment plan often breaks down the longer-term vision into more immediate priorities, in most cases covering periods of 7–12 years. An MFF generally finances a portion of medium-term plans. Operational teams will be required to describe the sector investment plans. As far as possible, teams will also show projected tranche schedules over the period covered by the MFF.

12. Nonphysical investments address thematic and institutional issues, such as capacity development, governance, gender, private sector development, and safeguards. Regional cooperation is also becoming relevant. Where possible, these components should be financed through ADF and grant resources (in countries eligible for both ADF and OCR funding and in ADF-only countries), or through TA grants. This is generally an area suitable for official cofinancing (some partners only finance nonphysical investments), and for special funds and/or partnership facilities.

13. Given the substantial capacity constraints in most sectors, as well as in the institutions overseeing them, Operational teams should incorporate financing for institutional capacity development into individual MFF tranches. Exceptions to this should be clearly justified in the RRP. Assessment of institutional capacity constraints, at the level of both MFF and individual tranches, should follow ADB’s Capacity Development Medium Term Framework and Action Plan.¹ Depending on the specific capacity constraints identified, capacity development could focus on three parts: (i) assistance with the implementation of a project approved under the first tranche;

(ii) due diligence advisory services to help prepare investments or projects for the second and other tranches; and (iii) special advisory services to work on policy framework refinements, planning assistance, institutional change management, monitoring and evaluation of the overall investment program, results measurement, and reporting to the authorities and ADB. The first of these capacity development components can be structured to include technical and nontechnical expertise, such as project design and supervision, safeguards, governance, procurement, and financial management. The second component can cover standard ADB project finance requirements, including technical, financial, commercial, legal, regulatory, social, safeguards, operational, governance, implementation, and disbursement. The third component can focus on planning; policy reformulations; results measurement; and overall MFF monitoring, evaluating, and reporting.

14. Such capacity development arrangements require proper due diligence followed by sound structuring. Planning well for both long- and short-term experts is a key to success. Estimating today the type of expertise needed tomorrow, including detailed projections of person-months and budgets, is complicated. Overall “mandates” will be needed, divided among various advisory teams, each managed by a team leader and comprising long-term advisors and short-term experts. The budgets should not be view as fixed, i.e., they should have sufficient contingencies to enable clients to engage additional experts as required on short notice. If necessary, expert and budget deficiencies can be corrected in subsequent tranches.

5. Financing Plan

15. An MFF needs separate financing plans for the entire facility and for individual tranches. Where feasible, financing plans should specify the sources of finance, time, and amounts. They should distinguish among internally generated resources (e.g., by the executing agencies), national and local government budgets, domestic sponsors and financial institutions (banks and nonbanks, including capital markets), and international financiers (sponsors, banks, private equity, venture capital, capital market operators, export credit agencies, export–import banks, and international financing institutions). Cofinancing can be provided on a joint or parallel basis. Usually, ADB only participates in the international financier part of the financing plan.

6. Undertakings

16. To blend investment (physical) with thematic matters (nonphysical), future MFFs will include facility-level undertakings, including any warranties and representations where necessary, relating to principles and actions on sector, operational, thematic, financial, legal, institutional, policy, and other areas. These would be commitments by clients to take or maintain certain actions over the term of the MFF. Such undertakings will provide a broader and monitorable set of commitments. More specific covenants can be described in the individual legal agreements. Facility-level undertakings, which will be set out in the FFA, will capture basic principles and criteria under which ADB will make finance available. They will also cover ADB operating policies and procedures. A breach of undertakings will trigger ADB’s right to hold back financing, and to suspend or terminate the MFF.

7. Decision-Making Criteria and Filters

17. Decision-making criteria and filters for the MFF will be included in the Operations Manual. The criteria will determine when financing for MFFs and individual tranches will be approved, rejected, terminated, and suspended. The criteria separate processing from implementation.
During the processing cycle, the concept paper becomes the first major entry point for Management to decide on the suitability of an MFF. At this stage, the teams must justify the choice of modality. This will be done by producing a matrix comparing the MFF with other instruments and modalities. The concept paper will also provide an early opportunity for Management to consider an indicative road map, strategic context, policy framework, investment program, financing plan, list of key issues and constraints, likely undertakings, and the proposed due diligence plan. The processing cycle also offers additional entry points for decision making (due diligence reports, Management review meetings, staff review committee meetings, negotiation of the FFA and legal agreements, and the preparation of the RRP). These entry points allow Management to check for compliance with each of the preconditions.

18. Each MFF will include a facility DMF. If each tranche will have its own unique outputs, a tranche DMF will also be prepared. Otherwise, the facility DMF will be used to monitor tranche implementation and will be updated as needed with the approval of each new tranche. During implementation, the DMF for the overall facility will track the direction of the road map, policy framework, safeguards framework, financing plan and broad investment program, inputs, activities, and results. Review mission reports will update this information. MFF teams will use this material in the annual reports submitted to the Board on each MFF. The tranches will be monitored in the same way as stand-alone projects. A tranche DMF will track inputs, activities, and results. Review mission reports will cover the design, commercial and operational matters, status of policy actions, undertakings, covenants, compliance with ADB policies and procedures (including safeguard requirements), capacity development actions, procurement, fiduciary oversight, anticorruption measures, and governance. Noncompliance in these areas may trigger decisions by Management leading to termination or suspension of MFF, or rejection of the PFRs, or suspension or cancellation of the related tranche. PFR reports will provide the status of progress on the facility undertakings and describe how lessons from implementation of prior tranches are incorporated into the proposed subsequent tranche design.

C. Sector and Investment Eligibility

19. The MFF will be eligible to provide financing in all sectors, services, industries, and thematic areas covered by ADB in that country (ideally at the CPS stage). The MFF can finance multiple projects under an investment program in a sector or in various sectors, or large stand-alone projects with substantial and related individual components with long-term implementation plans. The MFF can also finance slices of long-term contract packages in such large stand-alone projects or investment programs.

D. Conversion Instruments

20. The facility amount approved for an MFF can be converted into loans, grants, guarantees, and also to any cofinancings administered by ADB. The loans can be funded from OCR or Special Funds resources. Grants can be funded from Special Funds resources or any fund administered by ADB. Loans to financial intermediaries can be utilized for a range of projects consistent with ADB’s policy on financial intermediation loans\(^2\). Guarantees can be partial credit guarantees or political risk guarantees. Equity financing is not considered appropriate for MFFs at this stage. While sector loans were permitted only in the first tranche in the pilot phase, now any tranche can be converted into a sector loan. Each tranche will offer standard ADB financial terms and conditions, including variations on tenors, currency options, swaps, and fixed and variable

repayment schedules. The financial terms and conditions may differ among tranches.

21. Any financing from ADF (loans or grants) will require the financing packages to be synchronized with the ADF availability cycle, and to take into account possible changes resulting from the performance-based allocation exercise. The FFA should emphasize the indicative nature of the funding commitment against the availability of funds.

E. Limited Supplementary Financing

22. Any portion of the facility amount may be applied to provide supplementary financing of purely price or financing arrangement changes in prior ADB interventions in the same sector. The likely requirement for such supplementary financing should be included in the assessments leading to the preparation of the MFF road map with respect to the quality of existing and future assets. This is the most limited type of supplementary financing provided by ADB and its inclusion within the MFF modality would be consistent with, and, indeed leverage off the programmatic orientation of the MFF. Of course, in addition to MFF processing requirements, the appraisal procedures for this type of supplementary financing set forth in ADB's Policy on Supplementary Financing\(^3\) must also be satisfied.

F. Administration of Cofinancing

23. Any portion of the facility amount approved for an MFF can also be converted into cofinancing to be administered by ADB. Cofinancing may be joint or parallel. It is proposed that administration of such cofinancing by ADB not be separately approved by the Board, but be reported to the Board for information as part of the annual report. This approach will provide flexibility, streamline procedures, and support better implementation of the MFF.

G. Multitranche Financing Facility Processing

24. The main steps, criteria, and filters for processing, implementing, and reporting on the MFF are summarized in paras. 25–36.

1. Concept Clearance

25. All MFF concept papers will be cleared in accordance with the prevailing ADB business processes for stand-alone loan projects.\(^4\) The format for the papers will be similar to the one used for stand-alone loan projects. However, it will include variations to accommodate the additional information needs of the overall facility: sector road map, strategic context, policy framework, matrix to justify the modality vis-à-vis others, investment program (divided between physical and nonphysical investments), and financing plan. Other information to be provided will include the indicative size of the MFF and the first PFR. Ideally, the concept paper will be backed by a problem tree analysis to highlight key issues or root causes of problems and consequences. Each MFF will include risk mitigation measures to better manage the implementation risks and minimize need for changes to an MFF. Appendix 5 illustrates the methodology involved in a problem tree analysis.

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2. Implementation, Due Diligence, and Design and Monitoring Frameworks

26. ADB staff will work with clients and advisors on the implementation of the MFF, including the processing of new tranches, and the monitoring, evaluation, and reporting on previous tranches. ADB staff will pay particular attention to the undertakings included in the FFA.

27. DMFs highlight inputs, outputs, outcomes, and results. Principles to be measured under MFFs may include cost recovery, efficiency, competition, resource management, transparency, and sector development. DMFs will capture the MFF impact, policy factors; road map; investment and financing plans; and the nonphysical components, including crosscutting themes and regional cooperation.

28. The due diligence plans will distinguish between the MFF and its tranches. The overall facility will require work on the road map, strategic context, policy framework, and investment and financing plans. This will help establish a safeguard framework and define the corresponding undertakings; any required policy refinements; action plans on given themes; the planning and phasing of interventions; reporting requirements; and mechanisms for monitoring, evaluating, and measuring results. A DMF will be prepared for the overall facility. Each tranche will also have its own DMF.

29. Each of the tranches will involve, as applicable, due diligence on technical, commercial, legal, regulatory, financial, economic, social, governance, fiduciary oversight, capacity, procurement, anticorruption, implementation, safeguards, and other matters. Unless modified in this paper and/or the related Operations Manual, the processing and implementation of MFFs will follow standard ADB policies and operational procedures, including all compliance requirements, for processing loans, grants, guarantees, and credit lines. In the event a client requests retroactive financing for each tranche under the MFF, it should be discussed in the RRP, and included in each PFR. Subsequent tranches will benefit from the work of advisors engaged with funds from clients or from the MFF.

30. Changes in MFFs that would require Board approval will include (i) a substantial and material change in the strategic direction of the road map, (ii) a change in the policy framework that negatively affects the viability or sustainability of the investment program/plan, (iii) a change in the sectors covered by the investment program, or (iv) substantial and material change in the type of the investments contemplated under the investment program/plan.

3. Documentation

31. For an MFF, the FFA will be a critical document between ADB and its client; for individual tranches, the respective legal agreements between ADB and its client will document the specific terms and conditions under which the financing is being provided. The FFA sets out the principal features of the investment program or the project; it also covers the undertakings made by the client to ADB. When the negotiations are held at ADB headquarters in Manila, the negotiated FFA will be signed by the client and the concerned director general (or an authorized representative); when negotiations are held in the field, the client and the relevant country director (or an authorized representative) will sign it. The FFA should be signed before the Board considers a proposed MFF. If this is not achievable due to operation of any local law or government policy or any other exceptional circumstance, the FFA may be signed after Board approval, but any material change must be resubmitted to the Board for approval. The legal agreement for the first tranche must be executed within 12 months of Board approval of the MFF; otherwise the validity of the MFF will lapse and their extension will require Board approval.
32. There is a need to simplify the FFA as it has grown into an unwieldy document. Safeguard frameworks, which are separately agreed with the clients, will be incorporated by reference instead of being attached to the FFA. The RRP for MFFs will require a new format to capture the MFF preconditions. A reduction in the duplication of information currently contained in the FFA increasingly is needed. For example, the road map, strategic context, policy framework and investment program, provided in the FFA need only be summarized in the RRP.

4. Reporting and Monitoring

33. A consolidated annual report will be prepared for all approved MFFs in each country by the relevant regional departments and submitted to the Board in January every year. This will help bypass the traditional “bunching” season, and give the Board an opportunity to seek early clarifications on the performance of each approved MFF. The report will provide (i) statistical information on the MFF, including progress made on each of the physical and nonphysical components; (ii) risks and issues, and actions being taken to mitigate the risks and resolve the issues; (iii) DMF updates; (iv) status of compliance with undertakings; and (v) any changes in circumstance or material facts relating to the investment program/plan.

34. A project performance monitoring system will be established for the entire MFF, as well as for its individual tranches. A facility completion report will be prepared for the facility as a whole; _project completion reports for tranches will be prepared following applicable operational guidance_. Post-evaluation reviews may be undertaken of the overall MFF or any of its tranches.

5. Disclosure

35. In compliance with ADB’s Access to Information Policy, the following documents will be made publicly available: (i) FFA upon approval of the MFF by the Board; (ii) legal agreements upon signing; (iii) project information document for each tranche upon processing of such tranche; (iv) the annual report to the Board upon circulation to the Board; (v) facility completion report upon circulation to the Board; (vi) safeguard frameworks for the MFF before appraisal; (vii) the summary environmental impact assessment or summary initial environmental examination for the tranche, where applicable, 120 days before the approval of the tranche; and (viii) draft resettlement plan and draft indigenous people’s development plan before appraisal, in case of the first tranche, and before Management review of the PFR, in case of the second and subsequent tranches. ADB shall also make the PFRs available to interested parties on request.

6. Approvals

36. All MFF proposals will be submitted to the Board for approval, following standard ADB rules and procedures for sovereign project processing. _Proposals will indicate the cutoff date for approval of the last tranche under the proposed MFF. All tranches under an MFF are expected to be approved within 8 years from Board approval of the facility_. MFFs will be subjected to Management review meetings and staff review committee meetings. The FFA and first PFR will be attached to the RRP for an MFF. Management will convert the facility amount approved by the Board into financings for individual tranches. Tranches will be processed by the regional departments and approved by the President. _The Board will be notified of subsequent tranches before submission to the President. Projects categorized as A for environmental impact in a subsequent tranche will be submitted to the Board for its decision on whether_
to authorize the President to convert the tranche. The Board will approve addition of a new tranche or other changes if they result in a change in the MFF as specified in para. 30 of this policy paper. In deciding whether to approve the second and subsequent tranches, Management will consider, among other things, compliance with the MFF undertakings, as well as the status of the road map, investment program, and policy considerations. Any surplus under an individual tranche that is canceled will replenish the overall facility by an equivalent amount. Management review meetings for the second and subsequent tranches will be held at the discretion of the concerned vice-president.