

Asian Development Bank

ADF Financial Management

The views expressed in this paper/presentation are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB), or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this paper and accepts no responsibility for any consequence of their use. Terminology used may not necessarily be consistent with ADB official terms.

Manila
21 November 2007

ADB

Outline

- I. Overview of the Asian Development Fund (ADF)**
- II. Overview of ADF Financial Management**
- III. Overview of ADF Currency Management**
- IV. SDR Conversion Option**
- V. Conversion Steps**

Intent and Scope

- Facilitate the understanding of ADF's financial management

Important:

- Numbers are for illustrative purposes only
- Focus on concepts, directions and major conclusions

I. Overview of the Asian Development Fund (ADF)

Background Information on ADF

- Established in 1973
- ADB's oldest and largest special fund
- Provides loans on concessional terms and grants to eligible developing member countries
- Disbursed and outstanding ADF loans (as of September 2007): US\$23.3 billion equivalent with 98% legacy loans and 2% full-fledged SDR loans

ADB's Financial Resources

Ordinary Capital Resources (OCR) comprises paid-in capital from its members, accumulated reserves, and borrowings from the open capital markets

Special Funds (established and administered by ADB)

- Asian Development Fund (ADF), Technical Assistance Special Fund (TASF), Japan Special Fund (JSF), ADBI Special Fund, Asian Tsunami Fund, Pakistan Earthquake Fund

Trust Funds Managed by ADB

- Japan Fund for Poverty Reduction (JFPR), Japan Fund for Information and Communication Technology (JFICT), Channel Financing Arrangements (CFAs)

Eligibility for ADF

- DMC Classification: 4 Groups - A, B1, B2 and C
- Key Classification Criteria
 - gross national product (GNP)
 - debt repayment capacity
- Financing Eligibility
 - **Group A:** ADF only
 - **Group B1:** ADF with limited amounts of OCR
 - **Group B2:** OCR with limited amounts of ADF
 - **Group C:** OCR only

Eligibility for ADF

ADF Eligibility of DMCs as per Decision Matrix^a

Proposed Per Capita GNP Cutoff (\$925 in 1997 Prices)				
Debt Repayment Capacity	Below Per Capita GNP Cutoff		Above Per Capita GNP Cutoff	
	Least Developed Country ^b		Least Developed Country ^a	
	Country ^b	Other	Country ^a	Other
Weak	<u>ADF Only (A)</u> Afghanistan, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic, Myanmar, Nepal, Solomon Islands, Timor-Leste	<u>ADF Only (A)</u> Kyrgyz Republic, Mongolia, Tajikistan	<u>ADF Only (A)</u> Maldives, Samoa, Tuvalu, Vanuatu	<u>ADF with Limited OCR (B1)</u> Armenia, Cook Islands, ^d Georgia, Marshall Islands, Federated States of Micronesia, Tonga
Limited	<u>ADF with Limited OCR (B1)</u> Bangladesh	<u>ADF with Limited OCR (B1)</u> Azerbaijan, Pakistan, Sri Lanka, Viet Nam	<u>ADF with Limited OCR (B1)</u>	<u>OCR with Limited ADF (B2)</u> Indonesia, ^e Nauru, ^c Palau, ^c Papua New Guinea
Adequate	<u>OCR with Limited ADF (B2)</u>	<u>OCR with Limited ADF (B2)</u> Popele's Republic of China, ^c India, ^c Uzbekistan	<u>OCR with Limited ADF (B2)</u>	<u>OCR Only (C)</u> Fiji Islands, Kazakhstan, Malaysia, Philippines, Thailand, Turkmenistan

^a Some cells do not list DMCs because the current borrowing DMCs do not fit the specific characteristics of a particular cell. This could change as new members are classified and existing DMCs graduate to the next level.

^b The following DMCs are classified as LDCs: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao, People's Democratic Republic, Maldives, Myanmar, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu, and Vanuatu (United Nations, December 2003. *List of Least Developed Countries*).

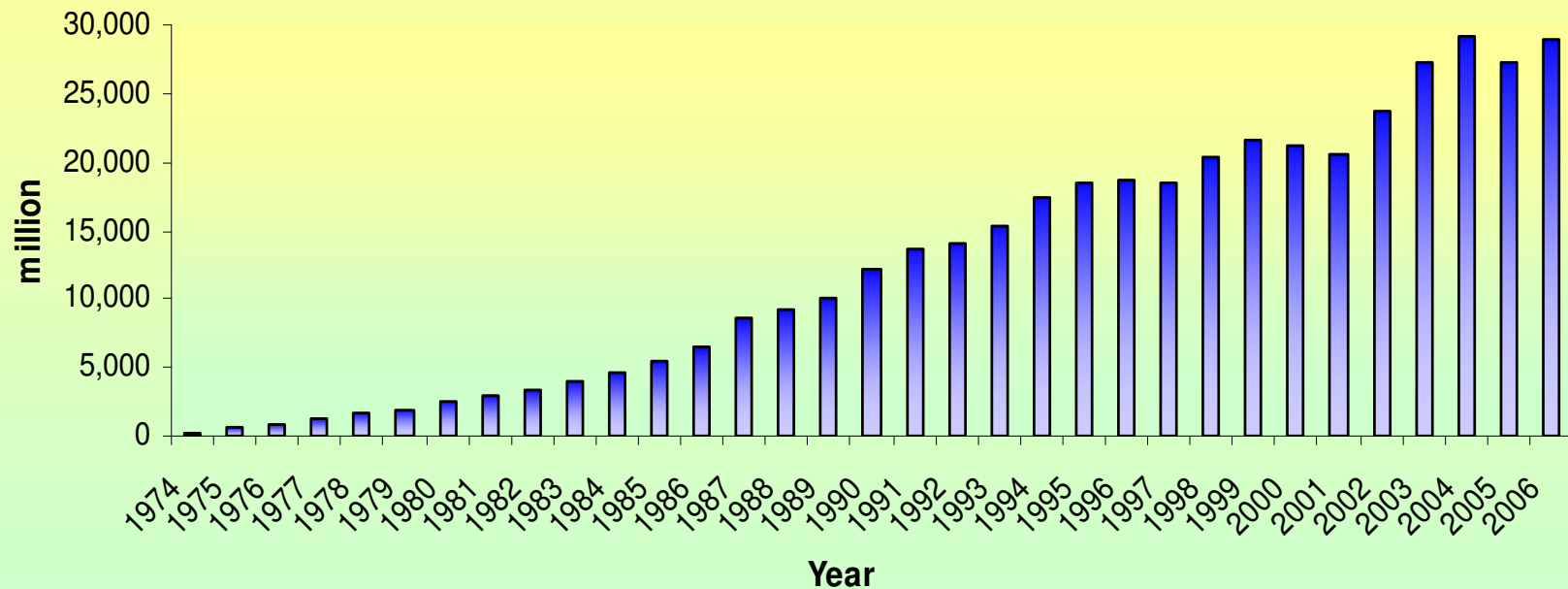
^c Currently no access to ADF.

^d Limited OCR eligibility will take effect only after the country's external debt position has improved.

^e On watch list for graduation from ADF.

ADF Operations

Total ADF Assistance (1974–2006)
(\$ equivalent)



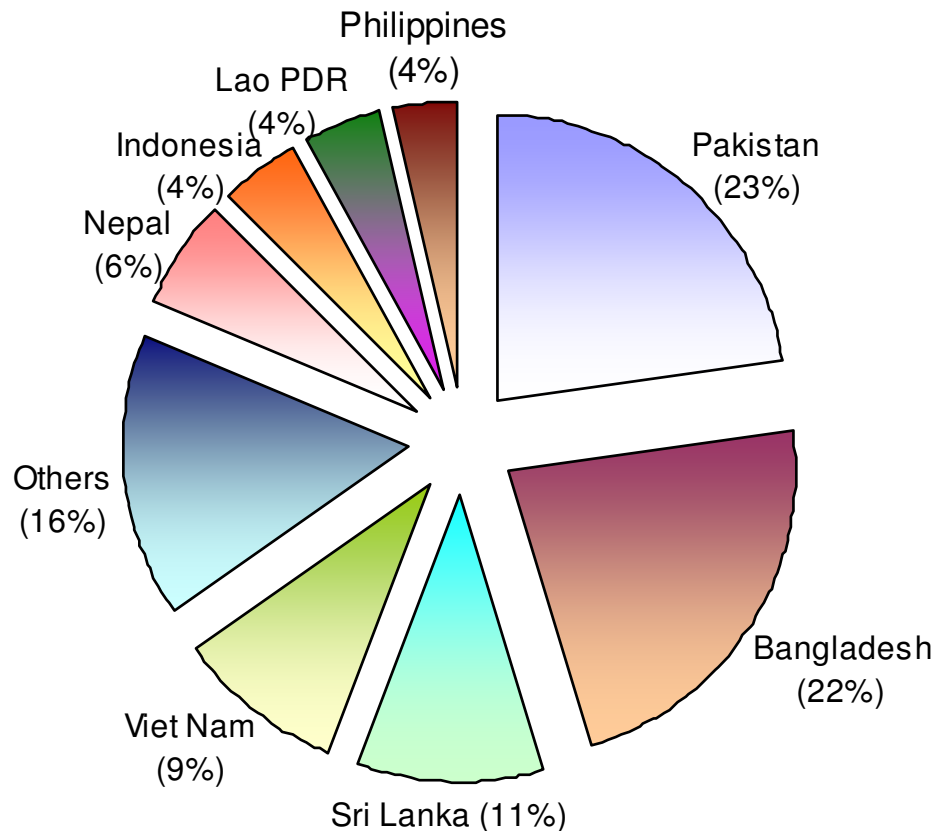
Note: Total loans & grants including (i) disbursed and outstanding, (ii) approved but not yet effective, and (iii) undisbursed.

Total ADF loans and grants increased from US\$178 million in 1974 to US\$29.7 billion in September 2007.

ADF Operations

ADF Loans Outstanding

Disbursed and Outstanding: \$23.3 billion equivalent



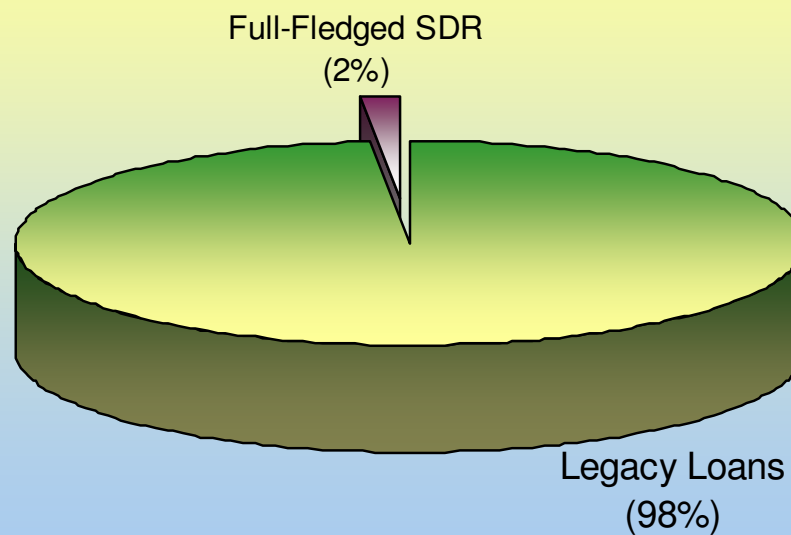
as of September 2007.

Top 5 Borrowers:

- Pakistan
- Bangladesh
- Sri Lanka
- Vietnam
- Nepal

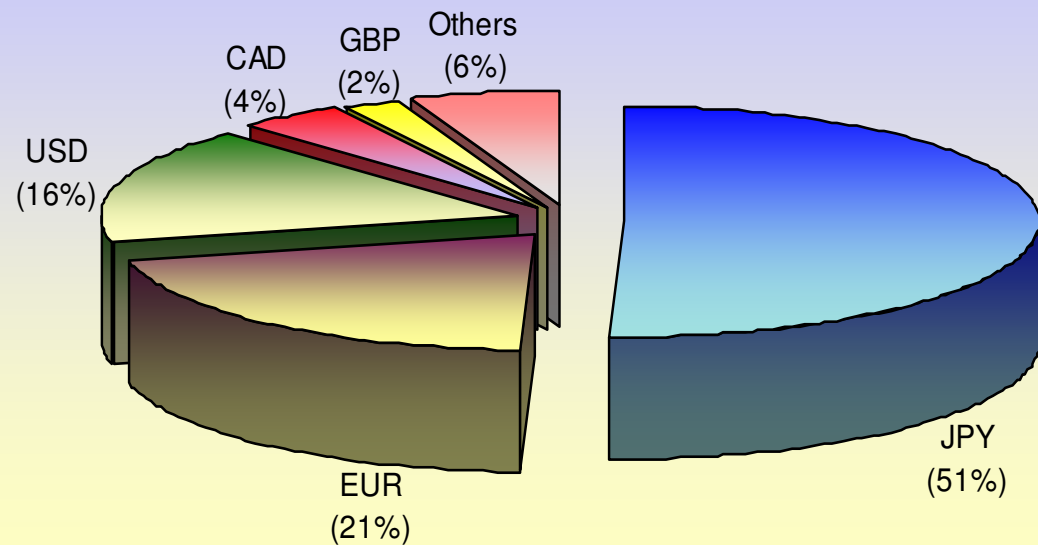
ADF Operations...cont.

ADF Loans Outstanding as of 30 September 2007
\$23.3 billion equivalent



ADF Operations...cont.

Total ADF Outstanding Legacy Loans by Currency
as of September 2007
\$22.9 billion equivalent (98% of \$23.3 billion equivalent)



II. Overview of ADF Financial Management

Modes of ADF's Developmental Financing



LOANS

EQUITY

TECHNICAL ASSISTANCE



GUARANTEES

GRANTS

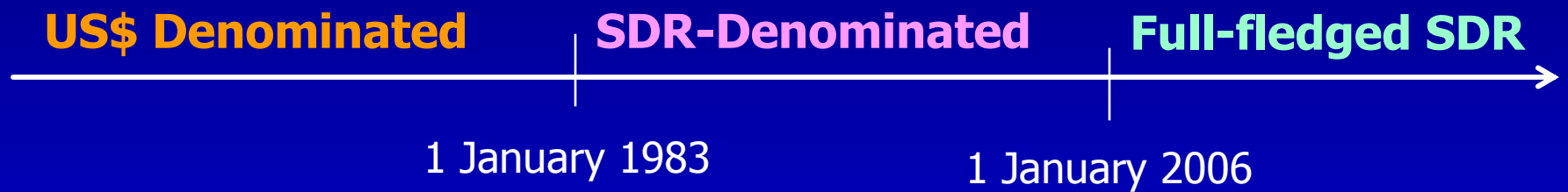
ADF Concessional Lending Product

Current Loan Terms

Item	Maturity	Grace Period	Interest Charge
(Applicable to loans negotiations of which have been completed on or after 1 Jan 1999)			
Project Loans	32 years	} 8 years }	} 1% p.a. during grace period, 1.5% p.a. during amortization period, equal amortization
Program Loans	24 years		
(Loan terms that have been approved by the Board of Directors in June 2004)			
Emergency Assistance Loans	40 years	10 years	1% p.a.

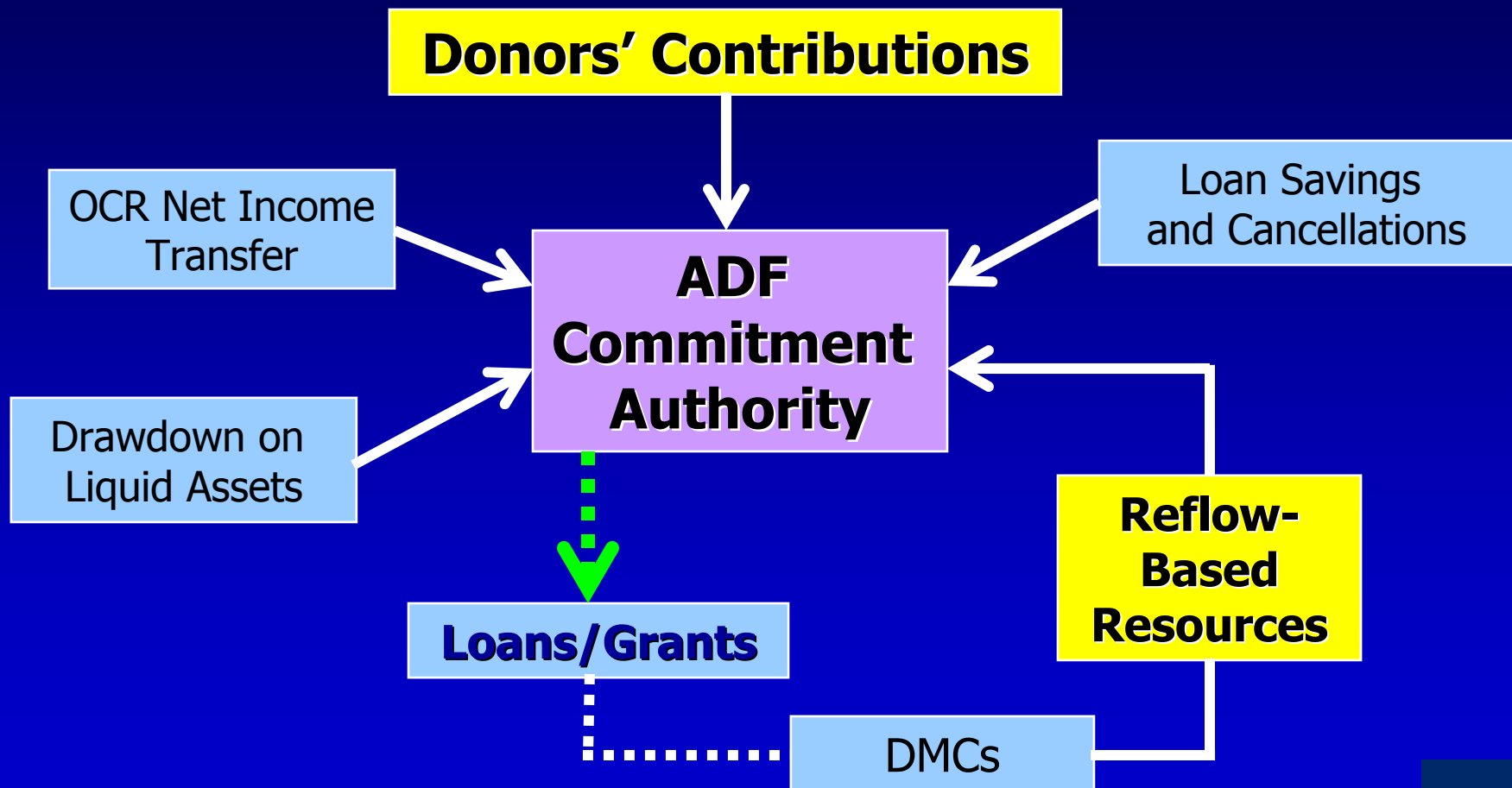
Currency of ADF Loan Commitment

History



ADF Financial Resources

ADF financial resources mainly consists of the following:



ADF Financial Resources

Major financial resources:

Donors' Contributions

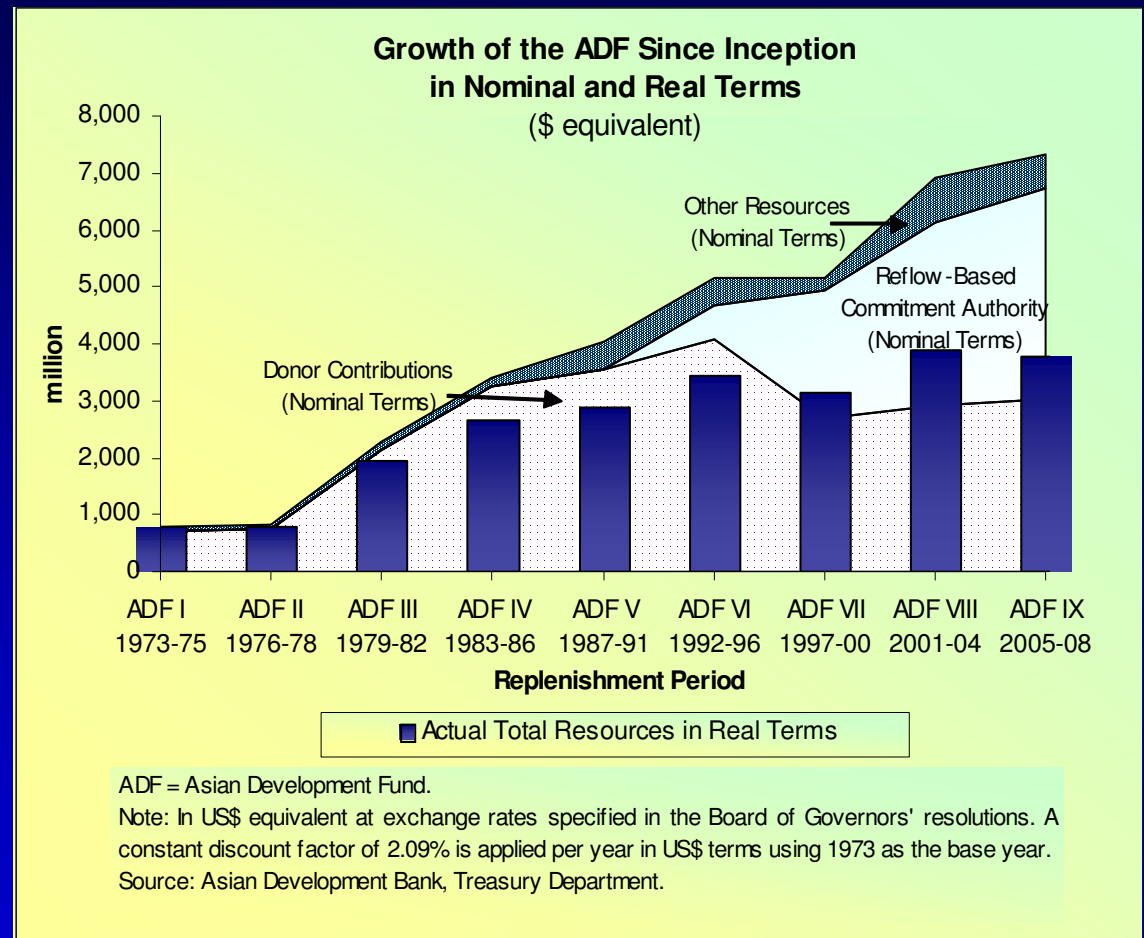
- periodic replenishments
- 8 replenishments: ADF I–IX
- in 15 donors' currencies:
 - Australian dollar
 - Canadian dollar
 - Danish krone
 - Euro
 - Japanese yen
 - Korean won
 - Malaysia ringgit
 - Norwegian krone
 - New Zealand dollar
 - Pound sterling
 - Singapore dollar
 - Swedish krona
 - Swiss franc
 - Thai baht
 - United States dollar

Internal resources/reflows: loan repayment, loan income and investment income

Commitment Authority

ADF I–IX

- Since inception, ADF grew by 32% in nominal terms and 22% in real terms per replenishment
 - Total commitment authority accumulated to about \$35.9 billion
 - 64% funded by donor contributions
 - 27% funded by reflow-based resources



ADF Financial Management

- ADF accounting books are kept separately from OCR, following the special purpose financial statements
- Treasury Department provides financial management of ADF:
 - ✓ Ensures the healthy financial position of the fund's resources;
 - ✓ Formulates financial management policies and assists with the implementation;
 - ✓ Supports ADF replenishment negotiations and subsequent execution and midterm review;
 - ✓ Responsible for cash management (disbursement, encashment, investment, currency transactions, etc.);
 - ✓ Monitors commitment authority;
 - ✓ Risk Management Unit performs risk management

III. Overview of ADF Currency Management

Currency Management Practices

Evolution of Currency Management Practices

1. Currency Preservation Principle

- All loans prior to 2006
- Currency Priority Basis

2. SDR-Based Approach

- **Phase 1** (since 2006)
 - New loans*/full-fledged SDR loans
 - Legacy loans**
- **Phase 2** (starts 2008)
 - Conversion of legacy loans to full-fledged SDR loans

* Loans invited for negotiation from 1 January 2006.

** Loans invited for negotiation prior to 2006.

Issues of the Currency Practice on Legacy Loans (Pre-2006)

- A currency mismatch between contractual commitments in SDR and actual obligations in 15 donors' currencies
- Implications from the currency priority practice:
 - challenge in currency planning and debt portfolio management
 - unequal FX effects among borrowers due to various compositions of liability currencies

Key Terms for Currency Management of ADF Loans

**SDR-Denominated
Loan**

**Loan-Denominated
Currency**

Currency of loan used
for budgetary purposes
SDR since 1983

**Rupee/Kip/
Dong/SDRs**

**Disbursement
Currency**

Currency requested by
borrower in which
goods/services will be
financed

SDR Currencies

Cost Currency = SDR
Currencies

Currency disbursed or
used by ADB to obtain
funds for disbursement

Liability Currency
= SDR

Currency recorded by
ADB as the liability of
borrower

USD

Repayment Currency
= one of the SDR
currencies selected by
the borrower

Currency of loan service
payments

Introduction of SDR-based Practice (Post 2006)

Item	Full- Fledged SDR Loans and Converted Legacy Loans	Legacy Loans – Phase 1	
		Undisbursed Balance	Disbursed and Outstanding
Loan Denomination	SDR	SDR	SDR
Cost Currency	SDR Currencies	SDR Currencies	Donors' Currencies
Liability Currency	SDR	SDR Currencies	Donors' Currencies
Repayment Currency	One of the SDR Currencies; changeable upon advance notice	<ul style="list-style-type: none"> • proportional recalling of multiple liability currencies • option to pay in one of SDR currencies, changeable upon advance notice 	

Benefits of Full-Fledged SDR Loan to Borrowers

- Resolves the mismatch between contractual loan commitments and borrower's actual obligations
- Reduces number of liability currencies from up to 15 currencies to SDR
- Increases flexibility in repayment currency
- Simplifies and streamlines currency planning and debt management
- Harmonizes concessional financing modality with IDA

Benefits of Full-Fledged SDR Loan to ADF

- Improves ADF product and financial management
- Harmonizes the practice with IDA
- Reduces currency volatility of the assets and frees up financial resources for developmental lending

IV. SDR Conversion Option for Legacy Loans

SDR Conversion Option

- Option to convert multiple liability currencies under legacy loans into SDR
- Available for all ADF borrowers with no arrears in outstanding loans
- Starting January 2008
- As part of the conversion, undisbursed balance will follow the practice of full-fledged SDR loans
- No administrative fee to borrowers

Background on SDR

- Created by the IMF in 1969
- Value is based on a basket of 4 major currencies:

Currency	IMF Currency Amount	FX Rates	Value
Euro	0.4100	0.702889	0.583307
Japanese yen	18.4000	114.430000	0.160797
Pound sterling	0.0903	0.487995	0.185043
U.S. dollar	0.6320	1.000000	0.632000
			1.561147

Current

Daily FX
Rates

SDR Value as of 25
October 2007

- Reviews SDR currency weighting every 5 years
- Last reviewed in 2005, valid from 2006 to 2010

Potential Implications: SDR Conversion
Option
Sample ADF Exposure

**Scenario Analysis:
With Conversion
vis-à-vis
Without Conversion**

Sample: Loans Outstanding (as of September 2007)

Currency (in millions)	LC Total	Current US\$ Eq ¹	FX Rates	SDR Eq Current ¹
Australian dollar	6.0	5.4	0.8887	3.4
Canadian dollar	34.1	34.4	1.0076	22.1
Danish krone	13.5	2.6	0.1913	1.7
Euro	92.2	131.6	1.4268	84.5
Japanese yen	62,730.1	546.4	0.0087	351.0
Korean won	931.1	1.0	0.0011	0.7
Norwegian krone	3.7	0.7	0.1842	0.4
Pound sterling	0.4	0.8	2.0388	0.5
Swedish krona	32.9	5.1	0.1552	3.3
Swiss franc	21.6	18.6	0.8593	11.9
United States dollar	101.2	101.2	1.0000	65.0
Totals		847.7	1.5567	544.6 847.7

¹ Based on exchange rates as of 28 September 2007

Note: Figures may not add to total due to rounding.

Potential Implications Based on Scenario Analysis

- **Scenario Analysis:**
 - (i) with conversion
 - (ii) without conversion
- **Two Approaches Used:**
 - (i) historical foreign exchange pattern
 - 20-year historical foreign exchange rate movements (1987–2007)
 - (ii) projected changes in foreign exchange rates
 - 5%–50% change

Potential Implications: With or Without Conversion

Basis for analysis and assumptions

- Disbursed and outstanding loan balance and currency mix of the Sample as of September 2007
- No repayment prior to maturity
- With conversion scenario: assuming the conversion takes place at the end of September 2007
- No change in SDR currency composition and weighting

a. Historical Foreign Exchange Rate Pattern

20-Year Historical Monthly Volatility*	
Currency	Annualized Volatility
Australian dollar	10.2%
Canadian dollar	5.5%
Danish krone	10.4%
Euro**	9.0%
Japanese yen	11.6%
Korean won	10.9%
Malaysian ringgit	7.2%
Norwegian krone	10.2%
Pound sterling	10.2%
Swedish krona	10.7%
Swiss franc	11.5%
Thai baht	10.8%
SDR	5.4%

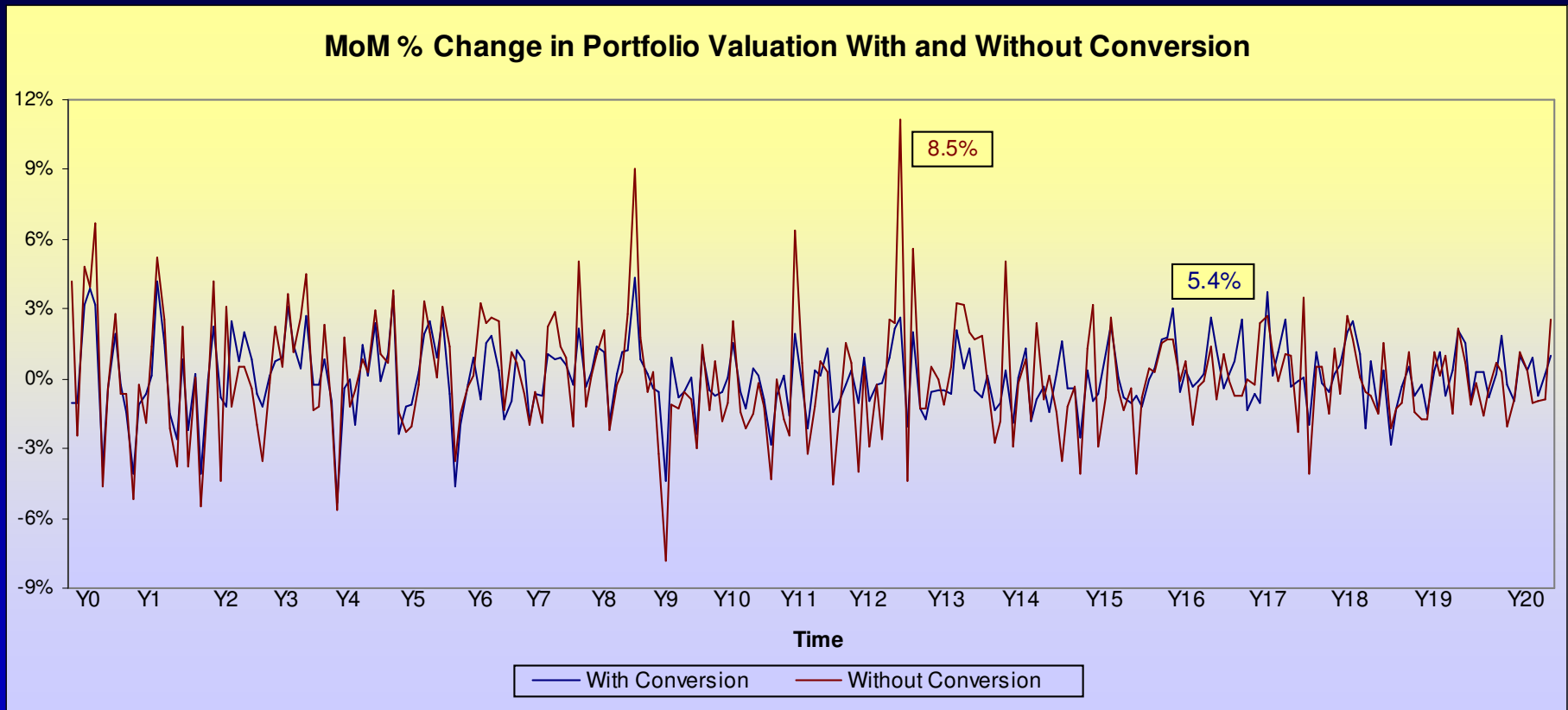
Sample Exposure	
Volatility of Portfolio Value in USD	
Scenario	
Without Conversion	8.5%
With Conversion	5.4%

- SDR is less volatile than the single liability currency based on historical data
- With conversion, volatility of the obligation value is lower

* Data from Bloomberg

**DEM is proxy for rates prior to December 1999

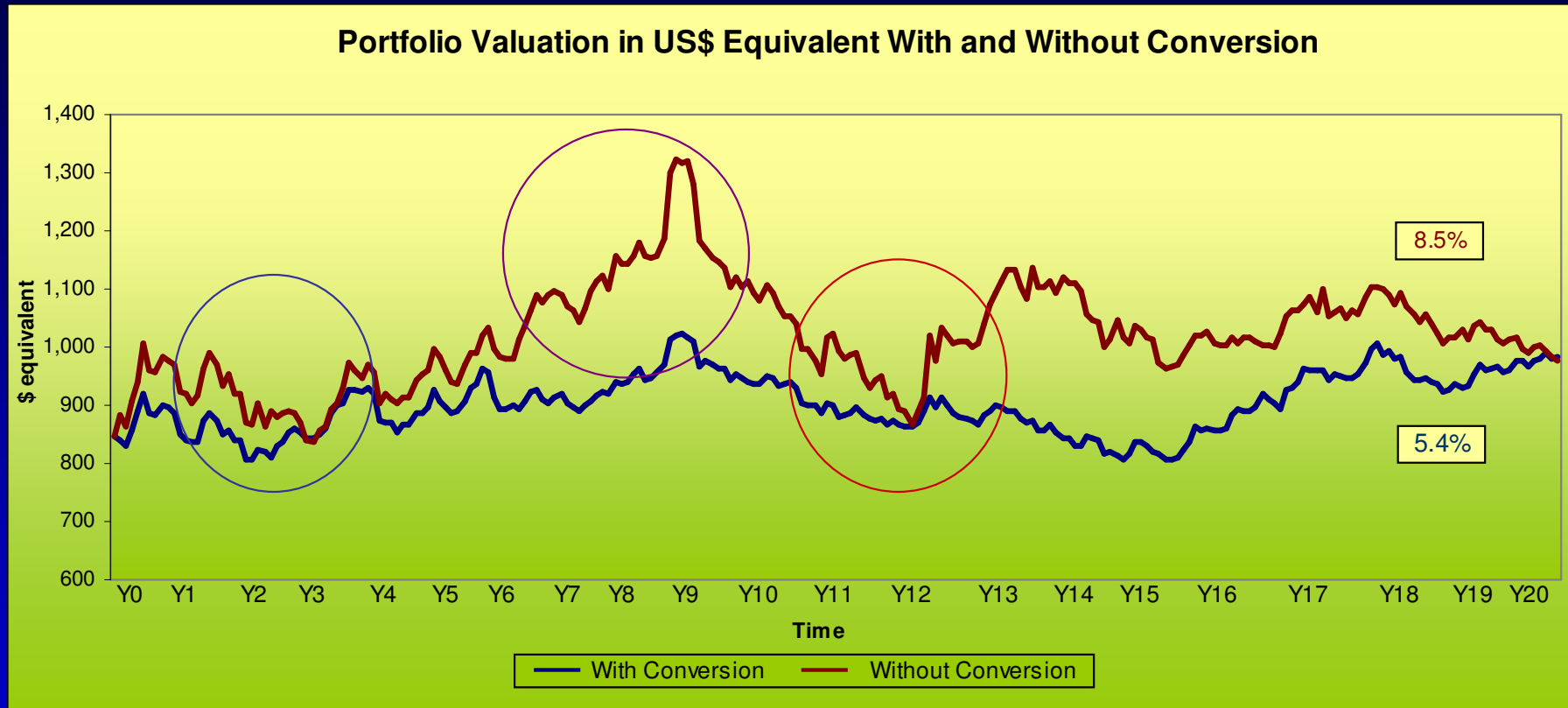
a. Historical Foreign Exchange Rate Pattern



Less volatile with conversion based on a 20-year historical exchange rates

- With Conversion: 5.4%
- Without Conversion: 8.5%

a. Historical Foreign Exchange Pattern



- Conversion scenario shows a lower volatility based on 20-year historical exchange rates

b. Projected Foreign Exchange Change

**% Change in Obligation Value in USD Due to FX Change
Without Conversion**

Currency	+5%	+10%	+15%	+20%	+25%	+30%	+35%	+40%	+45%	+50%
AUD	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
CAD	0%	0%	1%	1%	1%	1%	1%	2%	2%	2%
Danish krone	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Euro	1%	2%	2%	3%	4%	5%	5%	6%	7%	8%
Japanese yen	3%	6%	10%	13%	16%	19%	23%	26%	29%	32%
Korean won	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Norwegian krone	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Pound sterling	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Swedish krona	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Swiss franc	0%	0%	0%	0%	1%	1%	1%	1%	1%	1%
All*	4%	9%	13%	18%	22%	26%	31%	35%	40%	44%

- The calculation does not factor in correlation effects between currencies.
- Decrease in FX would lead to opposite effect to obligation value.

b. Projected Foreign Exchange Change

% Change in Obligation Value in USD Due to FX Change
With Conversion

Currency	+5%	+10%	+15%	+20%	+25%	+30%	+35%	+40%	+45%	+50%
EUR	2%	4%	6%	7%	9%	11%	13%	15%	17%	19%
JPY	1%	1%	2%	2%	3%	3%	4%	4%	5%	5%
GBP	1%	1%	2%	2%	3%	4%	4%	5%	5%	6%
All*	3%	6%	9%	12%	15%	18%	21%	24%	27%	30%

Correlation Coefficient

	EUR	JPY	GBP	SDR
EUR	1.000	-0.400	0.723	-0.622
JPY	-0.400	1.000	-0.348	-0.622
GBP	0.723	-0.348	1.000	0.780
SDR	0.905	-0.622	0.780	1.000

- Conversion scenarios continue to have lower fluctuation

- The calculation does not factor in correlation effects between currencies.
- Decrease in FX would lead to the opposite effect in the obligation value.

Conclusion from Scenario Analysis

- Conversion of liability currencies from donor currencies to SDR provides
 - lower volatility in the obligation value
 - potential smaller amounts of obligations
 - less number of liability currencies to be monitored and managed

V. Conversion Steps

Conversion Steps

- ADB will provide the Letter of Agreement (LOA) to borrowers with ADF legacy loans
- Each borrower informs ADB of its decision to convert by submitting the signed LOA
- This submission will be applicable for all outstanding legacy loans
- Conversion will be effective 1 month after receipt of signed LOA from a borrower
- Conversion date will be 1st loan service payment date of each loan

Sample Letter of Agreement

This document is a draft prepared for the purpose of the SDR Conversion Option Workshop. It is not a final document and does not commit ADB.

[date]

[To the Borrower]

Dear [name of the contact person]:

Re: Conversion of Payment Obligations under Asian Development Fund (ADF) Loans into Special Drawing Rights (SDR)

1. Under the Asian Development Fund Currency Management Proposal approved by the Asian Development Bank (ADB) on 28 November 2005, ADB is authorized to value the obligations of its borrowers regarding repayment of principal and payment of interest charge or service charge, as the case may be, in respect of loans made from ADB's Asian Development Fund (ADF) in terms of Special Drawing Rights (SDR). ADB has implemented this policy for the new loans made to borrowers since 2006 (loans for which the invitation to negotiate was issued after 1 January 2006).

2. In accordance with the Asian Development Fund Currency Management Proposal, ADB is now offering [Name of DMC] (the Borrower) the option to convert into SDR the Borrower's payment obligations for the loans made by ADB to the Borrower listed in paragraph (3) below.

3. This letter applies to the Borrower's loans for which the Loan Agreements incorporate by reference the following ADB's Special Operations Loan Regulations: (a) Special Operations Loan Regulations, dated 6 May 1969 (the "1969 Loan Regulations"), (b) Special Operations Loan Regulations, dated 17 February 1977 (the "1977 Loan Regulations"), (c) Special Operations Loan Regulations, dated 7 December 1982 (the "1982 Loan Regulations"), and (d) Special Operations Loan Regulations, dated 1 May 2004 (the "2004 Loan Regulations"), which are listed below (hereinafter referred to collectively as the "Loans" or each loan individually as the "Loan"):

1969 Regulations	Loan	1977 Regulations	Loan	1982 Regulations	Loan	2004 Regulations	Loan
Loan No. []- xxx(SF)		Loan No. []- xxx(SF)		Loan No. []- xxx(SF)		Loan No. []- xxx(SF)	
Loan No. []- xxx(SF)		Loan No. []- xxx(SF)		Loan No. []- xxx(SF)		Loan No. []- xxx(SF)	
Loan No. []- xxx(SF)							
Loan No. []- xxx(SF)							
Loan No. []- xxx(SF)							

Sample Letter of Agreement...cont.

4. For each Loan, the Borrower's obligation to repay the principal and to pay the interest, service fee, service charge, or interest charge (as the case may be) in the several currencies withdrawn from the Loan Account will be converted into SDR at the exchange rate between each currency concerned and the SDR, as determined by ADB on the Conversion Date. The Conversion Date for each Loan will be the first date on which the principal, interest, service fee, service charge, or interest charge (as the case may be) is due under the relevant Loan, falling at least one month after the date when ADB will have received a counterpart of this letter of agreement duly signed by the Borrower, provided that if ADB receives a counterpart of this letter of agreement duly signed by the Borrower on or prior to 31 December 2007, the Conversion Date for each Loan will be the first date on which the interest, service fee, service charge, or interest charge (as the case may be) is due under the relevant Loan, falling after 31 January 2008.

5. For the purpose of the conversion referred to in paragraph 4 above, each Loan Agreement (Special Operations) entered into between the Borrower and ADB in relation to a Loan (a) which is listed under column "1969 Loan Regulations" in paragraph 3 above is amended in accordance with the provisions of Appendix 1 attached hereto, (b) which is listed under column "1977 Loan Regulations" in paragraph 3 above is amended in accordance with the provisions of Appendix 2 attached hereto, and (c) which is listed under either column "1982 Loan Regulations" or column "2004 Loan Regulations" in paragraph 3 above is amended in accordance with the provisions of Appendix 3 attached hereto.

6. For the avoidance of doubt, the conversion will not affect the undisbursed amount of each Loan which will be equal to the difference between (a) the principal amount of the Loan specified in Section 2.01 of the Loan Agreement (Special Operations) for such Loan less any amount that has been cancelled, if any, and (b) the equivalent in SDR of the amounts in various currencies withdrawn from the Loan Account based on the value of such currencies expressed in SDR as of the respective dates of withdrawal.

7. Promptly after the Conversion Date of each Loan, ADB will provide the Borrower with a new amortization schedule for such Loan revised in accordance with the provisions of paragraph 4 above. For each Loan, the revised amortization schedule will replace, as of the Conversion Date, the amortization schedule included in Schedule 2 to the relevant Loan Agreement.

8. For the purposes of (i) Section 3.02 (a) of the 1969 Loan Regulations, and (ii) Section 4.03 (a) of the 1977 Loan Regulations, 1982 Loan Regulations and 2004 Loan Regulations, the currency of payment of principal of a Loan shall be the currency indicated below by the Borrower.

9. Please indicate your agreement to this letter by countersigning the two (2) original counterparts of this letter in the space indicated below, and returning one signed counterpart to ADB. The other signed counterpart may be retained by you for your records. For each Loan, the amendments to the Loan Agreement will be effective on the Conversion Date as defined in paragraph 4 above.

Sample Letter of Agreement...cont.

Very truly yours,

[Name of ADB signatory]
[Title]

Confirmed and Agreed:

The currency of payment referred to in paragraph 8 of this letter of agreement shall be:^{*}

- Euro
- Japanese Yen
- Pound Sterling
- United States Dollar

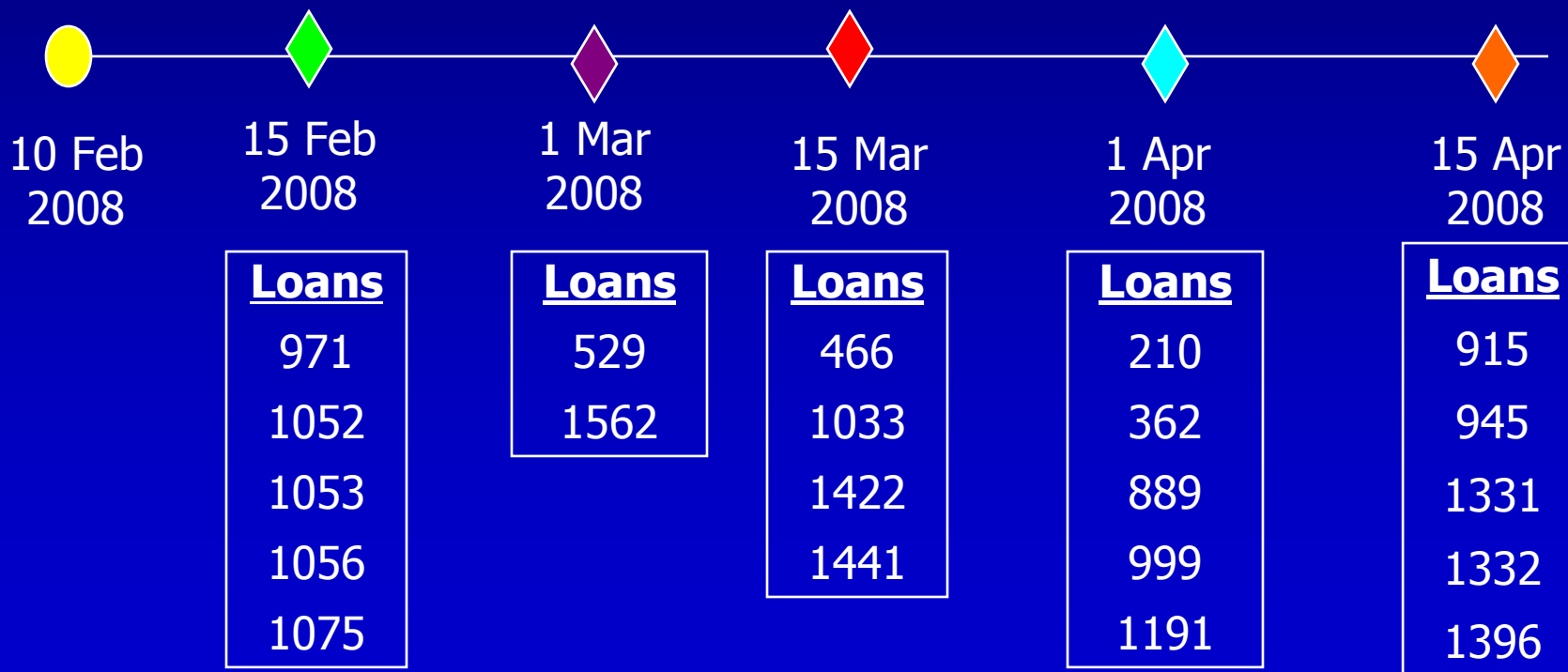
[NAME OF DMC]

By: _____
Name:
Title:
Date:

^{*} The Borrower may only choose one currency.

Illustration of the Conversion Dates

10 January 2008	Letter of agreement signed by borrower and received by ADB
LSP Date of Each Loan	Value date of conversion



Q & A

Thank you

Background

- **28 November 2005:** ADB's Board of Governors authorized ADB to value disbursements, repayments and charges under loans from resources of the ADF in terms of SDR (Resolution No. 311)
- **December 2005:** ADB's Board of Directors authorized ADB to offer the full-fledged SDR approach to all ADF loans.
- **Since 2006,** ADB has introduced new loans to ADF borrowers under the full-fledged SDR approach
- New "Special Operations Loan Regulations" dated 1 January 2006 ("Loan Regulations 2006") were approved by ADB and are applicable only to new ADF loans negotiated starting 1 January 2006
- ADB is now giving the option to ADF Borrowers to convert all their ADF loans made before 2006 (ADF Legacy Loans) into SDR