INTRODUCTION

1. **Why were the OCR Loan Regulations revised?**

   In anticipation of the discontinuation of LIBOR, on 26 July 2021 the ADB Board of Directors approved the Flexible Loan Product (FLP) to replace ADB’s LIBOR-based loan product. It was then necessary to revise the Ordinary Operations Loan Regulations Applicable to Regular Loans Made from ADB’s Ordinary Capital Resources (OCR Loan Regulations) to give effect to the FLP. In addition to LIBOR related changes, the ADB Board approved the introduction of a floor of no less than zero for ADB’s interest rates to provide clarity should negative interest rates occur and enhancements to strengthen the debt monitoring and reporting of borrowers and guarantors, which have also been reflected in OCR Loan Regulations (2022).

2. **Why were the Ordinary Operations (Concessional) Loan Regulations, Special Operations Grant Regulations and Externally Financed Grant Regulations revised?**

   Subsequent to the approval of the OCR Loan Regulations (2022), corresponding enhancements to the debt monitoring and reporting requirements were incorporated into the Ordinary Operations (Concessional) Loan Regulations (COL Loan Regulations), Special Operations Grant Regulations and Externally Financed Grant Regulations.

3. **When will the OCR Loan Regulations (2022), COL Loan Regulations (2022), Special Operations Grant Regulations (2022) and Externally Financed Grant Regulations (2022) apply?**

   The OCR Loan Regulations (2022) superseded the OCR Loan Regulations (2017), the COL Loan Regulations (2022) superseded the COL Loan Regulations (2017), the Special Operations Grant Regulations (2022) superseded the Special Operations Grant Regulations (2017), and the Externally Financed Grant Regulations (2022) superseded the Externally Financed Grant Regulations (2017). These loan and grant regulations became effective on 1 January 2022 and are made applicable to all new OCR loans, COL loans and grants under ADB’s sovereign operations approved on or after 1 January 2022. Existing loan and grant regulations will continue to apply to OCR loans, COL loans and grants approved before 1 January 2022. Following the current practice, the new loan and grant regulations will be incorporated by reference in the loan, guarantee, and grant agreements for all such loans and grants.

4. **What are the changes?**

   The OCR Loan Regulations (2022):

   (i) introduced changes necessary to implement the FLP;

   (ii) formally reflected the “floor” of no less than zero for ADB’s interest rates; and
(iii) introduced enhancements to strengthen debt monitoring and reporting by borrowers and guarantors.

The COL Loan Regulations (2022), Special Operations Grant Regulations (2022) and Externally Financed Grant Regulations (2022) introduced enhancements to strengthen debt monitoring and reporting by borrowers, guarantors and recipients.

LIBOR RELATED CHANGES

5. What are the LIBOR related changes?

Under the new FLP, the Secured Overnight Financing Rate (SOFR) and the Tokyo Overnight Average Rate (TONA) replace the London Interbank Offered Rate (LIBOR) as the reference rate used in determining a floating rate of interest for regular loans denominated in US dollars and yen respectively.

Other LIBOR related changes are mostly technical, administrative and operational in nature and include:

(i) removing definitions that are no longer applicable, such as “Banking Day”, “Financial Centre”, “LIBOR”, “London Banking Day”, “Reference Rate Reset Date” and “Target Settlement Day”;

(ii) introducing new definitions such as “SOFR” and “TONA”; 

(iii) revising other definitions such as “Reference Rate” and “Relevant Rate Page”; and

(iv) revising the conventions for day count fractions used for SOFR and TONA, and the timing for determining interest rates as the “Reference Rate Reset Date” is no longer applicable.

6. Are the LIBOR related changes similar to ADB’s peers?

The LIBOR related changes are consistent with market practice and aligned with relevant multi-lateral development banks (MBDs). ADB followed a market-based approach to determining alternative reference rates as recommended by the relevant working groups, the Alternative Reference Rates Committee and the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks. ADB also aligned the modifications to its LIBOR-based loan product and the terms of the OCR Loan Regulations (2022) with those of IBRD and AIIB, who were identified as the market for MDB sovereign lending in Asia and the Pacific.

7. How does the definition of “Reference Rate” provide for alternative reference rates?

The definition of “Reference Rate” now provides for SOFR and TONA. The definition also reflects that the applicable Reference Rate may be specified in the loan agreement (e.g., if the loan is in a local currency) or changed upon a loan currency conversion.

8. How have the day count fractions been decided on?
ADB followed a market-based approach to the day count fractions it will use when calculating interest using alternative reference rates. The Alternative Reference Rates Committee recommended Actual/360 for SOFR-based loans, which is the standard day count convention used in US money markets. The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks recommended Actual/360 for TONA-based loans to maintain consistency with TONA.

**CHANGES RELATED TO INTEREST RATE FLOOR**

9. **Why was the zero floor introduced?**

The OCR Loan Regulations (2022) include a zero floor in interest to formalize the existing treatment of negative interest rates. The zero floor clarifies that if negative interest rates occur, the interest for regular OCR loans under sovereign operations shall not be less than zero.

10. **How will the zero floor be calculated?**

The calculation of interest is set out in Article III of the OCR Loan Regulations.

Section 3.02 Interest (a) of Article III of the OCR Loan Regulations (2022) provides, “[f]or each Interest Period, interest shall be calculated at the Floating Rate, as such rate may be modified from time to time in accordance with the provisions of Article V; provided, however, that the interest calculated in accordance with this Article for any Interest Period shall in no event be less than zero.” [Emphasis added.]

The zero floor therefore will apply to the aggregate of interest calculated in accordance with Article III, which consists of the Reference Rate and Fixed Spread (Section 3.02(a)), credit (Section 3.03(b)), maturity premium (Section 3.03(c)), rebate (Section 3.06(b)) and/or surcharge (Section 3.07(b)). It does not apply to commitment fees, prepayment premium, or front-end fees (applicable only to Contingent Disaster Financing loans) as these are not part of interest under Article III.

**CHANGES RELATED TO EXTERNAL DEBT MONITORING AND REPORTING**

11. **What are the changes?**

The changes are (i) a representation by a ADB’s Developing Member Country (DMC) borrower, guarantor, or recipient that it has not defaulted on any of its debt, other than as disclosed to ADB, at the time of the signing of a new loan or guarantee agreement; (ii) a representation by a DMC borrower and/or guarantor on the existence of liens on the assets of the borrower/guarantor as security for foreign currency debts, other than as disclosed to ADB, at the time of signing of a new loan or guarantee agreement; and (iii) an obligation on a DMC borrower and/or guarantor or recipient to provide information, on ADB’s reasonable request, in relation to the financial and economic conditions in the DMC.

12. **Who is required to give the two representations and when will they be given?**

Both representations form part of the OCR Loan Regulations (2022) and COL Loan Regulations (2022) and will therefore be incorporated by reference in each loan and guarantee agreement (not in a separate document). The representation on no default on debt also forms part of the Special Operations Grant Regulations and Externally Financed Grant Regulations. As such, the
representations will be made by the DMC (through its representative, e.g., Ministry of Finance) on the date of the loan, guarantee, or grant agreement by virtue of it being signed. This approach is consistent with the approach taken by IBRD and IDA.

13. Why does ADB’s representation on “no defaults” cover both domestic and foreign currency debt?

ADB’s representation covers defaults on any debt (i.e., foreign and domestic debt) because, when it comes to the financial health of ADB’s DMC borrowers and guarantors, visibility over the DMC’s defaults under its local currency debts is just as important as visibility over defaults under its foreign currency debts.

14. What are the implications of the requirement to provide information on the DMC borrower’s/guarantor’s financial and economic condition upon ADB’s reasonable request?

This requirement to provide information on the DMC borrower’s/guarantor’s financial and economic condition upon ADB’s reasonable request is included in all loan and grant regulations. Reinstatement of this requirement that existed in 2001 OCR Loan Regulations is helpful should ADB need any specific economic or financial information that is outside the scope of routine project-level work, to address any particular concerns that may arise in the future. This requirement relates directly to enhanced debt monitoring, reporting and transparency by the DMC borrowers and guarantors. A similar requirement is found in the regulations/conditions of ADB’s peer MDBs.

15. What is the negative pledge clause (NPC) requirement?

As part of the sovereign lending legal framework, the NPC enables ADB to provide loans to its borrowers without taking security. NPC is a prohibition on the establishment of a priority for other debts over the debt due to ADB. ADB should not be less protected than other creditors by being subordinated to other creditors’ debts. NPC is not a prohibition on Public Private Partnership or other forms of project financing in general. Pledging of assets are permissible so long as such pledges do not involve the assets of the DMC or ADB is provided with pari passu rights or an equivalent lien. The scope of NPC is limited to foreign currency debt for a DMC borrower/guarantor.

16. What are the changes on NPC?

The changes to the NPC in the OCR Loan Regulations (2022) and COL Loan Regulations (2022) include (i) providing clarity on the purpose of the NPC requirement; and (ii) distinguishing the NPC applicable to a borrower and/or a guarantor who is a DMC (scope covers liens with respect to foreign currency debt) from one applicable to a borrower who is a non-member (scope covers liens with respect to any debt). These changes make the NPC requirements more closely aligned with the approach of peer MDBs, but do not change the fundamental principle of the NPC as it has historically been applied by ADB.