LINKED DOCUMENT B: NONSOVEREIGN OPERATIONS PERFORMANCE

A. Slight Decline in New Project Evaluations in 2022

1. Twenty-four new project evaluations were finalized in 2022, 63% of which were infrastructure projects.[1] The remaining 2022 evaluations consisted of six loans to and one equity investment in financial institutions (FIs) and two equity investments in private equity funds (PEFs). The trends in performance of nonsovereign operations (NSO) are analyzed via 3-year moving averages rather than by single years, given the small number of NSO added every year to the Annual Evaluation Review (AER) (Table B1).

Table B1: Portfolio of Evaluations of Nonsovereign Operations Included in the Annual Evaluation Review

	Financial Institutions		Private Equity Funds		Infrastructure		Total	
Year	Successful	Total	Successful	Total	Successful	Total	Successful	Total
2016	3	3	2	4	3	6	8	13
2017	2	4	0	1	4	5	6	10
2018	3	9	1	2	1	1	5	12
2019	7	9	0	4	0	0	7	13
2020	5	9	0	4	12	16	17	29
2021	4	5	0	4	11	19	15	28
2022	0	4	0	2	11	15	11	21
Total	**24**	**43**	**3**	**21**	**42**	**62**	**69**	**126**

Note: The years are not based on the calendar years the Independent Evaluation Department evaluated the projects, but on the years the projects' extended annual review reports (XARRs) were completed (ending 30 June). For example, year 2022 covers XARRs circulated from 1 July 2021 to 30 June 2022.
Source: Asian Development Bank (Independent Evaluation Department).

2. The total number of projects evaluated declined slightly to 24 (footnote 1), after a continuous increase from 2017 to 2021. The increase in the total number of transactions evaluated in the previous years was the result of the high number of projects reaching operating maturity. NSO comprised the provision of any loan, guarantee, equity investment, or other financing arrangement to privately held, state-owned, or sub-sovereign entities. NSO may be (i) without a government guarantee; or (ii) with a government guarantee, under terms that do not allow the Asian Development Bank (ADB), upon default by the guarantor, to accelerate, suspend, or cancel any other loan or guarantee between ADB and the related sovereign.[2]

B. Infrastructure Projects Outperformed Financial Institution Projects and Private Equity Funds

3. Table B2 shows NSO performance by type or area of operations.[3] Infrastructure projects outperformed FI projects and PEFs and had an overall success rate of 68% in 2020–2022, compared with 50% for FI projects and 0% for PEFs. Infrastructure projects had an 83% success rate in 2017–2019, which gradually declined to an all-time low of 66% in 2019–2021. The success rate improved to 68% in 2020–2022. The decline stemmed from non-energy transactions evaluated during reporting years 2020–2022. All projects evaluated in reporting years 2017–2019 were energy projects with high success rates, i.e., 80% in 2017 and 100% in 2018.[4] In contrast, in 2020–2022, more non-energy infrastructure projects (16) were evaluated. Nine of the non-energy projects were rated *less than successful* or *unsuccessful* (i.e.,

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[1] The 24 new project evaluations in included 3 financial institutions projects, whose extended annual review reports (XARRs) were circulated in 2020. The project performance evaluation reports for the XARRs were completed in 2022. Hence, when analyzing trends, performance of these three projects were included in the 2020 reporting year.
[2] ADB. 2016. *Nonsovereign Operations. Operations Manual*. OM D10/BP. Manila.
[3] For simplicity, broad sector tagging was used to classify projects as FIs, PEFs, and infrastructure.
[4] No infrastructure projects were evaluated in 2019.

a success rate of only 44%) for failing to meet their development targets. The projects were in water and other urban infrastructure services; education; information and communication technology; transport; and agriculture, natural resources and rural development. Energy infrastructure projects' success rate in 2020–2022 was 79% (27 out of 34). In 2022, 10 out of 11 energy infrastructure projects evaluated were rated *successful* or better. Non-energy infrastructure projects fared worse in 2022 as only one out of four were rated *successful*.

Table B2: Rating by Area of Operations 2016–2022
(3-year moving average, %)

Time Period	Financial Market Operations					Private Equity Funds					Infrastructure				
	DR	ADD	IP	WQ	All	DR	ADD	IP	WQ	All	DR	ADD	IP	WQ	All
2016–2018	50	63	88	38	50	43	57	29	43	43	67	67	83	75	67
2017–2019	55	50	82	27	55	14	57	14	29	14	83	67	100	100	83
2018–2020	56	48	78	48	56	10	50	10	30	10	76	71	82	82	76
2019–2021	70	52	83	65	70	8	33	0	17	0	66	69	71	69	66
2020–2022	56	61	78	83	50	10	30	0	20	0	68	68	74	64	68

ADD = additionality, DR = development results, IP = investment profitability, WQ = work quality.
Source: Asian Development Bank (Independent Evaluation Department).

4. Changes in ownership structure of borrowers as well as the operational, financial, and management issues they faced weakened the performance of FI projects to a 50% success rate for 2020–2022 from 70% in 2019–2021, and to 0% in reporting year 2022 from 80% in 2021. All four FI projects evaluated in 2022 and with reporting year in 2022 were rated *less than successful* or *unsuccessful*. The FI projects were undermined by macroeconomic instability and public policy changes.

5. All 14 PEFs evaluated in 2019–2022 had *less than successful* or *unsuccessful* ratings,[5] including 2 evaluated in in 2022. The funds failed to achieve design and monitoring framework (DMF) targets and raise their targeted capital and did not fully deploy the capital they mobilized. Both regional PEFs evaluated in 2022 were rated *less than satisfactory* as they failed to achieve DMF targets and raise their targeted capital, which reduced the original scope of the planned investments. The reasons included the funds' inconsistent investment exit policies; structural weaknesses of the investment committee; ADB's lack of expertise or credible track record to act as a fund general partner to fundraise or successfully source, negotiate ,and exit PEFs, leading to implementation failures; and inadequate monitoring and supervision of targeted fund portfolio companies.

C. Steady Improvement in All Evaluation Criteria

6. The following sections assess performance using the four main evaluation criteria: (i) development results, (ii) ADB additionality, (iii) ADB investment profitability, and (iv) ADB work quality.[6] The improvement observed in NSO overall performance reflects the improvement observed in development results evaluation. Table B3 shows the 3-year moving averages for all evaluated projects during 2016–2022 against the four main performance criteria.

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[5] IED noted the 14 PEFs were approved in 2004–2012. In 2015, the Private Sector Operations Department Investment Funds and Special Initiatives Division updated its Business Strategy Guidelines (internal memorandum, 2015). The guidelines identified, among other proposals, the need for ADB to partner with experienced fund managers with demonstrated exit track records and operating expertise in the targeted sector. The guidelines were to be applied to funds approved from 2015 onward.

[6] The analysis uses a four-point rating scale for each criterion: *excellent, satisfactory, less than satisfactory*, and *unsatisfactory*. *Excellent* and *satisfactory* ratings indicate satisfactory performance. The development results criterion sets the minimum overall project rating. As per IED guidelines, the overall project rating cannot be better than its development results rating.

Table B3: Rating by Evaluation Criteria Component, 2016–2022
(3-year moving average, %)

3-Year Moving Average	Component Ratings				
	DR	ADD	IP	WQ	Overall
2016–2018	54	63	74	51	54
2017–2019	51	54	71	40	51
2018–2020	54	56	67	56	54
2019–2021	57	57	63	59	56
2020–2022	58	62	65	63	55

ADD = additionality, DR = development results, IP = investment profitability, WQ = work quality.
Source: Asian Development Bank (Independent Evaluation Department).

1. Better Development Results Charted

7. Performance against development results improved over the most recent 3-year period.[7] The trend observed in development results mirrored the trend in overall performance. Development results dropped from 54% *satisfactory* ratings in 2016–2018 to 51% in 2017–2019. They improved to 54% in 2018–2020 and 58% in 2020–2022, largely because of infrastructure projects, particularly renewable energy projects, most of which met the stated outcomes in their DMFs. Year-on-year, the *satisfactory* rating of development results remained at 57%, reflecting the improvement in infrastructure projects (2022: 73% vs. 2021: 58%) offset by the decline in FI projects (2022: 80% vs. 2021: 25%). Improvement in the development results rating of infrastructure projects in 2022 was mainly driven by energy projects achieving their targets, especially in generating annual electricity, providing generation capacity, and reducing greenhouse gas emissions through project-supported infrastructure assets. In contrast, three of the four FI projects evaluated and included in reporting year 2022 had *less than satisfactory* development results ratings. The reasons were (i) changes in ownership and business strategy of the clients, which were no longer aligned with the project objectives identified at appraisal; and (ii) deterioration of financial management indicators of the client brought about by serious operational, financial, and management issues and macroeconomic instability in the developing member country. The development results rating is largely driven by the rating of contribution to private sector development and ADB's strategic objectives.

2. Additionality Showed Continued Improvements

8. ADB additionality continued to improve from its lowest 3-year period success rate of 54% in 2017–2019,[8] to 56% in 2018–2020 and 62% in 2020–2022. Year-on-year, the *satisfactory* rating of ADB additionality improved from 57% in 2021 to 67% in 2022. All three broad sectors—financial market operations, PEFs, and infrastructure finance—showed improvement in 2022 over 2021. Of the 15 infrastructure projects evaluated in 2022, 10 or 67% yielded satisfactory or excellent additionality ratings, while in 2021, the *satisfactory* rating for additionality was 63% (12 of 19 projects). In infrastructure, ADB provided valuable financial additionality such as long-term, local currency, or lower-cost financing unavailable in the market, and working capital loans not readily available from financial markets during the coronavirus disease (COVID-19) pandemic. ADB encouraged participation of other commercial lenders and investors and provided equity investment that strengthened investor confidence. ADB

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[7] Development results are a composite of (i) contribution to private sector development (PSD) and ADB's strategic objectives; (ii) economic performance; (iii) environmental, social, health, and safety performance; and (iv) business success. Based on all validations and evaluations done from 2012 to 2022, out of the 74 PPERs/XVRs with less than satisfactory or unsatisfactory ratings on project's contribution to PSD and ADB's strategic objectives, 71 projects or 96% had both less than satisfactory/unsatisfactory development result ratings and less than successful/unsuccessful overall ratings. This provides evidence that the project's contribution to PSD and ADB's strategic objectives has the biggest impact on development results, and ultimately overall project rating.

[8] The evaluation of ADB's additionality was based on an assessment of how the projects would have proceeded without ADB support. It took account of ADB's financial additionality in providing funding or catalyzing other funding, and nonfinancial additionality in (i) mitigating risk; (ii) providing policy, sector, institutional or regulatory change; (iii) helping projects achieve higher standards; and (iv) providing knowledge, innovation, and capacity building.

provided nonfinancial additionality such as improved environmental, social, health, and safety standards and practices adopted in the design, construction, and operation of the projects, and facilitated capacity and knowledge building. In the infrastructure projects for which ADB did not provide additionality, other lenders were expected to step in, or other sources of financing were available.

9. In FI projects, ADB provided financial additionality (e.g., longer-term finance not readily available in the market) as well as nonfinancial additionality (e.g., support that improved the company's governance and operations, and provision of technical assistance and advice) to three or 75% of the four FI projects evaluated in 2022. In 2021, the *satisfactory* rating for additionality was 60% (three of five FI projects). For one regional PEF, ADB helped mobilize funds from other sources and provided advice on project design and development. However, the other regional fund evaluated in 2022, which aimed to invest in climate change and environment-related sectors, was rated *less than satisfactory* for additionality because ADB failed to provide sufficient hands-on oversight and guidance on the fund's investment proposals.

10. Despite the observed improvement in ADB additionality, for NSO projects evaluated in 2022 with *less than satisfactory* ratings for ADB additionality, the most common reason cited was absence of financial additionality rather than nonfinancial additionality.[9]

3. Investment Profitability Showed Slight Improvement

11. The investment profitability of nonsovereign projects improved to 65% in 2020–2022 after a continual decline in the previous 3-year period.[10] The success rate of ADB investment profitability decreased from 74% in 2016–2018 to 63% in 2019–2021 and improved to 65% in 2020–2022. Of 15 infrastructure projects evaluated in 2022, 12 or 80% were rated *satisfactory* or *excellent*, an improvement from the previous year's success rate of 63%. Those with *less than satisfactory* or *unsatisfactory* ratings saw excessive covenant breaches and waivers, pricing below cost recovery and market, and impaired loans. The investment profitability of FI projects declined from 100% (five out of five) in 2021 to only 50% (two out of four) in 2022, the lowest success rate for FI projects in 8 years. Projects that had *unsatisfactory* performance faced financial difficulties and poor financial performance because of factors such as economic policy changes and increased competition. As in 2021, both PEFs had *unsatisfactory* ratings in 2022. Net equity financial internal rates of return for the PEFs were either negative or below the target return.

4. ADB Charted Improvement in Work Quality

12. ADB work quality continued to improve from its lowest 3-year period rating of 40% of projects with *satisfactory* ratings in 2017–2019 to 63% in 2020–2022.[11] In 2020–2022, ADB screening, appraisal, and structuring increased to a 64% *satisfactory* rating while monitoring and supervision likewise increased to a 76% *satisfactory* rating (Table B4). In the 15 evaluated infrastructure projects in 2022, ADB's front-end work was rated *less than satisfactory* in four projects mainly because of over- or underestimation of important financial metrics factored into projections at appraisal, which did not

[9] Financial additionality refers to (i) provision of financing that is not available from commercial sources on reasonable terms (i.e., longer tenor, larger amounts, or financing in local currency); (ii) introduction of an innovative financing structure that helps reduce risk or lowers the private sector client's cost of capital; (iii) use of a multilateral development bank's own equity account; or (iv) mobilization of commercial capital. Nonfinancial additionality refers to (i) provision of guidance or technical assistance to improve project or client standards; (ii) provision of knowledge and expertise to improve the client's capacity to realize the anticipated development impact; (iii) work to change government policies and regulations to improve country or sector practices; or (iv) mitigation of nonfinancial risks (country, political, or project risk).

[10] For projects involving loans, the evaluation of ADB investment profitability considers whether (i) market pricing was achieved, (ii) the ADB pricing model was cleared, and (iii) principal and interest payments were made as scheduled. For equity investments, the real net equity financial internal rate of return of ADB's investment is compared with the minimum return requirements defined at approval.

[11] Assessment of work quality reviews ADB's performance in (i) screening, appraisal, and structuring; and (ii) monitoring and supervision.

adequately consider risks. The result was unrealistic targets in DMFs or unrealistic project sizing (e.g., approved loan was too large for project needs).

Table B4: Rating by Work Quality Component, 2016–2022
(3-year moving average, %)

3-Year Moving Average	Component Ratings		
	Screening, Appraisal, and Structuring	Monitoring and Supervision	Overall ADB Work Quality
2016–2018	57	69	51
2017–2019	46	63	40
2018–2020	59	70	56
2019–2021	57	71	59
2020–2022	64	76	63

Source: Asian Development Bank (Independent Evaluation Department).

13. Three of the four FI projects evaluated during 2022 had satisfactory ratings for front-end work quality. The lone project that performed poorly had weaknesses observed in the DMF. The two evaluated PEFs had *less than satisfactory* ratings for their front-end work quality because of insufficient preparation, reflecting the large scope in a challenging region and the major structural weakness in the composition and function of the fund's investment committee.

14. For monitoring and supervision, ADB performed well in 17 of the 21 evaluated projects in 2022. ADB kept itself sufficiently informed of project progress, and supervision reports were generally timely, with satisfactory information supplied in 12 of 15 infrastructure projects and in all 4 FI projects. Only 3 of 15 infrastructure projects and 1 of 2 PEF projects evaluated in 2022 received *less than satisfactory* ratings for monitoring and supervision.

D. Increase in Variance between Self-Evaluation and Validated Ratings

15. The variance between self-evaluation and validated ratings for overall nonsovereign performance increased from 4% in 2021 to 20% in 2022,[12] the second largest recorded since 2016. The variances in 2016–2021 were 4%–36%. The variance in 2022 reflected four rating downgrades mainly in development results because of the non-achievement of planned outputs and/or outcomes. On a 3-year moving average (Table B5), the variance during 2020–2022 was the second lowest (11%), covering a total of 76 evaluated projects. The largest variance (24%) was registered in 2016–2018.

Table B5: Success Rates of Extended Annual Review Reports Compared with Extended Annual Review Report Validation Reports and Project Performance Evaluation Reports, 2016–2022 (%)

3-Year Moving Average	2016–2018	2017–2019	2018–2020	2019–2021	2020–2022
XARR	79%	74%	69%	62%	66%
XVR/PPER	56%	53%	54%	55%	55%
Variance	24%	21%	15%	7%	11%

PPER = project performance evaluation report, XARR = extended annual review report, XVR = XARR validation report.
Source: Asian Development Bank (Independent Evaluation Department).

[12] The Private Sector Operations Department completed 22 XARRs from July 2021 to June 2022, of which 20 were validated by IED. The other two XARRs submitted were subjected to a project performance evaluation report, to be completed in the second half of reporting year 2023.