ADB

Financial Profile 2004

Asian Development Bank

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Every effort has been made to ensure the accuracy of the data used in this publication. Variations in data in the Asian Development Bank (ADB) publications often result from different publication dates, although differences may also come from source and interpretation of data. ADB accepts no responsibility from any consequence of their use.

The term "country," as used in the context of ADB, refers to a member of ADB and does not imply any view on the part of ADB as to the member's sovereignty or independent status.

In this publication, $ refers to US dollars.

May 2004

Contents

Abbreviations and Acronyms

ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
ADBISF	ADB Institute Special Fund
ADF	Asian Development Fund
CFA	Channel financing arrangement
DMC	Developing member country
ECP	Euro-commercial paper
FAS	Financial Accounting Standards
GMTN	Global Medium-Term Note Program
GNP	Gross national product
ISDA	International Swaps and Derivatives Association, Inc.
JFICT	Japan Fund for Information and Communication Technology
JFPR	Japan Fund for Poverty Reduction
JSF	Japan Special Fund
JSP	Japan Scholarship Program
LBL	LIBOR-based loan
LIBOR	London Interbank Offered Rate
MBL	Market-based loan
OCR	Ordinary capital resources
OECD	Organisation for Economic Co-operation and Development
PCG	Partial credit guarantee
PMCL	Pool-based multicurrency loan
PRG	Political risk guarantee
PSCL	Pool-based single-currency loan
SPL	Special program loan
TASF	Technical Assistance Special Fund

Box 1: Selected Financial Data

31 December
(amounts in $ million)

	Statutory Reported Basis[a]				
	2003	2002	2001	2000	1999
Income and Expenses					
From Loans	1,383.0	1,710.0	1,813.7	1,861.3	1,674.6
From Investments	308.7	330.4	403.4	399.9	344.0
From Other Sources	48.5	19.7	21.6	39.7	9.2
Total Income	**1,740.2**	**2,060.1**	**2,238.7**	**2,300.9**	**2,027.8**
Interest and Other Financial Expenses	987.5	1,155.1	1,434.1	1,576.7	1,447.2
Administrative Expenses[b]	118.5	90.6	59.0	92.6	105.9
Technical Assistance to Members	(0.4)	56.0	20.0	-	-
Provision for Losses	18.0	4.5	9.8	5.9	24.8
Total Expenses	**1,123.6**	**1,306.2**	**1,522.9**	**1,675.2**	**1,577.9**
Operating Income before FAS 133	616.6	753.9	715.8	625.7	449.9
FAS 133 Adjustments	(178.4)	224.8	147.5	-	-
Net Income	**438.2**	**978.7**	**863.3**	**625.7**	**449.9**
Average Earning Assets	37,540	38,244	36,272	36,693	34,788
Annual Return on Average Earning Assets	1.17%	2.56%	2.28%	1.71%	1.29%
Return on Loans	4.56%	5.93%	6.42%	6.59%	6.41%
Return on Investments	3.74%	4.26%	5.91%	5.09%	3.96%
Cost of Borrowings	4.65%	4.10%	5.54%	5.90%	5.66%
Reserve-to-Loan Ratio	37.59%	32.04%	28.47%	27.26%	25.97%
Interest Coverage Ratio	1.44	1.85	1.58[c]	1.40	1.31

	Pre-FAS 133 Basis	
	2003	2002
	(Unaudited)	
Net Income	617	754
Average Earning Assets	37,524	38,244
Annual Return on Average Earning Assets	1.64%	1.97%
Return on Loans	4.56%	5.93%
Return on Investments	3.13%	4.26%
Cost of Borrowings	3.70%	4.32%
Reserve-to-Loan Ratio	36.72%	30.83%
Interest Coverage Ratio	1.62	1.65

- Nil.
a FAS133 was implemented in 2001. Accordingly, statutory reported basis is the same as pre-FAS 133 basis prior to 2001.
b Net of administration charge allocated to the Asian Development Fund and 2003 loan origination costs that are deferred.
c Excludes the one-time cumulative effect of recording the adoption of FAS 133 on 1 January 2001.

INTRODUCTION

The Asian Development Bank (ADB), a multilateral development bank, was established in 1966 and operates under the Agreement Establishing the Asian Development Bank (Charter) which is binding upon the member countries which are its shareholders. The purpose of ADB is to foster economic growth and cooperation in Asia and the Pacific (region) and to contribute to the economic development of the developing member countries (DMCs) in the region individually and collectively. ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its DMCs reduce poverty and improve their living conditions and quality of life. ADB's strategy for reducing poverty rests on three pillars: pro-poor sustainable economic growth, inclusive social development, and good governance. ADB's main instruments in providing assistance to its DMCs are policy dialogues, loans, technical assistance, grants, guarantees, and equity investments.

ADB was founded primarily to act as a financial intermediary to transfer resources from global capital markets to DMCs for socioeconomic development. Its ability to intermediate funds from global capital markets for lending to its DMCs is an important element in achieving its developing missions.

ADB's financial strength is largely based on the support of its shareholders and its financial policies and practices. Shareholder support is reflected in the form of capital backing from members and in the record of borrowing members in meeting their debt-service obligations. ADB adheres to prudent financial policies and practices that have allowed it to build reserves, diversify its funding resources, manage a portfolio of liquid investments and control a variety of financial risks.

Ownership

As of 31 December 2003, ADB was owned by 63 members. Luxembourg and the Republic of Palau joined ADB in 2003. Twenty-two of ADB shareholders were members of the Organisation for Economic Co-operation and Development (OECD) and 41 were developing members in the Asia and Pacific region.

The two largest shareholders, as of 31 December 2003, were Japan and the United States, each with 15.8% of total subscribed capital and 12.9% of voting

Table 1. Shareholdings
as of 31 December 2003

OECD Members	%	Developing Members	%
Japan	15.8	China, People's Rep. of	6.5
United States	15.8	India	6.4
Australia	5.9	Indonesia	5.5
Canada	5.3	Malaysia	2.8
Korea, Rep. Of	5.1	Philippines	2.4
Germany	4.4	Pakistan	2.2
France	2.4	Thailand	1.4
United Kingdom	2.1	Other regional	7.8
Italy	1.8		
New Zealand	1.6		
Other non regional	4.8		
Total	**65.0**	**Total**	**35.0**

power. The OECD members together owned 65.0% of the total shares and 59.0% of the total voting power, and provided 63.9% of professional staff. The total callable capital of these OECD members is equivalent to 123.0% of ADB's outstanding borrowings after swaps as of 31 December 2003. Members with investment-grade and higher debt ratings accounted for about 77.0% of ADB's callable capital.

Ordinary Capital Resources and Special Funds

In making loans, ADB provides funds from either its ordinary capital resources (OCR), which are the main subject of this brochure, or from its Special Funds.

ADB finances its OCR operations through borrowings, paid-in capital, retained earnings, and OCR loan repayments. Special Funds are primarily contributed by member countries and are provided in turn by ADB on concessional terms to ADB's less-developed member countries. Special Funds operations are completely segregated from ADB's ordinary operations. Unless otherwise stated, all information in this publication relates to ADB's OCR operations.

Financial Operations

ADB adheres to prudent borrowing and lending practices. It maintains adequate levels of net income, liquidity, and reserves; continuously monitors the creditworthiness of its borrowers; and requires thorough technical, financial, and economic justifications for all projects for which loans are provided. Under its current lending policy, ADB restricts its loans, equity investments, and guarantees to an amount not more than its paid-in and callable capital and reserves (including surplus but excluding special reserve). Under the current borrowing policy, ADB's gross outstanding debt cannot exceed the callable capital of its nonborrowing members, paid-in capital, and reserves (including surplus and special reserve), subject to the Charter limit of 100% of callable capital.

Triple-A Rating

ADB bonds are rated Triple-A by Moody's, Standard & Poor's, the Japan Credit Rating Agency, and Fitch. The Triple-A rating reflects solid shareholder support—much of the subscribed capital is held by non-borrowing members rated AAA/AA while borrowing members accord ADB "preferred creditor status", and additionally, ADB's high asset quality, strong financial fundamentals, and prudent risk management policies.

Location

ADB is headquartered in Manila and has 27 other offices, including 18 resident missions located in Afghanistan, Azerbaijan, Bangladesh, Cambodia, People's Republic of China, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao People's Democratic Republic, Mongolia, Nepal, Pakistan, Papua New Guinea, Sri Lanka, Tajikistan, Uzbekistan, and Viet Nam; a country office in the Philippines; a regional office in Vanuatu and a Pacific subregional office in Fiji Islands; a special office in Timor-Leste; 2 extended missions located in Gujarat, India and Bangkok, Thailand; and three representative offices, located in Tokyo for Japan, Frankfurt for Europe, and Washington D.C. for North America. Under the Charter, and in accordance with a Headquarters Agreement with the Republic of the Philippines, ADB's financial transactions are not subject to Philippine laws, taxes, foreign exchange regulations, or other controls.

Organization

All powers of ADB are vested in the Board of Governors, which consists of one Governor and one Alternate appointed by each member. Governors meet at least once a year.

ADB has a resident Board of Directors at its headquarters made up of 12 members elected by the Governors. The Board provides policy guidance for ADB's general operations. It also considers and approves all loans, guarantees, equity investments, and technical assistance grants exceeding $1 million as well as ADB's annual borrowing program. The day-to-day operations of ADB are conducted by the President, who is also Chairperson of the Board of Directors, and four Vice-Presidents. ADB's management is supported by staff drawn from 52 countries. As of 31 December 2003, there were 831 professional and 1,475 supporting staff.

Immunity from Judicial Proceedings

ADB is immune from every form of legal process, unless it chooses to waive such immunity, except in relation to borrowings; guarantees; and the purchase, sale, or underwriting of securities, in which cases action may be brought against ADB in a court of competent jurisdiction.

Tax Status of ADB

ADB's Charter states that ADB, its assets, property, income, and operations and transactions are exempt from all taxation and from all customs duties. ADB is also exempt from any obligation for the payment, withholding, or collection of any tax or duty.

Tax Status of Obligations and Securities of ADB

Under the Charter, no member may impose any tax on ADB's obligations (i) if such tax discriminates against such obligations solely because they are issued by ADB; or (ii) if the sole jurisdictional basis for such tax is the place or currency in which the obligations are issued, made payable, or paid, or the location of any office or place of business maintained by ADB. ADB is not under any obligation to withhold or pay any tax on its borrowings.

CAPITAL STRUCTURE

The capital structure of ADB is fundamental to its strength. As of 31 December 2003, the subscribed capital stock of ADB was $51,996.6 million. The subscribed capital is composed of paid-in and callable capital. ADB's equity is made up of paid-in capital and accumulated earnings (reserves) amounting to $12,852.4 million at 31 December 2003.

The relationship between loans and subscribed capital and the relationship between borrowings and callable capital underline the conservative policies followed by ADB in its financial operations.

Relationship Between Loans and Subscribed Capital

OCR loans, equity investments, and guarantees are limited to the level of ADB's total callable and paid-in capital, ordinary reserve, and surplus, or a one-to-one ratio of loans to capital.

As of 31 December 2003, loans disbursed and outstanding plus undisbursed commitments, equity investments, and guarantees totaled $41,545.7 million, compared with the maximum lending authority of $61,415.4 million—a loans to capital ratio of 0.68 to 1.

Relationship Between Borrowings and Callable Capital

The paid-in portion of ADB's subscribed capital is available for disbursement of OCR loans as part of ADB's ordinary operations. Callable capital is available for the protection of ADB's creditors such as bondholders and other lenders and can be called only if required to meet ADB's obligations in relation to its borrowings or to cover any guarantees outstanding. ADB's outstanding debt and guarantees cannot exceed its callable capital.

Total Borrowing Limitation

Currently, ADB's policy is not to enter into any new borrowing or guarantee chargeable to OCR if such borrowing or guarantee, when added to outstanding gross borrowings and guarantees, would exceed the aggregate of the callable capital of its nonborrowing members, paid-in capital and reserves, subject to the Charter limit of 100% of callable capital. As of 31

December 2003, total outstanding borrowings after swaps and guarantees of $26,821.2 million was equivalent to 62.1% of such ceiling or 55.5% of ADB's total callable capital.

Mechanism for Calling the Callable Capital

While ADB does not foresee an event that might require a call on its callable capital, all member countries (including those whose currencies are nonconvertible) would be required to meet any call on a uniform percentage on all callable shares. Failure by any member to honor this obligation would not relieve any other member from its obligation to meet a call. If the amounts received on such a call were insufficient to meet ADB's obligations, ADB is authorized to issue further calls until it has the necessary funds to satisfy its obligations fully, up to the full amount of each subscription to callable capital.

The following table summarizes the resources backing ADB's obligations:

Table 2. Resources Backing ADB's Obligations
as of 31 December 2003

Resources	Amount ($ million)	% of Outstanding Borrowings (After Swaps)
Cash (unrestricted) and investments	12,307	48
Callable capital	48,340	189
Outstanding loans	25,506	100
Total	**86,153**	**337**

Development of ADB's Capitalization

The following table summarizes ADB's capitalization for recent years.

Table 3. Capitalization of ADB
(amounts in $ million)

Item	1999 Amount	1999 %	2000 Amount	2000 %	2001 Amount	2001 %	2002 Amount	2002 %	2003 Amount	2003 %
Total outstanding borrowings (after swaps)	27,087	72	26,031	71	25,218	70	26,120	68	25,571	67
Capital stock:										
Subscribed	47,597		45,271		43,628		47,234		51,997	
Less–callable capital	44,249		42,087		40,560		43,912		48,340	
Paid-in capital	3,348		3,184		3,068		3,322		3,657	
Less–other adjustments	226		134		78		75		87	
Net–paid in capital	3,122		3,050		2,990		3,247		3,570	
Reserves and accumulated net income and other comprehensive income	7,441		7,784		7,884		9,105		9,282	
Total paid-in capital, reserves, net income, and other comprehensive income	10,563	28	10,834	29	10,874	30	12,352	32	12,852	33
Total capitalization	**37,650**	**100**	**36,865**	**100**	**36,092**	**100**	**38,472**	**100**	**38,423**	**100**

BORROWING OPERATIONS

ADB has been an active borrower in world capital markets since 1969. Its borrowing program is determined by several factors, including ADB's lending operations, cash flow requirements, liquidity policy, and perception of current and future market conditions.

In the early years of operations, ADB's capital was the major source of funds for ordinary lending. Since the early 1980s, borrowings have accounted for a greater share than capital and reserves.

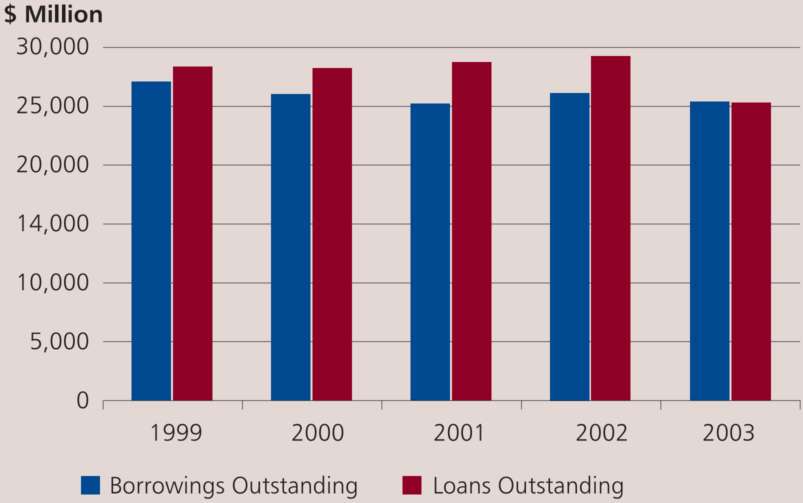
Within the context of the major objectives of ADB's borrowing program presented in Box 2, ADB continues to diversify its funding sources across markets, instruments, and maturities. One of ADB's core funding strategies is to maintain a strong presence in key currency bond markets through the regular issuance of benchmark global bonds. Consequently, ADB continues to enhance the execution of its global bond issues, focusing on offering investors fairly priced bonds through a price discovery process, achieving a broad-based distribution both geographically as well as by investor type, and ensuring secondary market liquidity. ADB also issues bonds on an opportunistic basis to generate funds at the lowest cost possible. Under its Global Medium-Term Note Program (GMTN), ADB can execute opportunistic and private placement transactions on short notice and in a size, structure, and maturity that meet investors' requirements. As part of its developmental mandate, ADB contributes to the development of regional

Box 2: Borrowing Objectives

Low-cost funding	To produce low-cost funds for ADB’s net cash requirements either directly or indirectly, on a fully hedged basis, through currency liability and interest rate swap transactions as well as financial derivative instruments.
Capital markets presence	To preserve ADB’s strong reputation and maintain continuous access to the world’s capital markets.
Development of regional capital markets	To access new markets, especially where contributions to the development of capital markets in the Asia and Pacific region can be achieved.

bond markets through local currency bond issuance. In 2004, ADB issued its first INR-denominated bond issue in India with a principal amount of INR 5 billion and a maturity of 10 years. This was the first bond issue by a supranational and foreign entity in India. Finally, ADB makes use of its $5 billion euro-commercial paper (ECP) program to bridge-finance cash flow deficiencies when market conditions are not favorable for issuing long-term debt.

Figure 1. ADB Borrowings Outstanding (After Swaps) and Ordinary Loans Outstanding
as of 31 December 1999 to 31 December 2003



Funding Operations for 2003

As in previous years, the 2003 borrowing program focused on ensuring the availability of long-term funds at the lowest possible cost to finance the OCR lending operations. During 2003, the total long-term funds raised by ADB amounted to $4,141.0 million compared to $5,944.9 million in 2002. Such funds were raised through one benchmark global bond issue and 63 opportunistic transactions in US dollars, Japanese yen, Canadian dollars, Australian dollars, and New Taiwan dollars. The decrease in the 2003 funding size was mainly due to loan prepayments of $5,883.8 million received during the year. In line with its objective of minimizing cost, ADB further enhanced its private placement strategy in 2003. More than 70% of the 2003 borrowings were in the form of private placement, of which about 64% were targeted to retail investors, 24% callable structured notes, and 12% callable zero coupon notes and non-callable foreign exchange-linked notes. The average life of such borrowings, assuming that the call option for certain bonds is exercised on a first call basis, was 7.6 years (7.2 years in 2002).

As of 31 December 2003, the total amount of outstanding borrowings after swaps was $25,571.1 million compared with $26,119.6 million in 2002. The average life of outstanding long-term borrowings at the end of the years 2003 and 2002 was 4.2 years and 3.9 years, respectively.

The following table summarizes ADB's funding operations from 1999 to 2003.

Table 4. Funding Operations, 1999–2003
($ million)

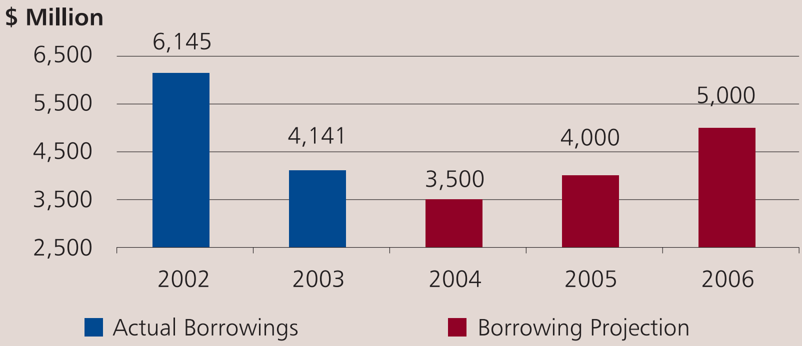
Item	1999	2000	2001	2002	2003
Long-Term Borrowings					
Total Principal Amount	4,815.9	1,692.6	1,207.1	5,944.9	4,141.0
Average Maturity to First Call (years)	4.5	5.6	6.2	7.2	7.6
Average Final Maturity (years)	6.2	7.3	8.7	9.9	13.7
Number of Transactions					
Public Offering	7	3	2	3	2
Private Placement	3	1	15	77	62
Number of Currencies (before swaps)					
Public Offering	4	1	2	1	2
Private Placement	1	1	3	5	4
Short-Term Borrowings[a]					
Total Principal Amount[b]	1,885.0	250.0	1,250.0	2,830.0	28.0
Number of Transactions	50	2	9	36	1
Number of Currencies	1	1	2	2	1

[a] All eurocommercial paper.
[b] At year-end, the outstanding principal amount was $370 million in 1999, nil in 2000, $400 million in 2001, $200 million in 2002, and nil in 2003.

Expected Borrowings

ADB's expected total borrowings from 2004 to 2006 will amount to approximately $12.5 billion equivalent. The size of this program will enable ADB to access the major international capital markets regularly in the future, as well as the region's capital markets. In addition, the size of ADB's issues

Figure 2. Borrowing Program, 2002–2006



may be increased to enhance the secondary market liquidity of ADB's bonds. ADB is committed to supporting the development of the region's domestic bond markets to improve their efficiency, transparency, liquidity, and accessibility.

Currency Diversification

ADB's policy is to diversify its borrowings among available currencies and markets to avoid becoming too dependent on any one currency or market for funding. ADB has, so far, borrowed in 19 different currencies. ADB's outstanding public bond issues are shown on pages 14-16.

Forms of Borrowing

While most of ADB's borrowings have been in the form of public bond issues in the major capital markets, ADB has also made direct placements of its securities with governments, central banks, and other financial institutions and has borrowed directly from commercial sources. In addition, ADB undertakes bridge-financing transactions through the issuance of ECP.

Use of Derivatives

In connection with its borrowing operations, ADB also undertakes currency and interest rate swap transactions. These swap transactions enable ADB, on a fully-hedged basis, to raise operationally needed currencies in a cost-efficient way while maintaining its borrowing presence in the major capital markets. At

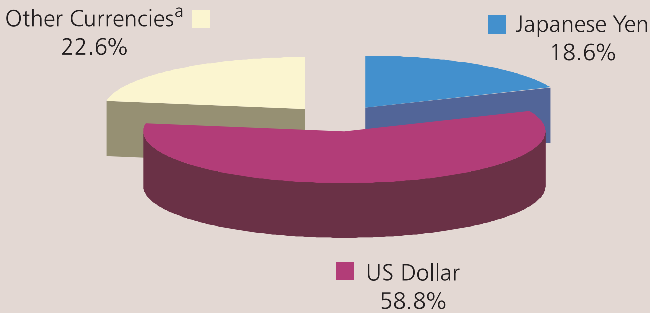
31 December 2003, the principal amounts receivable and payable under outstanding currency swap transactions totaled $9,587.0 million and $9,144.0 million, respectively. The notional principal amount of outstanding interest rate swap transactions totaled $6,159.9 million.

Currency and Interest Rate Composition of Borrowings After Swaps

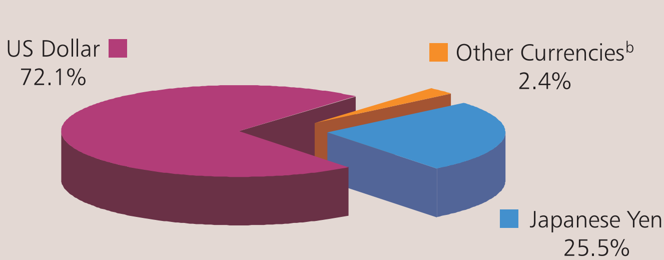
The currency composition of ADB's outstanding borrowings after swaps at 31 December 2003 was concentrated in US dollars, about 72.1% (72.3% in 2002)

Figure 3. Effect on Currency Composition
as of 31 December 2003

Currency Composition of Outstanding Borrowings (Before Swaps)



Currency Composition of Outstanding Borrowings (After Swaps)



[a] Includes Australian dollar, Canadian dollar, Euro, Hong Kong dollar, New Taiwan dollar, Pound sterling, and Swiss franc.

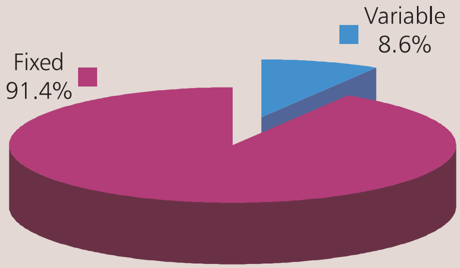
[b] Includes Australian dollar, Canadian dollar, New Taiwan dollar, Pound sterling, and Swiss franc.

of the borrowing portfolio. This reflects the borrowers' preference for US dollar loans.

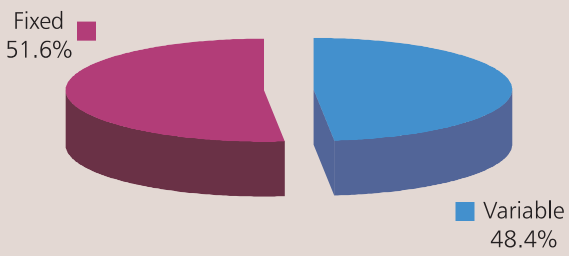
Of the outstanding borrowings after swaps at 31 December 2003, 51.6% was at fixed rates (56.6% in 2002) and 48.4% at variable rates (43.4% in 2002). See Figures 3 and 4 for the effects of the outstanding currency and interest rate swap transactions in relation to ADB's outstanding borrowings.

Figure 4. Effect on Interest Rate Structure
as of 31 December 2003

Interest Rate Structure of Outstanding Borrowings (Before Swaps)



Interest Rate Structure of Outstanding Borrowings (After Swaps)



ADB'S OUTSTANDING PUBLIC BOND ISSUES
as of 31 December 2003

Issue	Principal Amount (million)
Australian Dollar	
5 1/4%-5.37-year Bonds of 1999 due 15 September 2004	500
6 1/4 %-10-year Bonds of 2001 due 15 June 2011	500
Euro	
6 1/4%-10-year Bonds of 1996 due 1 March 2006	182
5 1/2%-10-year Bonds of 1997 due 24 October 2007	767
New Taiwan Dollar	
2 Tranches Bonds of 1999: 5.35%-5-year Bonds of 1999 due 8 March 2004	6,000
5.40%-7-year Bonds of 1999 due 8 March 2006	2,000
Inverse Floating 7-year Bonds of 2003 due 23 April 2010	5,000
Pound Sterling	
10 1/4%-25-year Loan Stock of 1984 due 24 March 2009 (S)	100
Swiss Franc	
6%-25-year Bonds of 1985 due 20 November 2010	100
Zero Coupon-30-year Bonds of 1986 due 7 February 2016	500

Issue	Principal Amount (million)
7%-12-year Bonds of 1992 due 1 June 2004	300
3%-8-year Bonds of 1998 due 24 April 2006	300
2.25%-6-year Bonds of 1999 due 28 April 2005	300
United States Dollar	
6.22%-30-year Bonds of 1997 due 15 August 2027 (P)	300
5.82%-30-year Bonds of 1998 due 16 June 2028 (P)	750
5.593%-20-year Bonds of 1998 due 16 July 2018 (P)	700
6 3/8%-30-year Bonds of 1998 due 1 October 2028 (P)	410
6.64%-15-year Bonds of 1999 due 27 May 2014 (P)	500
Euro-United States Dollar	
Zero Coupon-20-year Bonds of 1984 due 31 August 2004 (C)	1,000
7 %-5-year Notes of 2000 due 15 June 2005	300
4 1/4%-7-year Bonds of 2002 due 29 December 2009	500
Global United States Dollar	
6 1/8%-10-year Bonds of 1994 due 9 March 2004	750

Issue	Principal Amount (million)
6 1/4%-10-year Bonds of 1995 due 24 October 2005	750
6 3/4%-10-year Bonds of 1997 due 11 June 2007	1,250
5 1/2%-5-year Bonds of 1999 due 23 April 2004	1,250
7 1/2%-5-year Bonds of 2000 due 31 May 2005	1,000
7 1/2%-15-year Bonds of 2000 due 15 June 2015 (P)	300
4 7/8%-5-year Bonds of 2002 due 5 February 2007	2,000
4 1/2%-10-year Bonds of 2002 due 4 September 2012	500
2.375%-3-year Bonds of 2003 due 15 March 2006	1,000
Japanese Yen	
5.675%-20-year Bonds of 1993 due 12 February 2013	30,000
4.60%-10-year Reverse Dual Currency Bonds of 1995 due 27 April 2005	10,000
Euro-Yen	
3 1/8%-10-year Bonds of 1995 due 29 June 2005	40,000

(C) Call options exist.
(P) Put options exist.
(S) Sinking fund provisions apply.

LIQUIDITY PORTFOLIO MANAGEMENT

The current ADB's liquidity policy requires that ADB maintains a prudential minimum level of liquidity at all times during the calendar year equivalent to 40% of the proxy net cash requirements for the following 3 years (the sum of net disbursement and debt redemption). This is to provide capacity for ADB to meet its loan disbursements, debt servicing, and other cash requirements in the event of a major disruption in its cash flows. In addition, the policy allows ADB to maintain a discretionary liquidity portfolio, the primary objective of which is to provide flexibility in the execution of ADB's funding program. Also, ADB's liquidity portfolio contributes to ADB's earning base.

ADB's Board of Directors has approved certain policy restrictions relating to ADB's investment of funds not needed in operations (Investment Authority). The primary objective of the Investment Authority is to ensure the security and liquidity of funds invested. Subject to this primary objective, ADB seeks to maximize total return on its liquidity portfolio investments. ADB's investments are made in the same currencies as received. ADB does not convert currencies for investments. At present, liquid investments are held in 19 currencies.

ADB's liquid assets are held in government and government-related debt instruments, time deposits, and other unconditional obligations of banks and financial institutions, and to a limited extent, in corporate bonds, mortgage-backed securities, and asset-backed securities of high credit quality. The liquid assets are held in four sub-portfolios—core, operational cash, cash cushion, and discretionary liquidity—all of which have different risk profiles and performance objectives.

The core portfolio is invested to ensure that its primary objective of a liquidity buffer is met. Cash inflows and outflows are minimized to achieve the portfolio's objective of maximizing the total return relative to a defined risk tolerance level. The largest part of the portfolio is funded by equity. For this part, the performance is measured against external benchmarks with an average duration presently of about 2 years. The remaining part of the portfolio is funded by floating rate debt and aims to maximize the spread earned by ADB between borrowing cost and income on high-quality instruments.

The operational cash portfolio is designed to meet net cash requirements over a 1-month period. It is funded by equity and invested in short-term, highly liquid money market instruments. The portfolio performance is measured against short-term external benchmarks.

The cash cushion portfolio holds the proceeds of ADB's borrowings pending disbursement. The portfolio is invested in short-term instruments and its performance is measured against short-term external benchmarks.

The discretionary liquidity portfolio is funded by floating rate debt and aims to maximize the spread earned by ADB between borrowing cost and income on high-quality instruments. The size of the portfolio depends on factors such as the need to smoothen the build up of ADB's prudential liquidity over a given time horizon and the opportunities to undertake additional short-term borrowings for market presence purposes. The size of the portfolio is subject to a ceiling approved by the Board of Directors.

The year-end balance of the above portfolios in 2003 and 2002, excluding securities transferred under securities lending arrangements and pending sales and purchases, is presented in the following table.

Table 5. Year-End Balance
($ million)

Liquidity Portfolio	2003	2002
Core	6,174	6,546
Operational cash	2,235	144
Cash cushion	1,394	1,081
Discretionary liquidity	1,755	-
Total	**11,558**	**7,771**

The return on the liquidity portfolios during 2003 and 2002 is presented in the following table.

Table 6. Return on Liquidity Portfolio

	Annualized Financial Return (%)	
Liquidity Portfolio	2003	2002
Core	2.89	6.89
Operational cash	1.21	1.72
Cash cushion	0.68	1.04
Discretionary liquidity[a]	0.44	-

[a] Spread over funding cost

FINANCIAL RISK MANAGEMENT

In undertaking its development banking operations, ADB assumes a variety of financial risks. These include credit, market (interest rate and foreign exchange) and operational risks. ADB has established a risk management infrastructure designed to ensure that the risks associated with its activities are fully identified, measured, monitored, and managed. Guidelines and constraints relating to the assumption of credit, market, and operational risks are established within the parameters of various policy and operational documents. The Charter sets the broad policy objectives relating to the operations of ADB. General policy guidelines relating to risk assumption and management are articulated in several policy documents approved by ADB's Board of Directors. These include the income planning framework, the Liquidity Policy, and the Investment Authority. At the operational level, specific guidelines relating to the assumption of risk in ADB's financial operations are established by the Office of the President, Office of the Vice-President (Finance and Administration), and Office of the Treasurer.

In 2003, ADB further enhanced risk management functions by enhancing the risk metrics and assumptions used in valuation and risk analysis of the treasury activities and the performance measurement and attribution methodologies used for its investment portfolio. Stress testing and scenario analysis were developed as supplementary risk management tools while the architecture for valuing highly structured borrowings and related swap transactions was improved. Also, ADB undertook preparation for establishing a derivatives collateral management program for 2004 as an important part of credit risk management.

On 19 February 2004, ADB's Board of Directors approved an income planning framework for ADB's financial risk management. This framework is designed to measure the risks ADB takes in its lending activities and to assess those risks relative to the amount of capital the institution holds. Also, this will assess ADB's equity capital and loan provisioning requirements and assists in assessing the adequacy of its loan charges and the feasibility of other uses of net income. Such approved framework includes the following initiatives:

a. Change the policy of setting minimum levels for the reserve:loan ratio and interest coverage ratio of 25% and 1.31, respectively, to setting a target level for the equity:loan ratio.
b. Starting in 2004, ADB will provide a loan loss reserve for its public sector loans.
c. The adequacy of net income will be assessed based on the sum of the estimates of the loss of loan income due to an assumed nonaccrual shock plus the need to maintain growth in ADB's equity to match the growth in ADB's loan and guarantee portfolio.

Credit Risk

Credit risk can be defined as the potential loss arising from default of a borrower, counterparty, and issuer. ADB's credit risk management for lending operations involves continuous monitoring of the creditworthiness of the borrowing member countries and managing the risks through a rigorous capital adequacy framework. In country credit risk management, ADB uses an internal, quantitative risk-based capital model as the basis to monitor estimates of expected and unexpected loss linked to ADB's equity capital adequacy, loan loss allowance, minimum net income requirement, and pricing of OCR loans. The methodology involves examining ADB's lending portfolio, incorporating default probability, exposure, and loan loss severity of the borrowers and is used as foundation for managing lending risk within ADB.

Commercial credit risk is the risk of loss due to a counterparty not honoring its contractual obligations. Commercial credit risks involve issuer risk and counterparty risk. Issuer risk arises from ADB's investment transactions. It is concentrated in investments in debt instruments issued by sovereign governments, agencies, banks, and corporate entities. ADB restricts investments in corporate paper to A or higher rated instruments.

In connection with its investment and funding operations, ADB uses various cash and derivative instruments in its financial operations. These transactions involve counterparty credit risks. To manage and mitigate these risks, ADB restricts these activities to authorized dealers and counterparties meeting conservative credit risk guidelines. ADB monitors and controls counterparty credit risks arising from derivative transactions through credit approval, collateral agreements, and risk limits. ADB requires all swap counterparties to be rated A-/A3 or higher and to have entered into a Credit Support Annex to the Schedule of the International Swaps and Derivatives Association (ISDA) Master Agreement with ADB. Credit limits are calculated and monitored on the basis of current and potential exposure, which incorporates risks involved with counterparty default.

Overdue and Non-performing Loans

ADB's policy provides that if a payment of principal or interest on a public sector loan is not received within 30 days after the due date, a formal notice will be sent to the borrower, advising that unless all its outstanding arrears are received within 30 days of such notice, no further loans to, or guaranteed by, the borrower will be presented to the Board of Directors for approval nor will any previously approved loans be signed. In addition, if such payment is not received within 60 days after the due date, a formal notice will be sent to the borrower advising that, unless all its outstanding arrears are received within 30 days of such notice, disbursements on all ADB loans to that borrower will be suspended. Such overdue policy may be temporarily deferred (i) when payments are owed in currencies whose availability in the international financial markets is unduly constrained at the time the payments fall due; (ii) when the overdue amount is less than $50,000; and (iii) when significant partial payments of the overdue amount have been received by ADB, and/or the borrower has made acceptable arrangements to bring the outstanding amounts up to date. It is also the policy of ADB to place loans in nonaccrual status where principal, interest, or other charges are overdue by six months. Provisions for possible loan losses may be made when principal or interest is in arrears for 1 year for public sector loans made to or guaranteed by a member and six months for private sector loans.

Market Risk

Market risks can result from unfavorable market movements, primarily in interest rate and foreign exchange rates. The market risks associated with the loan portfolio are managed by passing all associated costs to borrowers and employing derivatives to manage and align characteristics of loans and borrowings. ADB assumes no significant market risks relating to its loan portfolio, except for minor cost of carry associated with borrowed funds held temporarily in liquid assets pending disbursement.

Market risk exposure is generally restricted to ADB's liquid asset investments. The principal source of interest risk arises from the income volatility associated with investments due to interest rate movements. ADB monitors and manages interest rate risks by employing various quantitative methods. All positions are marked-to-market and risk sensitive measures are calculated and compared to internally established risk limits daily. In addition, potential exposures are calculated and monitored against aggregate risk limits established under the present investment strategy.

ADB has a policy to match loans and investments in the same currencies in which the funds are received. However, the borrowed funds or funds to be invested may be converted into other currencies provided that forward exchange agreements are entered in simultaneously to ensure recovery of currencies converted.

Operational Risk

Operational risk represents the potential for loss resulting from inadequate or failed internal processes or systems, human factors, or external events, including business disruptions and system failure, transaction processing failures, and failure in execution of legal, fiduciary, and agency responsibilities. ADB is exposed to many types of operational risk and attempts to mitigate them by maintaining a system of internal control procedures and processes that are designed to control risk within appropriate levels.

Risk Management in Private Sector Operations

Managing commercial and sovereign risks is a key priority in ADB's private sector operations. The Risk Management Unit in the Private Sector Operations Department has two main functions. One is credit review, which evaluates and provides an independent credit assessment, separate from the operating division's judgment on each project. The other is special asset management which gives attention to the more vulnerable private sector projects and pursues recovery, restructuring, rescheduling, and where necessary, litigation in managing non-performing projects.

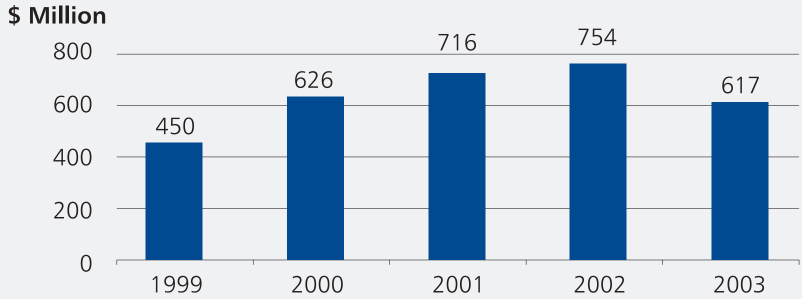
RESULTS OF OPERATIONS

ADB has achieved consistent profitability, earning profits every year since its inception. Operating income for 2003 before FAS 133 adjustment was $616.6 million, a decrease of $137.3 million (18%) from the operating income of $753.9 million in 2002. The decrease was predominantly due to (i) a decrease in net loan income after interest and financial expenses of $159.3 million attributed to the combined effect of decreases in average outstanding loans and borrowings. The decreases are attributed to significant loan prepayments ($5.9 billion) and to unfavorable fair value changes for swaps ($0.2 billion); (ii) a decrease in investment income of $21.8 million primarily due to changes in interest rate environment; and (iii) increases of $27.9 million and $13.5 million in administrative expenses and provision for losses, respectively.

The $222.5 million decrease in net income resulting from these three factors was offset by gains on equity investment disposals of $25.4 million and other income of $3.3 million and by a decrease in technical assistance of $56.5 million.

The following graph shows ADB's net income from 1999 to 2003. The net income from 2001 to 2003 shown in the graph excludes FAS 133 adjustments.

Figure 5. Net Income, 1999–2003



OCR OPERATIONS

Operating Policies

ADB is authorized to make, participate in, or guarantee loans to its DMCs or their governments, to any of their agencies or political subdivisions, and to public or private enterprises operating within such countries, as well as to international or regional entities concerned with economic development in the region.

Loans are made only for projects or programs of high developmental priority. ADB provides financing to its borrowers to cover foreign exchange expenditures incurred in a project and also finances local currency expenditures in certain cases. ADB requires its borrowers to absorb exchange risks caused by fluctuations in the value of the currencies that it has disbursed. Except in special circumstances, ADB requires that the proceeds of its loans, equity investments, and the loans it guarantees be used by borrowers only for procurement of goods and services produced in and supplied from member countries. ADB supervises the disbursement of its loans to ensure that the proceeds are applied only against eligible expenditures. It generally requires that borrowers seek competitive bids from potential suppliers; that engineering plans and specifications be drawn up independently of the suppliers or manufacturers; and that, if appropriate, independent consultants be retained by borrowers.

ADB's program lending is designed, as a complement to its project-specific lending, to develop a sector (or subsector) as a whole and improve a sector's performance through appropriate policy and institutional reforms over the medium- to long-term. The loan proceeds may be used to finance economy-wide import requirements on the basis of a negative import list, or where necessary and appropriate, sector-specific import requirements on the basis of a positive import list. The ceiling on program lending, as a percentage of total lending on a 3-year moving average basis, is 20%.

ADB adopted a program-cluster approach as an extension of its program lending modality to enhance flexibility and extended the time frame for program implementation to 7 years. ADB also introduced a special program loan facility (SPL) to provide, on an exceptional basis, assistance as part of an international rescue package, providing substantial support beyond ADB's anticipated assistance levels to crisis-affected countries. ADB charges higher rates for SPLs to help mitigate potential adverse effects on ADB's financial strength and risk-bearing capacity. SPLs are exempted from counting toward the ceiling on regular program lending.

Ordinary Operations Loans

From its establishment through 31 December 2003, ADB had approved loans aggregating $76,276.3 million in its ordinary operations. As of 31 December 2003, ADB's total amount of outstanding loan commitments (approved ordinary operations loans less amounts cancelled or repaid) in its ordinary operations was $40,367.3 million.

The majority of ADB ordinary operations loans (98.0%) have been made to the public sector, namely, to member countries or, with the guarantee of the member government concerned, to government agencies or other public entities. The rest is to private enterprises and financial institutions without government guarantee (see Private Sector Loans and Equity Investments on page 32).

Major Recipients of Loans

As a general rule, the lesser developed of ADB's members borrow on concessional terms from the Asian Development Fund (ADF), while members with stronger economies borrow from OCR. ADB has made loans from OCR to 22 of its DMCs, with Indonesia receiving the largest aggregate amount, followed by People's Republic of China, India, Philippines, Pakistan, Republic of Korea, and Thailand. Effective January 1999, ADB has adopted a graduation policy and country classification system that applies the joint criteria of per capita gross national product (GNP) and debt repayment capacity to determine the eligibility of its DMCs for OCR and ADF resources.

Hong Kong, China; Republic of Korea; Singapore; and Taipei,China have graduated from regular ADB assistance. Only OCR loans are provided to the more advanced borrowing members in the region which include Fiji Islands, 3 members of the Association of South East Asian Nations (Malaysia, Philippines, and Thailand), and 3 Central Asian countries (Kazakhstan, Turkmenistan, and Uzbekistan). People's Republic of China, India, Indonesia, Nauru, and Papua New Guinea are eligible to receive OCR with limited amounts of ADF (although ADF resources are not available to

People's Republic of China and India during the ADF VIII period, while Indonesia is on a watch-list for graduation from the ADF). Members with access to limited amounts of OCR in addition to ADF include Azerbaijan, Bangladesh, Cook Islands (limited eligibility for OCR will be applied only after the external debt position improves), Marshall Islands, Federated States of Micronesia, Pakistan, Sri Lanka, Tonga, and Viet Nam.

Table 7. Country Breakdown of Outstanding OCR Loan Commitments
as of 31 December 2003

Country	$ Million	%
Indonesia	10,054.3	24.9%
China, People's Republic of	8,500.7	21.1%
India	7,859.6	19.5%
Pakistan	4,555.0	11.3%
Philippines	3,579.5	8.9%
Korea, Republic of	1,899.7	4.7%
Thailand	738.4	1.8%
Uzbekistan	709.7	1.8%
Others	2,470.4	6.0%
Total	**40,367.3**	**100.0%**

Types of Development Projects Financed

ADB lending is directed at developing the following sectors: energy, agriculture and natural resources, finance, industry and nonfuel minerals, social infrastructure, and transport and communications. Projects financed by these loans are designed to assist recipient members in developing a sound economic base to enable them to achieve and maintain higher and sustained levels of economic growth. ADB finances development of financial systems in DMCs and small- and medium-scale projects, mostly in the private sector, through loans to financial intermediaries within the borrowing members, which on-lend ADB funds for such projects.

With the adoption of the Poverty Reduction Strategy as its main goal, ADB provides loans to promote pro-poor, sustainable economic growth; inclusive social development; and good governance. To broaden and deepen the impact of its interventions, ADB promotes the role of the private sector in development, supports regional cooperation and integration, and addresses environmental sustainability in all its loans.

Table 8. Sectoral Breakdown of Outstanding Effective Loans
as of 31 December 2003

Sector	$ million	%
Transport and communications	$8,355.2	24.0%
Energy	7,312.8	21.0%
Finance	5,423.7	15.6%
Social infrastructure	6,418.4	18.5%
Agriculture and natural resources	3,060.3	8.8%
Industry and nonfuel minerals	1,487.9	4.3%
Multisector	1,168.0	3.4%
Others	1,547.4	4.4%
Total	**$34,773.7**	**100.0%**

The Project Process

In response to requests from member governments for OCR loans, ADB economists, financial analysts, technical specialists, and lawyers assess the economic, social, environmental, technical, institutional, and financial feasibility of projects and the manner in which the projects fit into the economic framework and development priorities of the borrowing members.

Strict standards of accounting and project implementation are maintained. Most contracts are awarded on the basis of international competitive bidding or international shopping or by domestic competitive bidding in certain limited cases. Projects are carefully analyzed and executed and, where appropriate, outside consultants are hired to ensure that the highest standards of performance are achieved throughout the life of the project.

Repayment Record

In its public sector ordinary operations, ADB has not suffered any losses of principal to date and follows a policy of not taking part in debt rescheduling agreements. Occasional delays have occurred in loan service payments, but these have not been material to ADB's operations. During 2003, a loan loss provision of $0.24 million was provided against one public sector loan to Nauru with a principal amount of $2.3 million that remained in nonaccrual status as of 31 December 2003.

In conjunction with its new income planning framework approved by its Board of Directors in February 2004, ADB shall provide loan loss reserve for its public sector loans starting 2004. This will be determined based on the expected loan portfolio loss, where the loan loss reserve is calculated as the difference between the estimate of the loan portfolio's expected loss and the accumulated loan loss provision.

In its private sector operations, ADB provides for possible losses on its private sector loans and diminution in the value of equity investments. Allowance for losses on impaired private sector loans and equity investments totaled $152.6 million through 2003. As of 31 December 2003, the total public and private sector loans in non-accrual status was equivalent to 0.3% of the total ordinary operations loan outstanding.

Lending Windows

ADB's currently available lending window is the LIBOR-based loan (LBL) window. The LBL window, introduced on 1 July 2001, is in response to borrowers' demand for new ADB financial loan products to suit their project needs and external debt risk management strategies. The LBL products give borrowers a high degree of flexibility in terms of (i) choice of currency and interest rate basis; (ii) options to link repayment schedules to actual disbursements for financial intermediary borrowers; (iii) the ability to change the original loan terms at any time during the life of the loan; and (iv) the option to purchase a cap and collar on a floating lending rate at any time during the life of the loan, while at the same time providing low intermediation risk to ADB.

Until 30 June 2001, ADB had three lending windows for loans from OCR: the pool-based multicurrency loan (PMCL) window, the pool-based single-currency loan (PSCL) window in US dollars, and the market-based loan (MBL) window. The MBL window provided single-currency loans in US dollars, Japanese yen, or Swiss francs to private sector borrowers and government-guaranteed financial intermediaries at the prevailing market rates. With the introduction of the LBL window, the PMCL and MBL windows were retired on 1 July 2001 and the PSCL window on 1 July 2002. For ADB to evolve into a full-fledged LIBOR-based lender, ADB's

Board of Directors approved the program of offering its borrowers the option to transform the undisbursed balances of their PSCLs and MBLs into LBLs, provided that the undisbursed loan balance was not less than 40% of the loan amount as of 30 June 2001. By 15 December 2002, total undisbursed balances of $6.8 billion under 97 PSCLs were transformed to LBL terms as scheduled. As of 31 December 2002, the transformation program had been completed. In November 2003, ADB offered PMCL borrowers to transform PMCLs of $6.5 billion to PSCLs in Japanese yen. The purpose of the transformation was to change the accounting method for PMCLs to facilitate borrowers' loan administration. All PMCL borrowers, except one, confirmed the transformation. The transformation took effect in January 2004. A breakdown of ADB's ordinary operations loan portfolio by loan product as of 31 December 2003 and 31 December 2002 is presented in Table 9.

Table 9: Loan Portfolio by Loan Products
($ million)

	Public Sector		Private Sector	
	2003	**2002**	**2003**	**2002**
LIBOR-based Loans				
Outstanding	4,101	1,839	76	7
Undisbursed	13,710	12,024	114	58
Market-based Loans				
Outstanding	648	633	235	216
Undisbursed	243	315	105	190
Pool-based Multicurrency Loans				
Outstanding	6,502	7,083	10	10
Undisbursed	-	3	-	-
Pool-based Single-Currency Loans				
Outstanding	11,661	15,084	-	-
Undisbursed	561	1,041	-	-
Others				
Outstanding	2,130	4,195	143	167
Undisbursed	-	-	129	107
Total				
Outstanding	**25,042**	**28,834**	**464**	**400**
Undisbursed	**14,514**	**13,383**	**348**	**355**

Financial Terms of Loans

LBL window: ADB offers floating-rate loans and fixed-rate loans denominated in euros, Japanese yen or US dollars. However, initially, the loans bear a floating interest rate. With a floating interest rate, the rate is reset every 6 months on each interest payment date. The rate is the cost base rate plus a spread (fixed spread) that is specified in the loan agreement. The cost base rate is equal to LIBOR and reset every 6 months. The fixed spread for public sector borrowers is equal to ADB's basic lending spread prevailing at the time of loan signing while the spread for private sector borrowers reflects the credit risk of the specific project and borrower. The basic lending spread for public sector borrowers is 60 basis points. On 12 April 2004, ADB's Board of Directors approved, for all OCR borrowers who do not have arrears with ADB, a waiver of 20 basis points on the basic lending spread on ordinary operations public sector loans outstanding from 1 July 2004 to 30 June 2005. Borrowers may direct ADB to automatically implement a series of interest rate fixings either by period or by amount. The average lending rates of outstanding LBLs in US dollars and Japanese yen as of 31 December 2003 were 1.53% and 0.25%, respectively.

A commitment fee of 0.75% per annum is levied on all public sector loans, beginning 60 days after execution of the loan agreement. For project loans, the commitment fee accrues on the following increasing portions of the total loan amount (less cumulative disbursements): 15% in the first year, 45% in the second year, 85% in the third year, and 100% thereafter. For program loans, the commitment fee is 0.75% per annum of the aggregate principal amount of the program loan. A front-end fee of 1% is charged on public sector loans with the borrowers given the option to capitalize the fee. On 9 May 2003, ADB's Board of Directors approved a waiver of 50% of the front-end fee with respect to public sector loans approved on or after 1 January 2003. Additionally, on 12 April 2004, ADB's Board of Directors approved, for all OCR borrowers that do not have arrears with ADB, a waiver of the entire front-end fee of 1% on all new ordinary operations public sector loans approved from 1 January 2004 to 30 June 2005.

Public sector LBL loans provide for rebates and surcharges. Since the principle of automatic cost pass-through pricing is maintained for LBLs, ADB returns the actual sub-LIBOR funding cost margin to its LBL public sector borrowers through rebates. A surcharge could arise if ADB's funding cost is above the 6-month LIBOR. The rebate and surcharge are calculated every 1 January and 1 July of each year based on actual average funding cost margin for the preceding 6-month period. In 2003, ADB returned the actual sub-LIBOR funding cost margin of $5.6 million to its LBL public sector borrowers.

PMCL and PSCL window: The lending rates for the PMCL and PSCL US dollar loan windows are determined on the basis of the previous semester's average cost of borrowings plus a lending spread which is the same spread applicable to LBLs. The commitment and front-end fees applicable to public sector LBLs also apply to PMCLs and PSCLs approved on or after 1 January 2000.

ADB's pool-based variable lending rates for the first half of 2003 were 2.74% per annum for multicurrency loans and 6.31% per annum for US dollar loans. For the second half of 2003, the lending rate for multicurrency loans decreased to 2.46% per annum and remained 6.31% per annum for US dollar loans. For the first half of 2004, the pool-based lending rates decreased to 2.13% per annum for multicurrency loans and 6.27% per annum for US dollar loans.

MBL window: The interest rates on MBLs are on either fixed or floating rate terms. The lending rates for MBLs are determined on the basis of the 6-month LIBOR with reset dates of either 15 March and 15 September or 15 June and 15 December plus a lending spread. The lending spread for MBL to financial intermediaries in the public sector is the same as that applicable for pool-based public sector loans. For private enterprises, the lending spread is determined on a case-by-case basis to cover ADB's risk exposure to particular borrowers and projects. A front-end fee of about 1.0% to 1.5% of the loan amount and a commitment fee of about 0.5% to 0.75% per year on the undisbursed balance are typically charged on a floating rate MBL.

Private Sector Loans and Equity Investments

ADB directly supports private enterprises in DMCs through equity investments and direct lending to private enterprises without government guarantees. Aggregate amounts available for allocations by the Board of Directors for this program are currently limited to $1,500 million ($1,450 million for equity and loans from OCR and $50 million from ADF for loans only). However, in September 2001, ADB's Board of Directors agreed to allow approvals in excess of the existing $1,500 million capital allocation for private sector operations as an interim arrangement, pending determination of the appropriate capital allocation between public and private sector operations.

Private sector loans generally have shorter maturities, normally up to 12 years, than otherwise offered by ADB and bear higher market-based interest rates than those typically offered by ADB.

ADB is authorized under its Charter to make equity investments and underwrite or participate in the underwriting of securities. Under the Charter, the total amount of OCR that ADB may invest in equity capital may not exceed 10% of the total of its unimpaired paid-in capital stock, reserves (other than the Special Reserve), and surplus, which was $1,328.7 million as of 31 December 2003. At the end of 2003, the net equity investment commitments (approvals less disposals and sales) amounted to $413.9 million (about 31.2% of the Charter ceiling).

As of 31 December 2003, the overall private sector portfolio (equity investments and loans) amounted to $1,224.9 million from OCR and $6.0 million from ADF.

Guarantees

ADB has two guarantee instruments—partial credit guarantee and political risk guarantee—both designed to mitigate risk exposure of commercial lenders and capital market investors. These guarantees are not issued on a stand-alone basis but are provided for projects where ADB has a direct participation, such as equity investment or a loan. ADB can cooperate with other multilateral, official, and private sector entities in providing its guarantee products. Partial credit guarantee (PCG) provides comprehensive cover (both commercial and political risks) for a specific portion of the debt service provided by cofinanciers on either public or private sector projects. PCGs can cover local currency debt, including domestic bond issues or long-term loans from local financial institutions. For private sector transactions not supported by a counterguarantee from the host government, the exposure limit is $75 million or 25% of the project cost, whichever is less. Guarantee fees for private sector transactions are market-based. Guarantee fees for transactions backed by a counterguarantee of the host government comprise a standard guarantee fee of 40 basis points (0.4%) per annum on the present value of the outstanding guarantee obligation plus a front-end fee to cover ADB's processing costs. Fees can be charged either to the borrower or the lender.

Political risk guarantee (PRG) provides coverage against risks such as expropriation, currency inconvertibility or nontransferability, political violence, and breach of contract; and is available for loans and other debt instruments but not equity instruments. Tenors are based on merits of the underlying project. All or part of the outstanding debt service obligations to a lender may be covered. The cover may be for principal and/or interest payment obligations. For private sector projects, a PRG without a counterguarantee from the host government can be issued. However, PRG exposure to such private sector projects is subject to a maximum of $150 million, or 50% of the project cost, whichever is lower. Fees are market-based and comprise a guarantee fee, a front-end fee, and a standby fee. Guarantee fees for transactions backed by government guarantees comprise a standard fee of 40 basis points (0.4%) per annum on the nominal value of the outstanding guarantee obligation plus a front-end fee to cover ADB's processing costs. The PRGs are callable when a guaranteed event has occurred and such an event has resulted in debt service default to the lender.

At the end of 2003 and 2002, ADB's exposure on guarantee operations is shown below.

Table 10: Guarantee Exposure
($ million)

	2003		2002	
	Committed Amount	**Outstanding Amount**	**Committed Amount**	**Outstanding Amount**
Partial Credit Guarantee with counterguarantee	1,115.3	1,115.3	1,030.9	1,030.9
Political Risk Guarantee				
With counterguarantee	252.7	102.0	252.5	86.9
Without counterguarantee	31.6	28.3	-	-
	284.3	130.3	252.5	86.9
Total	**1,399.6**	**1,245.6**	**1,283.4**	**1,117.8**

Cofinancing and Relations with Other Development Organizations

ADB actively pursues cofinancing with official as well as commercial and export credit sources to complement its assistance to public and private sector projects in its DMCs. Cofinancing provides funds that are additional to ADB's planned lending levels and normally improves the terms of lending when blended with ADB's own direct loans. In connection with such activities, ADB maintains close relations with other international development organizations and acts as an administrator for, or has made joint financing arrangements with, several multilateral and bilateral development agencies. ADB has also been joined by commercial institutions in cofinancing projects in the region, and is continuing to promote increased commercial cofinancing. The total amount of cofinancing arranged in support of ADB-assisted operations as of the end of 2003 amounted to $40.6 billion for 637 loan projects and programs. This amount consisted of $22.9 billion from official sources, and $17.7 billion from commercial sources and export credit agencies.

SPECIAL FUNDS

In addition to its ordinary capital resources (OCR), ADB is authorized by its Charter to establish and administer Special Funds, which currently consist of the Asian Development Fund (ADF), the Technical Assistance Special Fund (TASF), the Japan Special Fund (JSF), and the ADB Institute Special Fund (ADBISF). Other funds managed by ADB are the Japan Scholarship Program, Japan Fund for Poverty Reduction (JFPR), Japan Fund for Information and Communication Technology, and various channel financing arrangements. In accordance with the Charter, ADB's Special Funds resources must at all times be held, used, and committed separately from OCR and must be shown separately in ADB's financial statements.

Asian Development Fund

ADF is designed to provide loans on concessional terms to those DMCs with low per capita GNP and limited debt repayment capacity. The same strict standards for loan approval and administration that apply to OCR loans are applied to ADF loans. Most ADF loans negotiated before 1 January 1999 have a nominal service charge of 1% per annum, and most are repayable over periods of 35-40 years, including a grace period of 10 years. ADF loans negotiated after 1 January 1999 are subject to an interest charge of 1% per annum during the grace period and 1.5% per annum during the amortization period. Project loans have a maturity of 32 years, including a grace period of 8 years while quick disbursing program loans have a maturity of 24 years, including a grace period of 8 years.

The resources for ADF loans consist mainly of contributions mobilized under periodic replenishments from DMCs. In 1997, the Board of Directors has interpreted the Charter to permit OCR net income and surplus transfers to ADF, following allocations to reserves, of amounts which would otherwise have been available for distribution to members as dividends. Any such transfer shall be approved by the Board of Governors on an annual basis in respect of such year's net income and surplus. As of 31 December 2003, ADF aggregate resources committed to loans and available for loan commitments amounted to $26,758.6 million.

The main beneficiaries of ADF loans have been Pakistan, Bangladesh, Sri Lanka, Viet Nam, Nepal, Indonesia, Philippines, and Laos. From its establishment through 31 December 2003, ADB had approved ADF loans totaling $28,793.1 million.

Technical Assistance Special Fund

The TASF is an important source of grant financing for ADB's technical assistance operations. TASF resources consist of direct voluntary contributions by ADB members, allocations from OCR net income and ADF contributions, and revenue from investments and other sources. As of 31 December 2003, aggregate TASF resources amounted to $1,005.5 million. Of this, $104.1 million was uncommitted as of 31 December 2003. Technical assistance is an important activity through which ADB helps its DMCs improve their capabilities to formulate, design, implement, and operate development projects. ADB also provides technical assistance for regional studies and activities. As of 31 December 2003, total grant-financed technical assistance approved by ADB amounted to $2,393.7 million. Such assistance has been approved for 40 DMCs and for regional activities.

Japan Special Fund

The JSF was established to help DMCs restructure their economies in light of the changing global environment and to broaden the scope for new investments, thereby assisting the recycling of funds to DMCs. It is used to finance or cofinance technical assistance projects on a grant basis and equity investments. As of 31 December 2003, the cumulative total contribution received from the Government of Japan for the JSF amounted to $852.7 million equivalent. Of the total contributions received, $727.6 million had been committed as of 31 December 2003. Through 31 December 2003, total technical assistance grants approved under the fund was $853.9 million.

ADB Institute Special Fund

The primary objective for establishing the ADB Institute (ADBI) is to improve sound management capacities of the agencies and organizations engaged in development work in DMCs. The ADBI serves as a focal point for research on innovative development strategies and for training in development management for policymakers and senior managers from developing members. The costs of operating ADBI are met from the ADB Institute Special Fund (ADBISF). The resources of ADBISF include voluntary contributions, donations, and grants from members, non-government organizations, and foundations. As of 31 December 2003, the cumulative commitments to the ADBISF amounted to about $83.1 million, excluding translation adjustments. Of the total contributions received, $69.8 million had been utilized as of 31 December 2003.

Other Funds Managed by ADB

Japan Scholarship Program

The JSP, funded by the Government of Japan, was established to provide opportunities for qualified citizens of DMCs to undertake postgraduate studies in economics, management, science and technology, and other development-related fields at selected educational institutions in the region. As of 31 December 2003, the cumulative total of grants received from the Government of Japan for such program was $60.9 million. At the end of 2003, a total of 1,621 scholarships have been awarded to recipients from 34 member countries.

Japan Fund for Poverty Reduction

The JFPR was established to support ADB-financed projects with poverty reduction and related social development activities on a grant basis in line with ADB's poverty reduction strategy. As of 31 December 2003, the Government of Japan's contribution to the JFPR amounted to about $302.4 million equivalent. At the end of 2003, ADB had approved 38 JFPR projects amounting to $116.0 million.

Japan Fund for Information and Communication Technology

The JFICT was established for a 3-year period to harness the potential of information and communication technology (ICT) and bridge the growing digital divide in the region. This fund will support ICT-related activities that can add substantive value to promote and impact the Poverty Reduction Strategy and other development objectives. As of 31 December 2003, the total contribution from the Government of Japan amounted to about $10.7 million.

Channel Financing Arrangements

The mobilization of official grant cofinancing plays a vital role in ADB operations. ADB mobilizes grant funds from external sources to support its technical assistance program and finance mostly soft components of loan projects. A majority of the grants for technical assistance are provided by bilateral donors under channel financing arrangements (CFAs). ADB acts as an administrator of the funds and applies its own guidelines and procedures on the recruitment of consultants, procurement, disbursement, and project supervision. To date, 152 technical assistance grants have been financed under CFAs totaling about $71 million.

In addition to the traditional type of CFA (which may be used for several sectors), the processing of thematic CFAs with bilateral agencies has risen sharply in the last couple of years in such areas as renewable energy, climate change, poverty reduction, governance, water, gender and development, and poverty and environment. Several thematic CFAs have been packaged as umbrella facilities to allow more than one donor to contribute.

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Regional

Afghanistan
* Australia
Azerbaijan
Bangladesh
Bhutan
Cambodia
China, People's Republic of
Cook Islands
Fiji Islands
Hong Kong, China
India
Indonesia
* Japan
Kazakhstan
Kiribati
* Korea, Republic of
Kyrgyz Republic
Lao People's Democratic Republic
Malaysia
Maldives
Marshall Islands
Micronesia, Federated States of
Mongolia
Myanmar
Nauru
Nepal
* New Zealand
Pakistan
Palau
Papua New Guinea
Philippines
Samoa
Singapore
Solomon Islands
Sri Lanka
Taipei,China
Tajikistan
Thailand
Timor-Leste
Tonga
Turkmenistan
Tuvalu
Uzbekistan
Vanuatu
Viet Nam

Nonregional

* Austria
* Belgium
* Canada
* Denmark
* Finland
* France
* Germany
* Italy
* Luxembourg
* Netherlands, The
* Norway
* Portugal
* Spain
* Sweden
* Switzerland
* Turkey
* United Kingdom
* United States

* OECD member

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