
ADB's Financial Structure and Resource Mobilization: An Introduction

October 2008

Treasury Department

ADB is a unique institution

UNDP

Development name says it all:

Asian

Development Bank

Bank

HSBC

Objectives and disclaimers

- Gain basic understanding of how ADB functions as a bank
- Focus on ADB's Ordinary Capital Resources (OCR)
- Focus on concepts, not numbers
- Numbers are for illustrative purposes only
- Official figures are contained in ADB's annual financial statement
- Projections are highly sensitive to assumptions. Financial projections should always be read with its set of assumptions

ADB's business model



- ADB borrows from international capital market as well as receiving paid-in capital from shareholders
- ADB then:
 - lends to public sector borrowers with sovereign guarantee at a uniform price, with ADB passing through the cost of funds to borrowers, together with a 20bp lending charge
 - lends to public and private sector borrowers without sovereign guarantee at market price
 - participates in equity investment
 - Provides political risk and credit risk guarantees
- Cash-flow & income from lending & investment used to repay borrowings from capital market and to increase equity
- ADB's business model rests on its AAA credit ratings

Three pillars to support ADB's AAA ratings

- Shareholder support
- Preferred creditor status and sovereign guarantee
- Prudential financial policy framework and practices

Three pillars to support ADB's AAA ratings

1: Shareholder support

- shareholder's callable capital provides the ultimate safeguard to bond investors
- Potential call on callable capital indicates grave financial situation and sends very serious negative message to the capital market
- Therefore the use of callable capital is not envisaged
- ADB's prudential financial management framework and practices serve to prevent such a call on callable capital

2: Preferred creditor status and sovereign guarantee

- member governments grant ADB loans preferential consideration including the access to foreign exchange reserves
- Preferred creditor status is not a legal status, but embodied in practice and consistent universal recognition
- Sovereign guarantee on public sector projects provide assurance of timely repayment of loans by project entities
- Preferred creditor status also covers private sector projects

Three pillars to support ADB's AAA ratings

3: Prudential financial policy framework and practices

- “The Bank shall be guided by sound banking principles in its operations.”
[ADB Charter Article 14 (xiv)]
- Financial policy framework defines the financial boundaries and benchmarks (capital adequacy, ALM etc)
- Best practices in daily financial management, supported by analytical tools
- Forward looking and long term perspective in ensuring sustainability of future financial strength
- Independent Risk Management Unit to ensure credit quality at entry, portfolio credit quality, treasury risk compliance etc
- ALCO committee to discuss financial management and compliance issues
- Quarterly report from TD and RMU to the Board

ADB's Simplified Balance Sheet Structure

as of 30 June 2008 (\$ billion)			
Assets		Liabilities and Equity	
Loans with S. Guarantee	32	Outstanding Borrowings	38
Loans without guarantee	2	Equity (Paid-in Capital,	15
Equity Investment	1	Reserves & surplus, etc.)	
Liquidity Investments	18		
Total Assets	53	Total Liabilities & Equity	53

Notes: Numbers are simplified and rounded for illustration purpose only.

- Two major income assets:
Loans & Liquidity investments
- Two funding sources for assets:
Borrowings and equity

ALM Attribution and Income Sources

Income
(\$million)

Asset

Liability &
Equity

56 + 0	Sovereign Guaranteed Loans \$32b 4%	Borrowing \$28b 3.8%
8 + 152		Equity \$4b 0%
40 + 0	N.S.G Loans \$2b 6%	Borrowing \$2b 4%
30 + 50	Equity Inv \$1b 8%	Equity \$1b 0%
Commitment Fee 40 + 0		
0 + 400	Liquidity Inv. \$10b 4.0%	Equity \$10b 0%
8 + 0	Liquidity Inv. \$8b 4.1%	Borrowing \$8b 4%

- Equity carries no direct financial cost to ADB, earns full interest rate; thus, it is the primary source of net income, whether funding loans or investments
- Loan charge (lending spread and commitment charge) provides secondary but important source of income, enough to cover expenses
- Borrowings are neutral to net income due to "cost-pass-through" mechanism
- AAA ratings ensure a small but positive earnings on liquidity funded by borrowings
- Interest rate has the most significant impact on ADB's income. 1% change in interest rate translates into approx. \$130 million difference in income

Notes: Tables and charts for illustration purpose only.
Rates are not actual.

$$182 + 602 = 784 - \text{admin exp } 200 = 584 + \text{divestment profit } 50 = \text{net income } 634$$

Capital adequacy, liquidity, net income and constraints

- Equity capital and liquidity provide safeguards in normal operations and in financial crisis
- ADB needs to management two objectives during a potential financial crisis
 - Still financially sound if substantive portions of ADB loans fall into arrears
 - Have sufficient liquidity for normal operation and increased lending when needed, even when access to capital market becomes difficult
- ADB's capital adequacy is defined by its Equity to Loan ratio (ELR), with current actual ELR ratio of 42.24% on June 30, 2008. ADB uses 26% ELR as a key metric for assessing its long term capital adequacy and also analyze short term capital adequacy through stress testing.
- Liquidity level should sustain lending for 18 months without access to capital market, subject to statutory constraints
- Net income critical to grow ADB's financial capacity and to be deployed for other developmental purposes
- ADB's financial constraints include Lending Authority, Borrowing Authority and ELR

Lending and borrowing authorities

Lending Authority

Subscribed capital	58
Reserves	11
Outstanding loan commitment	(51)
Guarantees	(1)
Equity Investment	(1)

Lending Headroom 16

Borrowing Authority

Callable capital from non-borrowing members	33
Paid-in capital and reserve	15
Borrowings	(38)
Guarantees	(1)

Borrowing Headroom 9

Note: as of June 2008. Numbers are in US\$ billions and may not add up due to rounding. Source: Monthly Financial Report (CTL)

- ADB's capacity is limited to its lending authority and borrowing authority
- Lending headroom is a function of project approval
- Borrowing headroom is a function of disbursement and other cash-flow needs
- Lending headroom projected for depletion in 2010
- Management has submitted a study on ADB's resource situation and options including the Fifth General Capital Increase (GCI V)

ADB's Financial Position, 1994–2008

(\$ million)

Account		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 H1	2008
Assets	Loan Outstanding	16,465	17,492	16,070	18,788	24,698	28,271	28,155	28,659	29,145	25,398	24,197	23,479	26,177	30,298	33,184
	Liquidity Investment	5,645	6,069	6,332	7,042	8,076	8,199	7,533	8,265	9,029	11,441	12,021	12,232	13,136	13,406	17,913
Liability & Equity	Borrowing Outstanding	13,684	14,599	13,663	17,494	23,744	26,285	25,367	24,881	25,905	26,264	23,921	24,398	27,608	31,570	37,487
	Equity	8,477	9,272	9,666	9,302	10,063	10,563	10,834	10,874	12,352	12,852	13,267	12,275	13,142	14,255	14,711
Net Income		513	660	572	467	464	450	626	714	753	614	386	391	652	673	

Notes: Numbers do not add up as certain classes of asset/liability were omitted. Income after expenses includes appropriations. 1994–2004 numbers are based on statutory reporting figures from ADB's Annual Reports. 2005 - 2008 figures are from Monthly Financial Report (CTL). Numbers are for Source: ADB annual Financial Statements, Monthly Financial Report, Quarterly Treasury Reports

- Loan portfolio grew through the Asian financial crisis
- Sharp decline in US dollar interest rate caused large prepayment in legacy loans (2002-2005)
- Allocable income stayed positive through ADB's history. 2004-2005 income lowest during the period
- Equity steadily accumulated to strengthen ADB's financial capacity

Allocation of 2007 Income

Allocable Net Income for 2007:	\$672.6 million
Allocation to loan loss reserve:	\$ 13 million
Allocation to Ordinary Reserve:	\$278.3 million
Transfer to Surplus:	\$278.3 million
Transfer to ADF:	\$ 40 million
Transfer to TASF:	\$ 23 million
Transfer to Climate Change Fund:	\$ 40 million

- For loans negotiated before 1 Oct 2007, proposed to maintain the waivers of
 - 20 bps lending spread
 - 100 bps front-end fee
 - 50bp/10bp commitment charge for program and project loans
- Subject to projected levels of net income, plans to propose continued waivers in 2009/2010 and 2010/2011

Income Outlook and Capital Adequacy, 2007–2011

(\$ million)

Financial Indicator		Actual		Projection			
		2006	2007	2008	2009	2010	2011
WPBF Case	Allocable Net Income	652.4	659.6	557.5	493.5	479.6	546.7
	ELR (%)	47.7	44.7	39.9	37.0	34.1	31.5
Sensitivity Case	Allocable Net Income	652.4	659.6	533.2	428.3	404.4	446.0
	ELR (%)	47.7	44.7	41.7	39.0	36.6	34.7

Source: Treasury Report: Second Quarter 2008

- Income outlook adjusted downward due to lower interest rate environment.
- Under both scenarios, projected income level sufficient to sustain ADB's efficient operations and provide for financial management needs in the medium term
- ELR outlook remains adequate.

Comparative Sovereign MDB Loan Charges

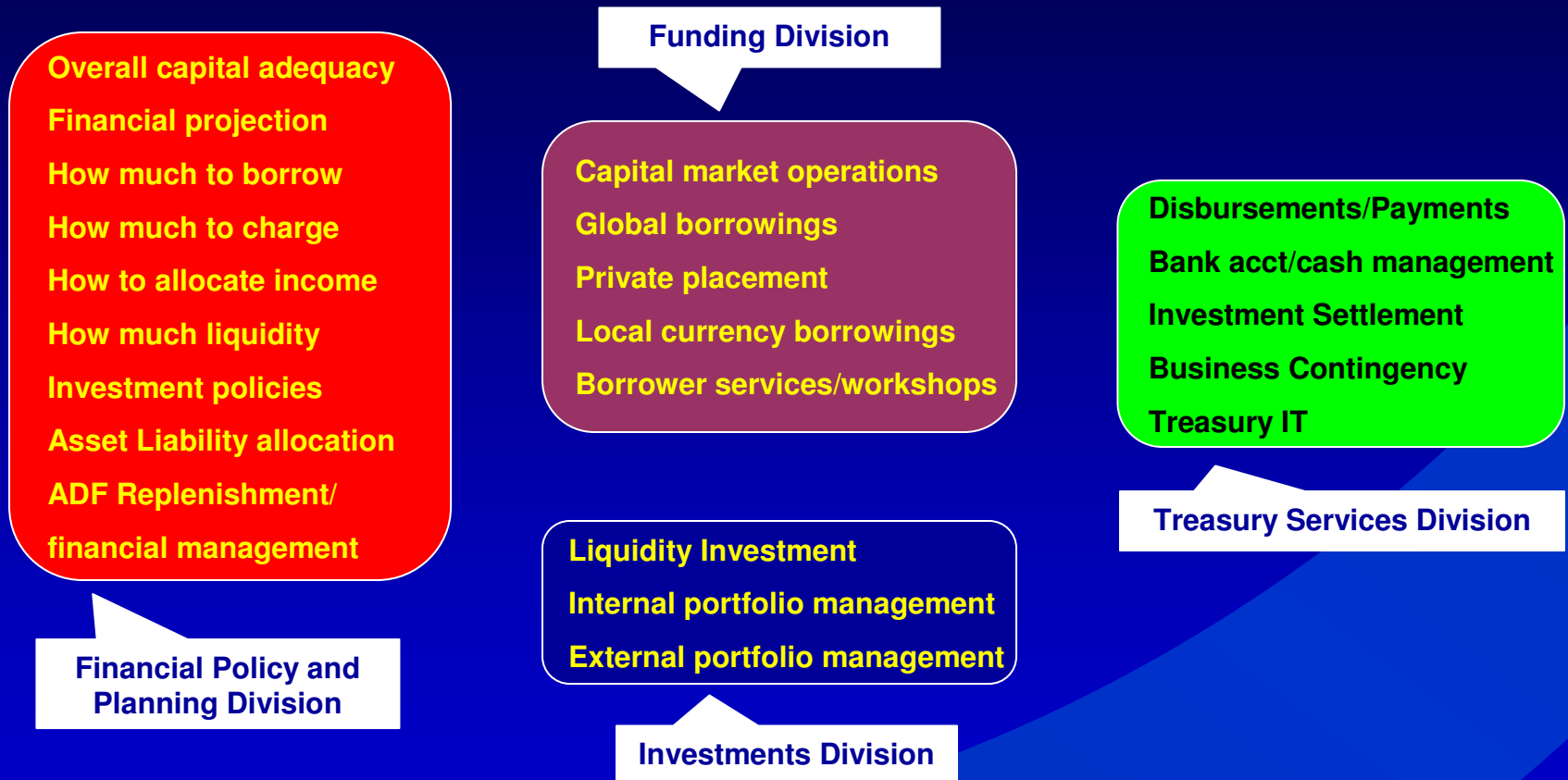
	LIBOR-Based USD Loans					
	(basis points) ³					
	IBRD		IADB	AfDB	EBRD	ADB
	VSLs*	FSLs**				
Interest Spread:						
Contractual spread	30	30	30	40	100	20
Risk Premium	-	5		-	-	-
Benefit of Sub LIBOR Funding ⁴ Cost	-32	-30	-24	-	-	-34
Waivers	--	--	-15	-	-	-
Net Spread over LIBOR (I)	-2	5	-9	40	100	-13
Charges:						
Commitment Charge	--	--	25	-	50	15
Waivers	--	--	-15	-	-	-
Net Commitment Fee	--	--	10	-	50	15
Spread Eqv. of Commitment Fee ⁵ (II)	--	--	4	0	23	6
Front-end Fee:						
Contractual Front-end Fee	25	25	0	0	100	
Waiver			-	-		
Net Front-end Fee	25	25	0	0	100	0
Spread Eqv. of Front-end Fee ⁵ (III)	3	3	0	0	14	0
Total Spread-Equivalent over LIBOR (I+II+III)	1	8	-5	40	137	-7

<http://treasury.worldbank.org/Services/Financial+Products/Lending+Rates+and+Loan+Charges/index.html>

Please consult the World Bank website for explanations

Four Functions of Treasury Department

ALCO Supervision/Quarterly Treasury Report to Board of Directors



Compliance monitoring by the independent
Risk Management Unit (RMU)

Conclusions & observations

- AAA ratings critical for ADB's business model
- ADB is financially very sound, with dedicated team ensuring its continuity
- ALCO committee provides oversight on financial management
- Quarterly Treasury Report keeps the Board informed regarding latest projections and analysis
- All financial policy changes and updates are subject to Board approval
- Level of loan charge reviewed annually and subject to Board approval
- Allocation of net income proposed by management, endorsed by Board of Directors and approved by Board of Governors annually
- TD submits annual borrowing program paper for Board approval
- Lending headroom projected for depletion in 2010. ADB to study implications and possible solutions through general capital increase and / or other avenues

Thank You
Q & A