
2006 DMC Orientation Program

Asian Development Fund (ADF)

14 September 2006

ADB

Outline

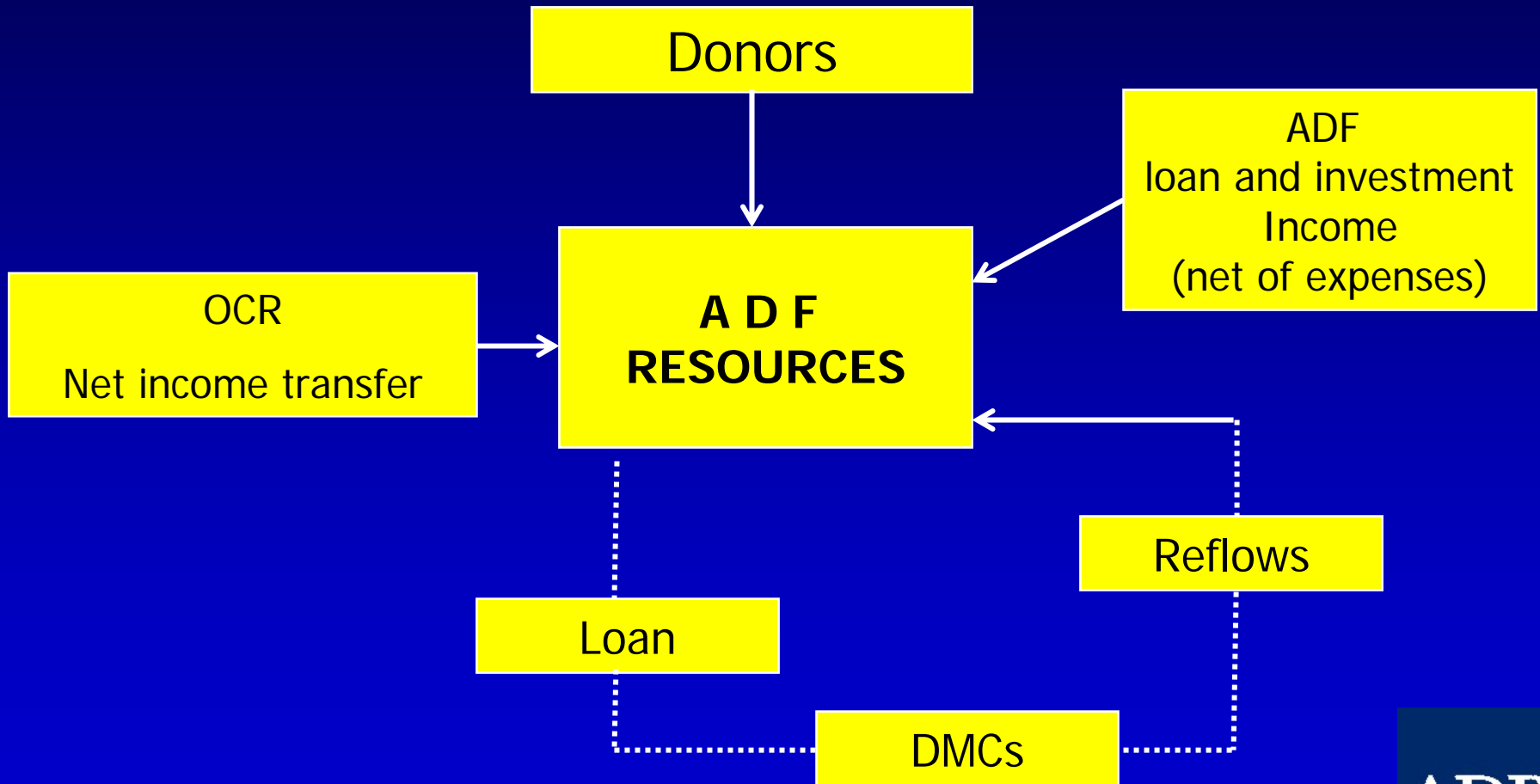
1. What is ADF?
2. Resources of ADF
3. ADF Lending and Its Borrowers
4. Priority Areas for ADF Loans & Grants
5. New ADF Currency Management Framework
6. ADF Financial Management

1. What is ADF?

- Established in 1973, ADF is the only multilateral development bank (MDB) concessional fund dedicated exclusively to promote economic and social development in Asia & Pacific region.
- ADB's largest special fund designed to provide loans on concessional terms and grants to members with low per capita gross national product and limited debt-repayment capacity.
- At the end of 2005, loans from ADF accounted for around 27% of cumulative ADB lending. As of 30 June 2006, outstanding loans from ADF amounted to \$21.1 billion.

2. Resources of ADF

ADF resources mainly consists of the following:



2. Resources of ADF

- ADF is replenished by periodic, voluntary contributions from donors. It has been replenished eight rounds.
- The current ADF period, ADF IX, covers the period 2005-2008. It became effective in April 2005 with the following highlights:
 - ✓ 28 donor countries, 2 potential new donors
 - ✓ \$7 billion ADF operation level during 2005-2008
 - ✓ Maximum 18% (or approximately \$1.26 billion) can be used for grants; with focus on post conflict/debt stressed poor countries and combating HIV/AIDS and other infectious diseases
 - ✓ 7% of basic contribution, or approx. \$220 million will go to the Technical Assistance Special Fund (TASF)
 - ✓ Performance-Based Allocation (PBA) was the primary driver to determine the level of assistance to ADF countries.

2. Resources of ADF IX Donors

Top Ten ADF IX Donors	Contributions (%)
Japan	35.00
United States	13.70
Australia	6.49
United Kingdom	6.00
Germany	5.78
Canada	4.66
France	4.41
Italy	3.90
Korea, Republic of	3.35
Netherlands	2.90
<i>Other DMC Donors</i>	
China, People's Republic of	0.89
Indonesia (contributed in ADF V)	
Malaysia	0.15
Thailand	0.09

3. ADF Lending and Its Borrowers

Eligibility for ADF

- DMCs are classified by ADB into three groups (A, B and C) primarily on considerations of gross national product (GNP) and debt repayment capacity.
- In principle:
 - Group A : ADF only
 - Group B1 : ADF with limited amounts of OCR
 - Group B2 : OCR with limited amounts of ADF
 - Group C : OCR only
- ADF resources are allocated in a manner consistent with ADB's strategic framework, taking absorptive capacity and country performance into account.

3. ADF Lending and Its Borrowers

Current Loan Terms

	Maturity	Grace Period	Interest Charge
Project Loans	32 years	8 years	1% during grace period and 1.5% during amortization period, and equal amortization
Program Loans	24 years		
(Applicable to loans of which negotiations are completed on or after 1 January 1999)			
Emergency Assistance Loans	40 years	10 years	1% per annum
(These loan terms were approved by the Board of Directors in June 2004)			

3. ADF Lending and Its Borrowers

Lending Operations Overview

	2001	2002	2003	2004	2005	2006 30 Jun
Number of Loans						
Approved	46	53	47	47	40	7
Effective	44	47	49	46	49	22
Outstanding loans ¹	802	848	892	934	982	1,003
Amount (\$M)						
Approval	1,361	1,650	1,379	1,242	1,403	98
Effective	1,422	1,589	1,650	1,278	1,478	829
Disbursement	1,024	1,136	1,128	1,055	1,247	515
Cancellation	(54)	(125)	(152)	(229)	(93)	(69)
Repayment	219	262	312	390	434	223
Loans Outstanding	14,832	17,233	20,047	21,627	20,238	21,139
Net Resource Transfers	658	718	641	469	612	191

¹ Total effective loans with undisbursed and/or outstanding balance.

3. ADF Lending and Its Borrowers

Outstanding Loans as of 30 June 2006

Loans Outstanding - ADF As of 30 June 2006 (\$ '000)		
Borrower	Loans Outstanding	Percent of Total Loans
Afghanistan	268,799	1.27
Azerbaijan	975	0.00
Bangladesh	4,921,395	23.28
Bhutan	95,774	0.45
Cambodia	595,075	2.82
Cook Islands	24,993	0.12
Indonesia	852,748	4.03
Kazakhstan	56,479	0.27
Kiribati	13,085	0.06
Kyrgyz Republic	477,864	2.26
Lao PDR	890,855	4.21
Maldives	55,409	0.26
Marshall Islands	61,366	0.29
Micronesia, Fed. States of	39,265	0.19
Mongolia	497,648	2.35
Myanmar	471,683	2.23
Nepal	1,282,272	6.07
Pakistan	4,817,343	22.79
Papua New Guinea	281,196	1.33
Philippines	856,449	4.05
Samoa	82,166	0.39
Solomon Islands	50,532	0.24
Sri Lanka	2,255,031	10.67
Tajikistan	113,334	0.54
Thailand	48,252	0.23
Tonga	46,115	0.22
Tuvalu	4,329	0.02
Uzbekistan	19,717	0.09
Vanuatu	49,796	0.24
Viet Nam	1,908,911	9.03
TOTAL	21,138,856	100.00

4. Priority Areas for ADF Loans and Grants

	2005			2001 - 2005		
	No. of Loans	\$ Million	%	No. of Loans	\$ Million	%
Agriculture and Natural Resources	5	228.30	16.60	45	1,451.78	20.77
Education	3	58.06	4.22	12	310.94	4.45
Energy	2	31.50	2.29	11	321.80	4.60
Finance	3	35.50	2.58	20	262.52	3.75
Health, Nutrition, & Social Protection	2	57.90	4.21	3	77.90	1.11
Industry and Trade		0.00	0.00	7	148.20	2.12
Law, Economic Management & Public Policy	2	78.00	5.67	7	142.40	2.04
Transport and Communications	7	164.80	11.98	30	1,022.44	14.62
Water Supply, Sanitation, & Waste Management	4	121.00	8.80	5	141.00	2.02
Multisector	12	600.52	43.66	30	1,379.54	19.73
Industry and Nonfuel Minerals		0.00	0.00	2	26.00	0.37
Social Infrastructure		0.00	0.00	41	1,248.30	17.85
Others		0.00	0.00	20	458.52	6.56
Total	40	1,375.58	100.00	233	6,991.34	100.00

5. New ADF Currency Management Framework

In response to President Kuroda's call for ADB to be more relevant, responsive and client focused, Management re-engaged ADF donors in 2005 with a proposal to improve ADF currency management practice:

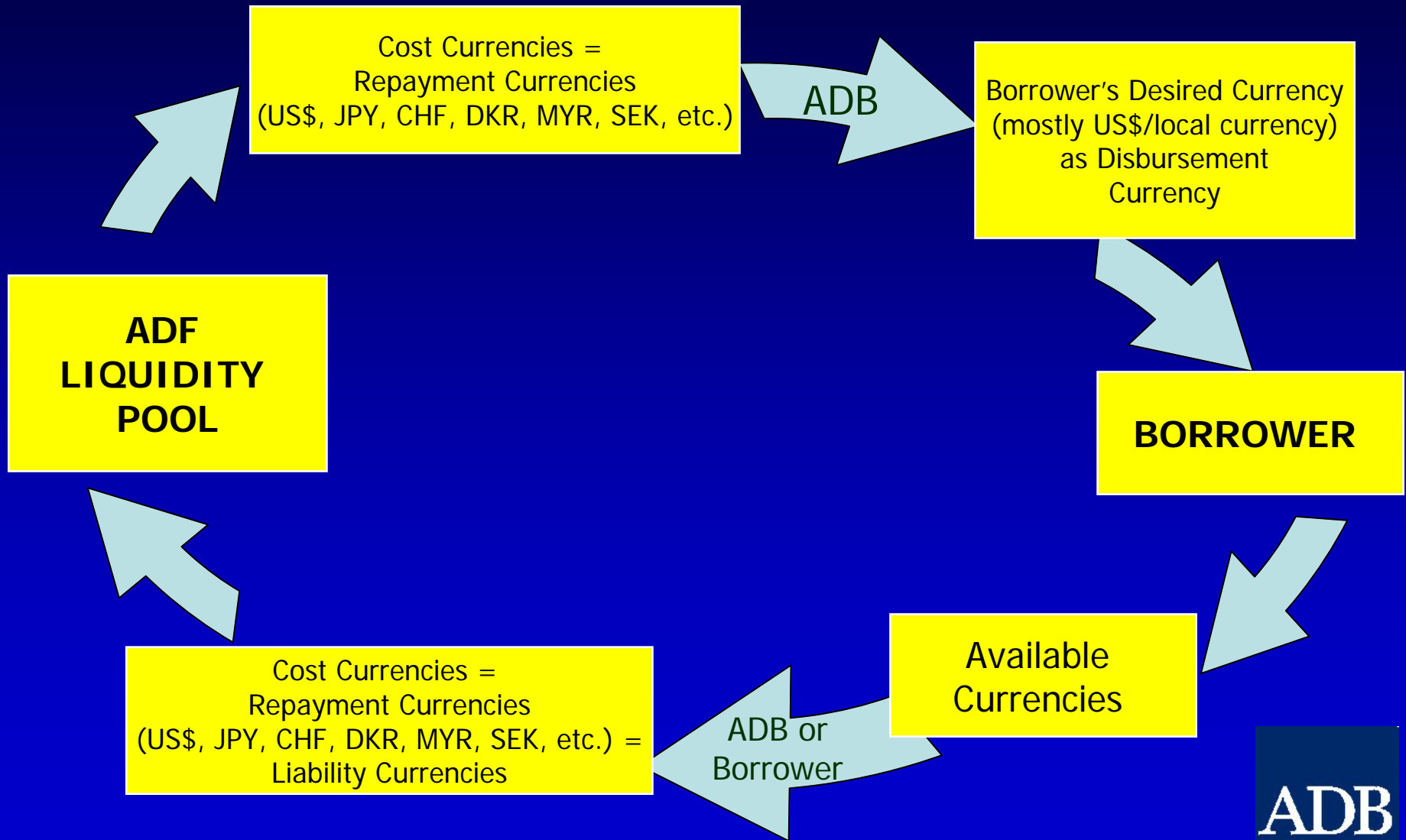
- To benefit borrowers with simplified currency options;
- To harmonize with IDA for best industry practice;
- To manage and mitigate currency exposures, both for borrowers and for ADB; and
- To enhance ADF resource management and financial planning capabilities.

5. New ADF Currency Management Framework – an Overview

- The new framework was approved by the Board of Directors in October 2005 and the subsequent Resolution was adopted by the Board of Governors.
- Donors also gave their consent to the new framework.
- Essentially, the practice of managing ADF resources in as many as 15 currencies was discontinued.
- The new framework does not change the modalities of ADF loans. Loan terms and the way that the loans are processed remain the same.

5. ADF Currency Framework

Previous Currency Practice



Previous ADF Currency Practice

- **Governed by the currency preservation principle**

The principle of currency preservation of ADF contributions was part of the “agreement” relating to the ADF between contributors and ADB (Article 19.3 of the Agreement Establishing the Asian Development Bank [the Charter]). Therefore, no systematic currency conversion was allowed and ADF was required to retain the donor contributed currencies primarily composed of national currencies, US dollars and SDR.

- **This resulted in a convoluted currency system with planning in USD, replenishment in SDR, contribution in national currencies/SDR/USD, loan denomination in SDR, while disbursement and repayment in a variety of currencies.**

Previous ADF Currency Practice

- Each loan had multiple disbursements and each disbursement was usually made in different currencies, based on ADB's currency priority.
- Similarly, currencies to be billed for each installment was determined by ADB's currency priority.
- The borrower's liability was locked in cost currency instead of SDR, creating a mismatch between the SDR amount in the loan commitment and the SDR equivalent of the borrower's actual repayment obligation.

Impact of Previous Practice on Borrowers

Under ADB's working principle of currency prioritization:

- The borrowers (DMCs) did not know the liability currencies until loans were disbursed. Any of the 15 currencies was used as cost or liability currency at ADB's discretion.
- It was difficult for DMCs to anticipate the sequence of currencies to be called by ADB over the repayment period.
- As a result, borrowers' debt management and planning has become a challenge.
- Finally, significant differences between ADF's currency practice and IDA's further complicate the borrowers' debt management.

Impact of Previous Practice on Borrowers

Inconsistency across the Borrowers

- In effect, an inconsistent product was delivered to the borrowers due to uneven distribution of currencies.
- The following simple illustration shows that given the same loan terms, due to different disbursement liability currencies, DMC 1 suffered a significant foreign exchange loss to ADF while DMCs 2 and 3 enjoyed gains.

Impact of Previous Practice on Borrowers

A S S U M P T I O N S

Loan Amount in SDR 100 million

Year Start Disbursement: 1981

Terms: 24 years with 8 years grace

Repayment terms: equal repayment

Disbursements Pattern

Year		Year	
1	6.80%	6	12.80%
2	7.90%	7	11.30%
3	14.30%	8	9.70%
4	15.10%	9	4.80%
5	14.70%	10	2.60%

Notes:

1. Exchange rates used per year end rates from 1981 to 2004.
2. Liability Currency refers to the cost currency ADB uses to convert to disbursement currency per request of borrowers.

Impact of Previous Practice on Borrowers

(amount in million)	Original Loan in SDR	DMC1 Liability Currency in Yen	DMC2 Liability Currency in USD	DMC3 Liability Currency in AUD
Total Disbursements in Liability Currency	100	21,741	110	148
Total Repayments in Liability Currency	100	21,741	110	148
in SDR Equivalent		134	79	73
Effect of Exchange Rate due to Current Practice in SDR	-	(34)	21	27
%Gain/ (Loss)	-	-33.8%	21.0%	26.9%

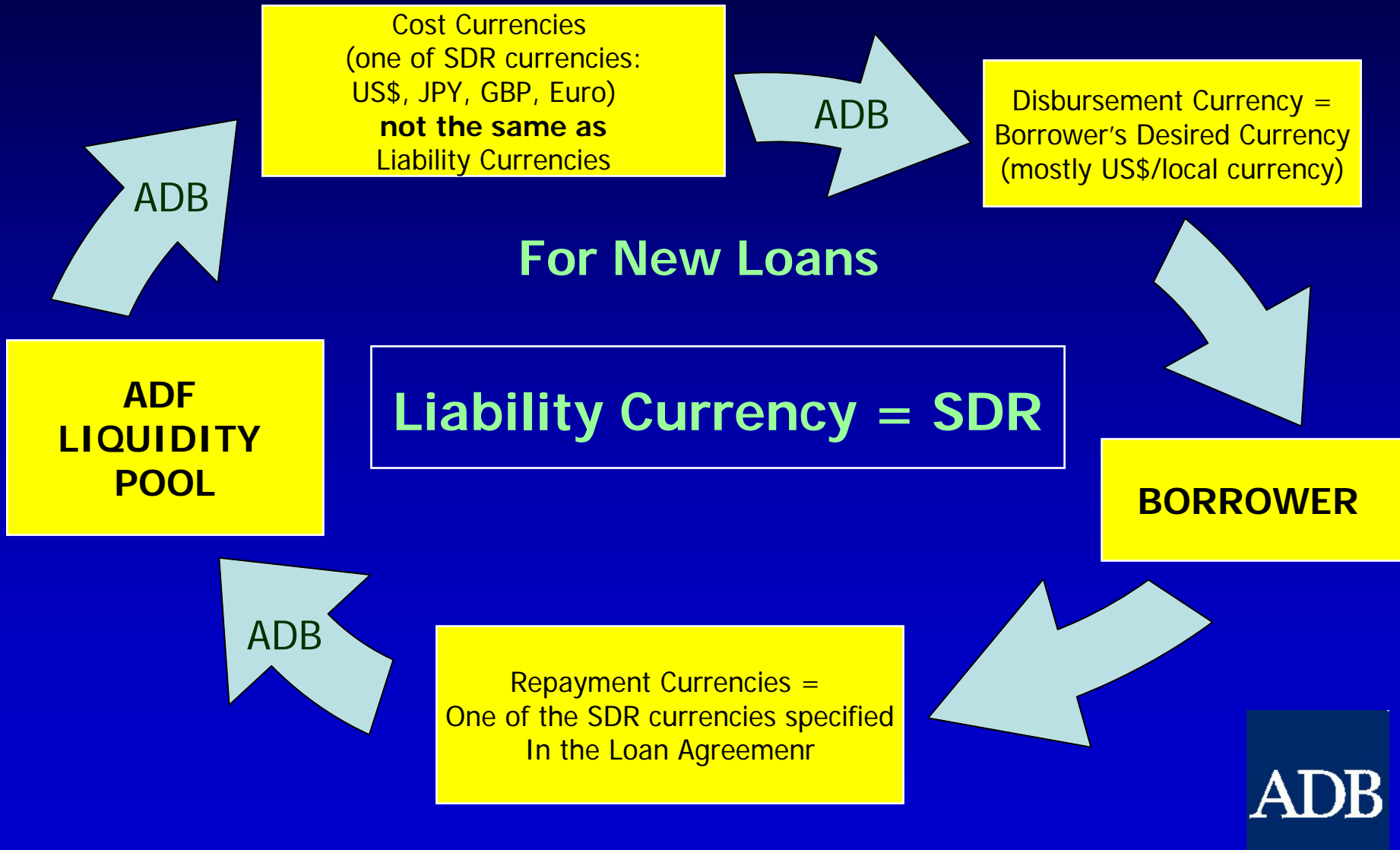
5. New ADF Currency Framework Streamline and Harmonize

Streamline SDR approach in key aspects of ADF financial management, operations and planning; harmonize the impact on the borrowing DMCs by setting the SDR as the liability currency.

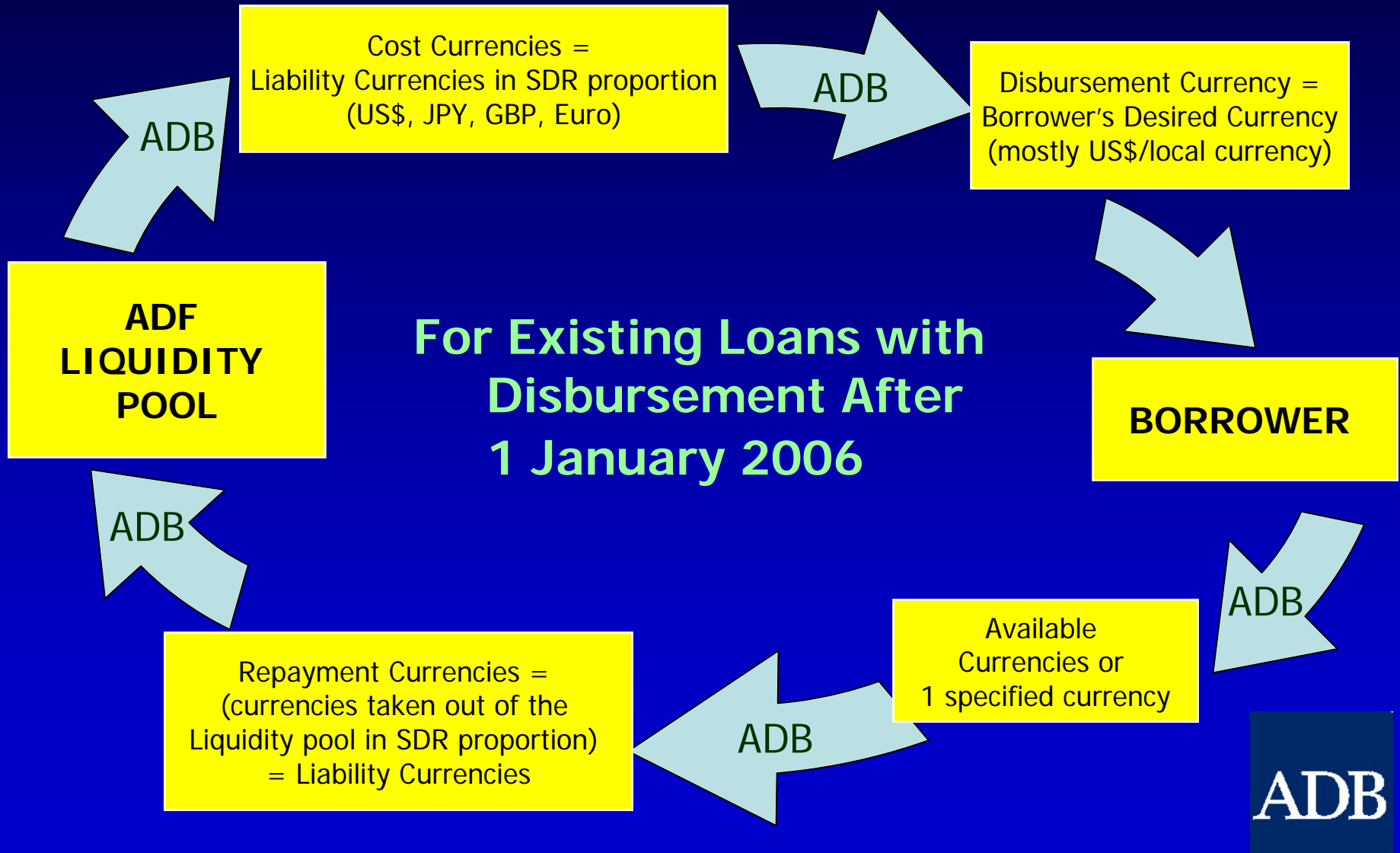
I. ADF LOANS			
For New Loans		For Existing Loans	
		Partially-disbursed	Fully-disbursed
Loan Denomination	SDR	SDR	SDR
Cost Currency	SDR Currencies	SDR Currencies	National Currencies
Liability Currency	SDR	Same as Cost Currency	Same as Cost Currency
Repayment Currency	SDR Currencies; predetermined at negotiations; changeable upon advance notice	(i) same as cost currency (ii) proportional recalling of multi-currency disbursement (iii) option to pay in SDR currencies	

Loans invited to negotiations on or after 1 January 2006 can apply the fully fledged SDR disbursement and collection practice.

5. ADF Currency Framework New Currency Practice



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New ADF Currency Framework - Existing Loans

Disbursement of undisbursed balance of the existing loans:

- starting date: 1 January 2006

Program Loan Disbursement: Proportionally disburse 4 SDR currencies as per SDR composition.

Other disbursements: SDR currencies is used as cost currencies. Disbursement mimics the currency composition of SDR basket, i.e., ADB disburses the SDR currencies in turn to approximate SDR disbursement.

Collection of existing loans:

- starting date: 1 July 2006 (for billings to be generated on/after this date)

Disbursed cost currencies can be proportionally recalled.

Option to repay in a single SDR currency (converted by ADB) is given.

Benefits To Borrowers

- More consistent ADF product fair for all borrowers;
- More predictable currency planning and debt portfolio management;
- Increased flexibility in repayment currencies;
- Streamlined concessional financing management with other MDBs; and
- More stable liability currency, as SDR is less volatile.

Also to recognize that:

- Long maturity structure of ADF loans entails extended transition period before fully recognizing the benefit.

5. New ADF Currency Framework Streamline and Harmonize

II. ADF MANAGEMENT

Principles	<ul style="list-style-type: none">(i) Currency preservation principle to be modified to allow currency conversion.(ii) Currency prioritization strategy to be changed to a rebalancing scheme, aimed at SDR realignment and immunized ALM.
Currency Rebalancing	<ul style="list-style-type: none">(i) Liquidity management through tranching approach(ii) Currency rebalancing by FX transactions.
Accounting	<ul style="list-style-type: none">(i) Reporting currency is still USD. Functional currencies will be based on the economic environment of ADF operations which may change over time as it becomes evident.(ii) Maintain two different ADF loan products (“new” and “existing”) for loan accounting and billing purpose until the old ADF loans are fully repaid.
Operation Planning	In SDR
Commitment Authority	In SDR
Contribution Currency	Will be mapped and converted to SDR currencies upon receipt.

6. ADF Financial Management

- ADF accounting books are kept separately from OCR, following special purpose financial statements.
- Treasury Department provides financial management of ADF:
 - ✓ Ensure the healthy financial position of the fund resources;
 - ✓ Formulate financial management policies and assist with implementations;
 - ✓ Perform risk management;
 - ✓ Support ADF replenishment negotiations and subsequent execution and midterm review;
 - ✓ Responsible for cash management (disbursement, encashment, investment, currency transactions, etc);
 - ✓ Monitor commitment authority.

Questions & Answers

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Special Operations Loan Regulations

OLD

Section 4.02. **Currency of Withdrawal.** Except as ADB and the Borrower shall otherwise agree, withdrawals from the Loan Account shall be made either in the currencies in which the cost of goods and services to be financed out of the proceeds of the Loan has been paid or is payable, or in such currency or currencies as ADB may from time to time select.

Section 4.03. **Currency of Payment Principal.** (a) The principal of the Loan shall be repayable in the currency withdrawn from the Loan Account. The amount repayable in each currency shall be the amount of that currency withdrawn from the Loan Account shall have been purchased by ADB with another currency for the purpose of such withdrawal, the portion of the Loan so withdrawn shall be deemed to have been withdrawn from the Loan Account in such other currency. Notwithstanding the foregoing provisions of this Section, the Borrower and ADB may agree to substitute gold or any convertible currency as the currency of repayment.

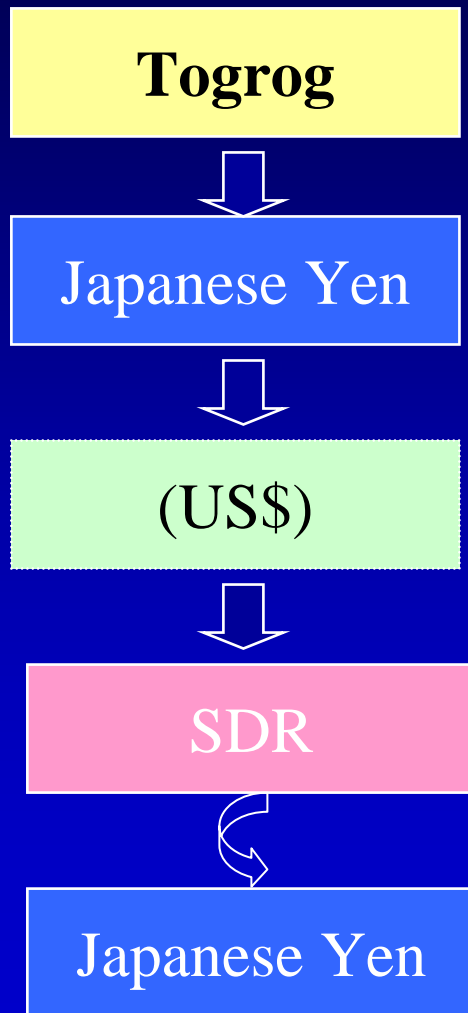
NEW

Section 4.02. **Currency of Withdrawal.** Withdrawals from the Loan Account shall be made in one or more of the currencies which constitute the SDR, as ADB may from time to time select. The amount of each withdrawal from the Loan Account shall be calculated as the SDR equivalent (determined as of the date of withdrawal) of the currency or currencies withdrawn from the Loan Account.

Section 4.03. **Currency of Payment Principal.** (a) The principal of the Loan shall be expressed in SDR and shall be repayable in one of the currencies which constitute the SDR as shall be specified in the Loan Agreement. The Borrower may at any time request that the principal of the Loan shall be repayable in any other of the currencies which constitute the SDR. Each such request shall be made in writing in such form and by giving such notice as ADB shall from time to time determine. Upon acceptance by ADB of such request, ADB shall notify the Borrower and the Guarantor of the modified provision providing for the currency of repayment.

2. Previous ADF Currency Practice

Simple Illustration of Loan Disbursement/Repayment - Single Disbursement



- The borrower requests Togrog payment to its contractors.
- ADB chooses to sell Yen at spot rate to buy and disburse Togrog amount.
- Yen amount is the repayment obligation to the borrower (liability currency to borrower) for this disbursement.
- *For reporting purposes, ADB records USD equivalent of the Yen sold. Yen is called the cost currency to the Bank.*
- SDR equivalent of the disbursement (of Yen) is recorded and debited to the loan account (to reduce the undisbursed loan balance).¹
- **Borrower will repay the principal and service charge based on the Yen amount.**

¹ Maximum availability of aggregate disbursement of a loan is controlled in SDR denomination.

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ASSUMPTIONS

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