# Commercial Cofinancing and Guarantees

Asian Development Bank
Office of Cofinancing Operations
2003

# ABOUT ADB

The Asian Development Bank (ADB) is a development finance institution established in 1966 to foster the economic and social progress of its developing member countries (DMCs) in the Asia and Pacific region (the region). As of 31 December 2002, ADB had 61 members, of which 44 are from the region. ADB's headquarters is in Manila, Philippines.

ADB assists DMC governments and government-owned entities through its public sector window. Public sector financing modalities consist of direct loans, grant assistance, and credit enhancements. ADB also assists the private sector through direct lending, equity investments, and credit enhancements. Direct assistance to the private sector is normally made without government guarantee.

The financial resources ADB uses to fund its lending operations include (i) ordinary capital resources, comprising subscribed capital, reserves, and funds raised from international financial markets; and (ii) the Asian Development Fund (ADF), comprising contributions made by members, accumulated net income, and amounts previously set aside from paid-in capital. Loans from ADB's ordinary capital resources account for about 70% of cumulative lending, and are made to countries that have attained a more advanced level of economic development. Loans from ADF resources are offered on highly concessional terms, mainly to low-income countries.

ADB actively promotes cofinancing of its projects and programs to mobilize additional private capital and to achieve greater leverage from the use of its own limited resources. Cofinancing is mobilized from official sources and commercial sources, including commercial banks, institutional investors, and export credit agencies.

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# ABBREVIATIONS

| | |
|---|---|
| BOO | build-own-operate |
| BOT | build-operate-transfer |
| CFS | Complementary Financing Scheme |
| DMC | developing member country |
| ECA | export credit agency |
| IFC | International Finance Corporation |
| L/C | letter of credit |
| LIBOR | London interbank offered rate |
| OCO | Office of Cofinancing Operations |
| OCR | ordinary capital resources |
| ODA | official development assistance |
| OECD | Organisation for Economic Co-operation and Development |
| PCG | Partial Credit Guarantee |
| PRC | People's Republic of China |
| PRG | Political Risk Guarantee |
| PRI | political risk insurance |
| PSOD | Private Sector Operations Department |
| SME | small or medium enterprise |

**Notes**

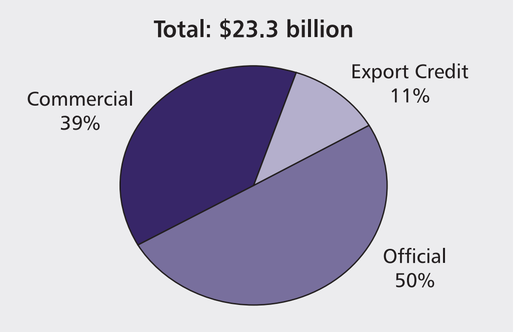
In this publication, "$" refers to US dollars. The term "country," as used in the context of ADB, refers to a member of ADB and does not imply any view on the part of ADB as to its sovereignty or independent status.

# INTRODUCTION

This booklet describes the strategy, policies, and financial instruments that form the basis of the commercial cofinancing and guarantee operations of the Asian Development Bank (ADB). It is primarily addressed to commercial lenders and related market institutions interested in participating in such operations.

Traditionally, cofinancing from official sources has accounted for the largest share of total ADB cofinancing. In recent years, however, official development assistance (ODA) to developing member countries (DMCs) has been declining, while cofinancing from commercial sources, including export credit cofinancing, has grown significantly. Over the last decade, commercial and export credit cofinancing amounted to $11.7 billion for 90 projects—50% of total cofinancing mobilized by ADB during the same period (*see chart*).

**Cumulative ADB Cofinancing by Source, 1993–2002**




ADB has made a concerted effort to modify and update its commercial cofinancing policies and products to enhance their effectiveness for DMC borrowers, commercial lenders, and project proponents.[1] This is in line with ADB's commitment to improve project quality and financial sustainability, and to increase the role of private capital in ADB-assisted projects and programs.

## Bridging the Financing Gap

For nearly all DMCs, achieving and sustaining an acceptable level of economic development requires large investments in key economic sectors. In most cases,

1 For example, ADB undertook a major review of its guarantee policies in 1999 and 2000, resulting in streamlining procedures and expanding the scope of guarantee operations

the funding requirements of such investments exceed the financing capacity of both the government and ODA providers (including ADB). In addition, the contribution of public sector funds to the total cost of these investments has declined in recent years. These factors have led to a gap in financing the necessary investments on which sustained growth depends.

ADB seeks to bridge the development financing gap in its DMCs by combining direct and indirect assistance. In the case of ADB's *public sector* projects and programs (for DMC governments and government-owned entities), direct assistance comprises loans and grants, while indirect assistance is mobilized by cofinancing from both official and commercial sources. As necessary, ADB uses its guarantees to facilitate commercial cofinancing of its public sector projects. In *private sector* projects, ADB assistance consists of direct loans and equity investments, and the use of credit enhancements to mobilize commercial cofinancing. Commercial cofinancing is thus an integral part of ADB's resource mobilization strategy, for both its public sector and private sector operations.

## ADB's Commercial Cofinancing Operations

The primary objective of ADB's commercial cofinancing operations is to assist DMC governments and private sector borrowers in securing commercial funds on suitable terms for ADB-assisted development projects. Commercial cofinancing is sourced from both domestic and international financial markets and, in the case of commercial debt, is supported by ADB's credit enhancement products as necessary.[2] The policies that guide ADB's commercial cofinancing and guarantee operations address the unique financing and risk mitigation requirements of DMC governments and commercial borrowers. These policies are applied in the context of the specific requirements of individual projects.

## For Additional Information

A separate publication, *Cofinancing–A Guide to ADB's Official and Commercial Cofinancing Operations*, is available from ADB's Office of Cofinancing Operations (OCO). In addition, OCO maintains updated profiles of commercial cofinancing opportunities on the ADB's web site at *http://www.adb.org*. These profiles identify commercial cofinancing and export credit components of

[2] In addition to debt, ADB's commercial cofinancing operations can be used to mobilize other types of funding as required (such as equity capital from institutional investors and grants from private sources).

ADB-assisted projects and provide details on the structure, amounts, and timing of such components.

Another source of information is OCO-arranged seminars and workshops at which prospective commercial cofinanciers may learn more about ADB's commercial cofinancing operations. Finally, OCO welcomes inquiries regarding cofinancing and related matters (see *Contact Information* at the end of this booklet).

# 1 COMMERCIAL COFINANCING: CONCEPTS AND STRATEGIES

## Cofinancing Defined

From ADB's perspective, cofinancing refers to incremental financial resources mobilized for ADB-assisted projects. Such resources are incremental to what the project sponsors provide. Cofinancing is, by definition, additional to any direct financing provided by ADB, the host government, and the project proponents.

Cofinancing is mobilized from both official and commercial sources. The main sources of commercial or "market" cofinancing consist of international and domestic commercial banks, insurance companies and institutional investors, as well as export credit agencies.

The predominant types of commercial cofinancing used to fund ADB-assisted projects include

- syndicated loans,
- floating rate notes,
- bond issues, and
- convertible debt.

Commercial cofinancing may also take the form of equity capital and private grant funding, depending on the financing needs of the project. However, ADB's credit enhancement products (e.g. guarantees and complementary financing scheme) are used exclusively to mobilize debt financing, not equity investments.

## Benefits of ADB's Commercial Cofinancing Operations

The main benefits of ADB's commercial cofinancing and guarantee operations are summarized below.

For DMC borrowers

- additional financial resources to close financing gaps and enable priority development projects to be realized,

- debt financing on the best possible terms resulting from the use of ADB's commercial cofinancing products, and
- ADB assistance in securing other types of financing (e.g., export credit) on favorable terms.

For cofinanciers

- enjoying benefits related to ADB's role as lender-of-record under the Complementary Financing Scheme or under the "guarantor-of-record" program;[3]
- mitigation of sovereign risk through ADB's Political Risk Guarantee;[3]
- comprehensive mitigation of risk through ADB's Partial Credit Guarantee;[3]
- access to ADB research and studies to help assess the scope for private sector participation in host countries, including commercial cofinancing and direct investments; and
- additional comfort from ADB's direct participation in all of its cofinanced projects.

## Cofinancing Arranged to Date

During 1970–2002, ADB arranged commercial cofinancing and export credit totaling $16 billion for 175 projects. Commercial cofinancing (including export credit) for both public and private sector projects has averaged $1.6 billion per year since 1998. This trend is expected to continue in the near term. (*See Appendix 1 for summaries of loan cofinancing, commercial and export credit cofinancing by recipient country and sector, and cofinanced projects receiving ADB guarantee support.*)

Since 1998, 11 DMCs have received commercial and export credit cofinancing totaling about $8.16 billion for 54 projects. The People's Republic of China (PRC) tops the list of recipients with about 57% of commercial and export credit cofinancing, followed by Thailand and the Philippines (*Table 1*).

As for the geographic origin of this cofinancing, during 1998–2002, ADB obtained funding from private sector institutions in 28 countries, with additional commercial and export credit cofinancing sourced through multilateral institutions such as the Multilateral Investment Guarantee Agency (*Table 2*).

[3] Each of these credit enhancement products is explained in more detail in subsequent sections of this booklet.

Table 1. **Leading Recipients of Commercial and Export Credit Cofinancing, by Country, 1998–2002[a]** *($ million)*

| Country | Recipient Total | No. of Projects | % |
|---|---|---|---|
| China, People's Republic of | 4,623 | 26 | 57 |
| Thailand | 950 | 1 | 12 |
| Philippines | 916 | 5 | 11 |
| Viet Nam | 598 | 8 | 7 |
| Pakistan | 476 | 3 | 6 |
| Sri Lanka | 255 | 5 | 3 |
| Bangladesh | 190 | 2 | 2 |
| India | 136 | 1 | 2 |
| Fiji Islands | 9 | 1 | 0 |
| Cambodia | 4 | 1 | 0 |
| Kazakhstan | 3 | 1 | 0 |
| **Total** | **8,160** | **54** | **100** |

[a] Includes cofinancing mobilized from domestic and foreign sources.

Table 2. **Commercial and Export Credit Cofinancing for ADB-Assisted Projects, by Country of Origin, 1998–2002[a]** *($ million)*

| Country of Origin | Amount | Country of Origin | Amount |
|---|---|---|---|
| Australia | 167 | Malaysia | 15 |
| Austria | 51 | Netherlands | 102 |
| Bahrain | 10 | Pakistan | 1 |
| Bangladesh | 80 | Singapore | 97 |
| Belgium | 93 | South Africa | 6 |
| Cambodia | 4 | Spain | 119 |
| Canada | 67 | Sri Lanka | 53 |
| China, People's Republic of | 4,112 | Switzerland | 41 |
| France | 428 | Taipei, China | 94 |
| Germany | 117 | United Arab Emirates | 6 |
| India | 136 | United Kingdom | 48 |
| Italy | 93 | United States of America | 92 |
| Japan | 576 | Viet Nam | 17 |
| Kazakhstan | 3 | MIGA | 120 |
| Luxembourg | 6 | Other Commercial Lenders | 1,386[b] |
| | | **Total** | **8,160** |

[a] For lenders in DMCs, cofinancing is primarily in the form of local currency debt.
[b] Including cofinancing from unidentified domestic banks arranged directly by the borrowers on a parallel basis, as well as ADB's guarantee products (political risk guarantee/partial credit guarantee).

## ADB's Role in Commercial Cofinancing

ADB plays an active role in identifying and arranging commercial and export credit cofinancing for its projects or programs. Examples of such assistance include

- sharing ADB's due diligence relating to proposed projects with prospective cofinanciers;
- formulating credit enhancement and risk mitigation structures to attract private sector participation;
- preparing invitations and soliciting financing offers from commercial/market sources;
- evaluating offers received; and
- mandating, negotiating, and documenting the cofinancing.

## ADB's Credit Enhancement Products

ADB currently uses three credit enhancement products to support commercial cofinancing:

- the Complementary Financing Scheme (CFS),
- the Political Risk Guarantee (PRG), and
- the Partial Credit Guarantee (PCG).

These credit enhancements, each of which is explained in more detail in subsequent sections of this booklet, are used only when necessary to mitigate risks associated with ADB-assisted projects or programs (i.e., risks which the "market" is unwilling or unable to undertake).

## ADB's Direct Participation Requirement

ADB's credit enhancement products are, in general, only used to support projects in which ADB has some direct participation. In public sector projects or programs, a direct ADB loan is generally required to meet this participation requirement. For private sector projects, ADB's participation typically consists of a direct loan and/or equity investment.

There is no fixed ratio between the amount of ADB's direct participation and the amount of commercial cofinancing. However, ADB seeks optimum leverage for its direct assistance whenever possible. For example, in the Philippines Power Sector Restructuring Program (a public sector operation approved in 1996), ADB initially provided a $300 million direct loan. This was augmented by an additional $500 million, yen-denominated commercial bond issue, supported by an ADB guarantee, approved in 2002. In the Meghnaghat Power Project in Bangladesh (a private sector project approved in 2000), ADB's debt financing package consisted of a $50 million loan from ADB's own resources, a $70 million loan from a syndicate of commercial banks under an ADB political risk guarantee, and another $20 million loan funded by the same syndicate of commercial banks under ADB's CFS.

*A list of recent ADB projects with commercial cofinancing supported by ADB's credit enhancements is in Table 3. Detailed information and illustrative examples pertaining to ADB's credit enhancement products are provided in subsequent sections of this booklet.*

## Cofinancing Strategies

ADB uses different strategies to mobilize private capital for ADB projects and programs. The objective in selecting a particular strategy is to achieve the most cost-effective means of financing and risk mitigation possible, including the best possible terms and conditions for the borrower. Where applicable, ADB seeks to achieve "fair" market value for any credit enhancement that it may provide. Ideally, ADB prefers to discuss cofinancing and structuring options with the borrower/sponsor at an early stage in the project cycle. The strategy ultimately agreed on is one that best balances the needs of the borrower with the requirements of the market.

For public sector projects and programs, a transparent, competitive process is used to select the underwriters/arrangers of commercial cofinancing. Financial institutions that have expressed interest in a particular transaction are invited to submit a commercial cofinancing proposal. ADB then assists and advises the borrower in evaluating such proposals. While pricing is an important criterion for selection, other criteria may also be considered, depending on the structure of the transaction.

For underwritten transactions, lead underwriters are chosen, and general syndication/selldown is normally arranged under their management, in consultation with the borrower and with assistance from ADB. For small transactions, ADB may act as the arranger.

Table 3. **Recent Commercial Cofinancing and Guarantee Transactions (1998–2002)**[1]

| Year | Country[2] | Project | Amount ($ million) | Term | Cofinancing[3] |
|---|---|---|---|---|---|
| 1998 | PRC | Fujian Pacific Electric Co. Ltd. | 150.0 | 12-year syndicated loan | ADB CFS loan |
| | | | 129.0 | 16-year export credit financing | COFACE and CESCE insured facilities |
| | | | 218.0 | 12-year syndicated loan | Commercial loan without credit enhancement |
| | | | 30.0 | 10-year syndicated loan | Commercial loan without credit enhancement |
| 1998 | SRI | Credit Enhancement | 65.0 | 10-year floating rate note | ADB PCG covering bullet repayment at maturity |
| | THA | Export Financing Facility | 950.0 | 5-year syndicated loan | ADB PCG covering principal and interest in first 3 years |
| | VIE | Nghi Son Cement Corporation Limited | 26.5 | 8.5-year syndicated loan | ADB CFS loan |
| | | | 30.0 | 10.5-year direct loan | IFC A loan |
| | | | 26.5 | 8.5-year syndicated loan | IFC B loan |
| | | | 54.6 | 12.9-year direct loan | JBIC (non-ODA) loan |
| | | | 101.3 | 12.9-year direct loan | JBIC (non-ODA) loan |
| 1999 | PRC | Chengdu Generale Des Eaux-Marubeni Waterworks Co. Ltd. | 21.5 | 12-year syndicated loan | ADB CFS loan |
| | PHI | Maynilad Water Services, Inc. | 126.0 | 12-year syndicated loan | ADB CFS loan |
| | | | 59.0 | 12-year syndicated loan | European Investment Bank |
| | | | 120.0 | 12-year syndicated loan | COFACE insured loan |
| 2000 | BAN | AES Meghnaghat Power | 20.0 | 10-year syndicated loan | ADB CFS loan |
| | | | 70.0 | 15-year syndicated loan | ADB PRG covering principal and interest that have fallen due according to agreed schedule but have not been paid by the borrower. |
| | | | 20.0<br>60.0 | 16-year senior loan<br>23-year subordinated loan | Commercial loans from IDCOL[4] without credit enhancement |
| | PAK | Small- and Medium-Size Enterprise Trade Enhancement Finance | 150.0 | L/Cs up to 360 days but may be extended up to 3 years on a case-to-case basis | ADB PRG cover in favor of international commercial banks that confirm import L/Cs |

Table 3. **Recent Commercial Cofinancing and Guarantee Transactions (1998–2002)[1]** *(continued)*

| Year | Country[2] | Project | Amount ($ million) | Term | Cofinancing[3] |
|---|---|---|---|---|---|
| | | | | | issued by Pakistani commercial banks at the request of eligible exporters |
| | PHI | North Luzon Expressway Rehabilitation and Expansion | 25.0 | 12-year syndicated loan | ADB CFS loan |
| | | | 55.0 | 13-year direct loan | EFIC insured loan |
| | | | 52.5 | 13-year syndicated loan | Commercial loan with MIGA cover |
| | | | 30.0 | 13-year syndicated loan | COFACE insured loan |
| | | | 45.0 | 13-year direct loan | IFC A loan |
| | | | 7.5 | | Commercial L/C facility |
| | SRI | AES Kelanitissa Power | 52.0 | 12-year syndicated loan | ADB PRG covering principal and interest |
| 2001 | SRI | Small- and Medium-Size Enterprise Sector Development Program | 90.0 | 10-year syndicated loan | ADB PCG on principal with government guarantee on interest |
| 2002 | VIE | Phu My 2.2 Power Project | 25.0 | 15-year syndicated loan | ADB PRG under the Co-guarantor Program |
| | | | 75.0 | 17-year syndicated loan | IDA Partial Risk Guarantee |
| | | | 50.0 | 15-year syndicated loan | COFACE political risk insurance |
| | | | 100.0 | 15-year direct loan | JBIC (non-ODA) loan |
| | | | 40.0 | 15-year direct loan | PROPARCO |
| | VIE | Phu My 3 Power Project | 32.0 | 13-year syndicated loan | ADB PRG on principal and interest, without government counterguarantee |
| | | | 43.0 | 13-year syndicated loan | MIGA guaranteed loan |
| | | | 95.0 | 13-year syndicated loan | NEXI insured loan |
| | | | 99.0 | 13-year direct loan | JBIC (non-ODA) loan |
| | PHI | Power Sector Restructuring Program | 500.0 | 18-year and 20-year JPY bond issue | ADB PCG with government counterguarantee |

Table 3. **Recent Commercial Cofinancing and Guarantee Transactions (1998–2002)[1]** *(continued)*

| Year | Country[2] | Project | Amount ($ million) | Term | Cofinancing[3] |
|---|---|---|---|---|---|
| | PAK | Financial (Nonbank) | 25.0 | 10-year syndicated loan | ADB PRG enhancing capital markets with government counterguarantee |
| | | | 175.0 | 10-year syndicated loan | ADB PRG to ensure availability of insurance cover with government counterguarantee |
| | | | 125.0 | 10-year syndicated loan | ADB PRG under the Co-guarantor Program |

1 In accordance with ADB policy, ADB had some form of direct participation (e.g., a direct loan or equity investment) in each of the projects listed in this table.
2 BAN = Bangladesh, PRC = People's Republic of China, IND = India, PAK = Pakistan, PHI = Philippines, SRI = Sri Lanka, THA = Thailand, and VIE = Viet Nam.
3 Refer to Notes section below for definitions of acronyms used in this table.
4 IDCOL, a financial institution owned by the Government, will fund its loans to the Project through existing credit lines from the World Bank, JBIC, and DFID.

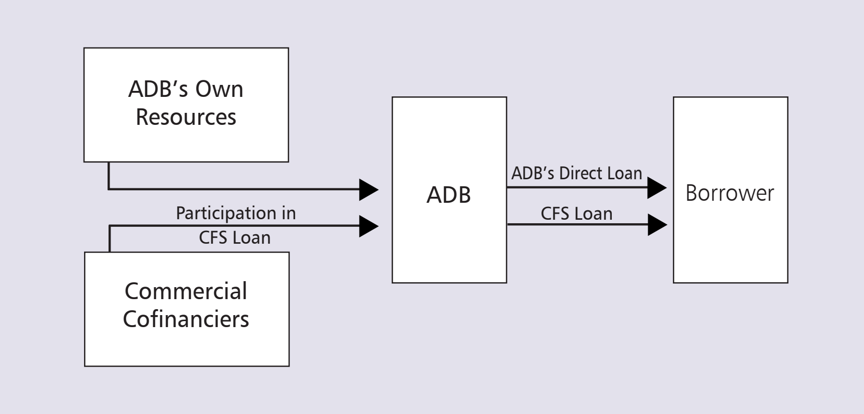
Note:

| | |
|---|---|
| CESCE | Compana Española de Seguros de Credito a la Exportacion |
| CFS | Complementary Financing Scheme |
| COFACE | Compagnie Francaise d'Assurance pour le Commerce |
| DFID | Department for International Development (United Kingdom) |
| EFIC | Export Finance and Insurance Corporation (Australia) |
| IDA | International Development Association |
| IDCOL | Infrastructure Development Co. Ltd. |
| IFC | International Finance Corporation |
| JBIC | Japan Bank for International Cooperation |
| MIGA | Multilateral Investment Guarantee Agency |
| NEXI | Nippon Export and Investment Insurance |
| PCG | Partial Credit Guarantee |
| PRG | Political Risk Guarantee |
| PRI | Political Risk Insurance |
| PROPARCO | Societé de Promotion et de Participation pour la Coopération Economique (France) |

# 2 COMPLEMENTARY FINANCING SCHEME

ADB's Complementary Financing Scheme (CFS) is a credit enhancement product that involves the prearranged sale to commercial lenders of participation in a cofinanced or "complementary" ADB loan without recourse to ADB for debt service.[4] The CFS is used solely to facilitate commercial cofinancing of ADB-assisted private sector projects. ADB is the "lender-of-record," since the complementary is made in ADB's name (*Figure 1*). *See Box 1 at the end of this chapter for an illustrative example of an ADB-assisted project that features CFS-supported commercial cofinancing*.

Figure 1. **The Complementary Financing Scheme**




## Benefits to Commercial Lenders Under CFS

Though funded by commercial lenders, the complementary loan receives the benefit of ADB's preferential status, since ADB acts as the lender-of-record. The complementary loan thus enjoys the same privileges and immunities as those applicable to ADB's direct loan, including

- exemption from restrictions on currency conversion and on the remittance of interest and repatriation of principal,
- exemption from withholding tax,

[4] Complementary loans are commonly referred to as "B-loans" to distinguish them from a multilateral institution's direct or "A-loan".

- reduced likelihood of rescheduling in the event of an external debt crisis in the borrowing country,
- exemption from special debt provisioning requirements in some countries, and
- benefits from linking the complementary loan with ADB's direct loan through an optional cross-default clause (*see Glossary*) .

Cofinanciers providing CFS loans also benefit from ADB's project appraisal, supervision, and loan administration services. Under the CFS, ADB acts as a channel for loan disbursements and debt service payments.

The maturities of CFS loans (for project finance transactions) typically vary from 7 to 8 years for industrial and manufacturing projects, and from 10 to 12 years for build-own-operate (BOO)/build-operate-transfer (BOT) infrastructure projects, which generally require longer-term financing.

## CFS Fees

For CFS loans, ADB charges market-based fees for its own account, as well as for the account of the participating institutions (CFS lenders). The fees are based on the estimated costs of arranging and administering the CFS loan, and on standard market practice (*Table 4*). The *arrangement fee* is a one-time front-end fee, and is fixed at the lower end of the normal range of such fees charged by international commercial banks for syndicated term loans. The *annual administration* fee covers the cost of CFS loan administration expenses.

Table 4. **CFS Fees Charged by ADB for Its Own Account**

| Fee | Amount |
|---|---|
| Arrangement | 75-100 basis points on the amount of the CFS loan, with a minimum of $20,000 |
| Administration | $5,000 per participating CFS lender per annum, with a maximum of $20,000 per annum per borrower. |

Participating CFS lenders normally charge a management fee (or front-end fee) and an annual agency fee. If the cofinancing is underwritten, the institutions involved may also charge an underwriting fee. These fees, which are market-based, are charged to the borrower.

## Eligibility

Any reputable financial institution can participate as a CFS lender, provided it operates commercially (i.e., it finances its loans from the market without government credit support or budgetary allocation). However, financial institutions are not eligible to participate in CFS transactions if their head offices are registered in the same country where the ADB-assisted project is located.

## Documentation

CFS documentation comprises

- a direct loan agreement between ADB and the borrower,[5]
- a complementary loan agreement between ADB and the borrower, and
- a participation agreement between ADB and the participating CFS lenders.

The relationship between a CFS lender and the borrower is indirect, although the borrower is informed of the identities of such lenders.

## Administration

As lender-of-record, ADB administers CFS loans on behalf of the participating CFS lenders with the same standard of care it exercises in loans for its own account. In matters of critical importance to CFS lenders, ADB does not act unilaterally, but instead seeks the lenders' views and consent prior to taking action, as specified in the participation agreement.

During 1970–2002, ADB arranged 39 CFS loans for 37 projects in 9 DMCs, for a total of $1.19 billion.

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[5] The direct ("anchor") loan fulfills ADB's "direct participation" requirement, making it possible to use the CFS to support commercial cofinancing.

### Box 1. **CFS Loan—Example**

Chengdu Generale Des Eaux-Marubeni Waterworks Co., Limited (PRC)

| | |
|---|---|
| Type | Complementary Financing Scheme ("CFS") |
| Borrower | Chengdu Generale Des Eaux-Marubeni Waterworks Co., Limited |
| Cofinanced Amount | $21.5 million |
| Term | 12 years |
| Syndicate | 7 commercial lenders |
| Total Project Financing | Debt: |

| | | |
|---|---|---|
| ADB Direct Loan | $ 26.5 million | (15 years) |
| ADB CFS Loan | 21.5 | (12 years) |
| EIB Direct Loan[1] | 26.5 | (12 years) |
| Subtotal Debt | 74.5 | |
| Sponsors' Equity | 31.9 | |
| **Total** | **$106.4 million** | |

| | |
|---|---|
| Use of Proceeds | Construction of a modern water supply plant in the People's Republic of China (PRC) with a capacity of 400,000 cubic meters per day to provide reliable water to nearly three million residents in the city of Chengdu. The plant will be transferred to the Government after 18 years. |
| Project Sponsors | Vivendi (France) and Marubeni Corporation (Japan) |
| Comments | The Project was the first pilot BOT water supply project in the PRC, the first Project financing to rely on municipal risk in the PRC, and the first private sector water project for ADB. The financing transaction won the "deal of the year" awards from *Project Finance International* and *Finance Intelligence Asia*. |

[1] Commercial banks provided the European Investment Bank (EIB) with a commercial risk guarantee.

# 3 THE POLITICAL RISK GUARANTEE

## Key Features

The Political Risk Guarantee (PRG) facilitates commercial cofinancing of ADB-assisted projects by guaranteeing payment of all or part of the project's debt service against specific political (or sovereign) risks. PRG coverage can include any combination of the following:[6]

- currency inconvertibility and/or nontransfer;
- confiscation, expropriation, nationalization, or deprivation of project assets;
- political violence, such as strikes or civil disturbances, including terrorism, sabotage, that negatively affects the project, and
- breach of contract, such as nondelivery by state-owned entities of project inputs (e.g., fuel supplies), or nonpayment for outputs (e.g., power or water).

PRGs are primarily designed to facilitate private sector development, either through public or private sector projects. (*Examples of projects with PRG support are in Boxes 2–4 at the end of this chapter.*)

PRGs are well suited to cases in which commercial lenders are prepared to take on the commercial (or credit) risks of a project, but require assistance from a multilateral institution or private insurer in mitigating political risks.

Since the political risks covered by a PRG relate to outcomes normally under the direct or indirect control of the host government, under certain circumstances the government may provide a guarantee to the project and or a counterguarantee (or indemnity) to ADB. This provides further assurance to cofinanciers and ADB of the host government's commitment to the project.

**Amount**. If the PRG is counterguaranteed by the host government, there is no limit on the amount of the PRG. For projects with PRG support for which there is no host government counterguarantee, ADB's total assistance may

[6] *Additional details concerning each of these areas of coverage are provided in the Glossary.*

be up to $150 million or 50% of project costs, whichever is less (with all ADB exposure calculated on a face value basis).[7]

**Fees**. The PRG fee structure has three components: (i) a front-end fee, (ii) a standby fee, and (iii) a guarantee fee. The amount of each of these fees is determined separately for each PRG by ADB's Guarantee Committee. The front-end fee covers due diligence and other up-front costs. The standby fee applies to the amount of cofinancing covered by the PRG that has not yet been disbursed.[8] The guarantee fee is usually charged as a percent per annum on the amount to be covered (normally comprises the principal outstanding and the amount of accrued interest). The level of guarantee fee depends on the perceived level of the risks covered, and on whether or not the PRG is counterguaranteed by the host government. If the PRG is counterguaranteed, ADB charges a guarantee fee of 0.40% per annum on the guaranteed amount. If the PRG is not counterguaranteed, the guarantee fee is charged at market rates.

## Cooperation with Political Risk Insurers

ADB's PRG can be structured to make it compatible with the Political Risk Insurance (PRI) products offered by other agencies, including the World Bank's Multilateral Insurance Guarantee Agency, private sector PRI providers, and export credit agencies (ECAs). Because of the size of some projects requiring PRI cover (particularly large infrastructure projects), and in recognition of the importance of risk sharing and collaboration, ADB can offer its PRG in parallel with other PRI providers, as described below.

**Parallel PRG Coverage**. Under this arrangement, public and private PRI providers offer PRI to the same project alongside or in parallel with ADB, under their respective names, terms, and conditions. This arrangement benefits PRI providers that (i) do not need the benefits of ADB's preferential status or "umbrella" and (ii) offer insurance, rather than guarantees, on terms that cannot be easily reconciled with those of ADB's PRG.

**ADB as Guarantor-of-Record**. Under this arrangement, ADB issues a guarantee for the entire amount of coverage requested by the borrower, but retains

7 The proportion between ADB's direct participation (e.g., in the form of a loan and/or equity investment) and PRG support is determined on a project-by-project basis, with a view to appropriately leveraging the PRG support.
8 For PRGs with counterguarantee, the standby fee is included in the guarantee fee.

only a portion of the exposure under the guarantee for its own account. The remaining exposure is underwritten by private sector PRI providers. ADB is the guarantor-of-record for the entire amount covered but assumes liability only for the portion retained for its own account. Thus, private sector PRI providers under a guarantor-of-record structure enjoy the same privileges and immunities as those applicable to ADB's PRG.[9] Recoveries, if any, are shared between ADB and the other PRI providers on a pro rata basis.

To cover the administrative expenses incurred in structuring each transaction and to compensate ADB for "fronting" the other PRI syndicate participants, ADB will charge an administration fee. This fee will be determined by ADB on a case-by-case basis.

The PRG collaboration structures described above enable project proponents to utilize PRI cover from multiple providers, thus facilitating projects that, without a sufficient amount of PRI cover, might not go forward. The host government can also take comfort in having a multilateral institution such as ADB involved in the project, to help ensure, inter alia, the technical and financial viability of the project. Project lenders benefit from the increased PRI cover in more difficult and challenging markets, while enjoying the comfort of an ADB guarantee, coupled with ADB's direct participation in the project.

9 Privileges and immunities of ADB's PRG include exemption from restriction on currency conversion and currency remittance, and exemption from withholding tax.

## Box 2. **Political Risk Guarantee—Example 1**

**AES Kelanitissa (Private) Limited (Sri Lanka)**

| | |
|---|---|
| Type | Syndicated loan supported by ADB Political Risk Guarantee |
| Borrower | AES Kelanitissa (Private) Limited |
| Cofinanced Amount | $52 million |
| Term | 12 years |
| Guarantee Coverage | The PRG covers breach of contract by the Government of Sri Lanka under the implementation and other agreements, including payment obligations relating to currency convertibility and transfer risk, expropriation and confiscation, change of law and events, which make project agreements unenforceable, and breach of fuel supply and power purchase agreements. |
| Counterguarantor | Sri Lanka |
| Syndicate | Fully underwritten by Australia and New Zealand Banking Group Limited |
| Project Financing | Debt: |

| | |
|---|---|
| Debt: | |
| ADB Direct Loan | $ 26.0 million |
| Cofinanced Loan under PRG | 52.0 |
| Subtotal Debt | 78.0 |
| Equity: | |
| AES Corporation | 24.0 |
| Hayleys Limited | 2.0 |
| Subtotal Equity | 26.0 |
| **Total** | **$104.0 million** |

| | |
|---|---|
| Use of Proceeds | Construction and operation of a 163-megawatt diesel-based combined-cycle power station. |
| Remarks | ADB's PRG support is expected to enable the borrower to mobilize long-term (12-year) debt of $52 million from commercial cofinanciers at significantly better terms than it could achieve on its own credit. |

## Box 3. **Political Risk Guarantee—Example 2**

**SME Trade Enhancement Finance (Pakistan)**

| | |
|---|---|
| Type | ADB Political Risk Guarantee facility guaranteeing payment to international banks confirming letters of credit (L/Cs) issued by Pakistani banks to finance imports of intermediate goods for eventual export. |
| Guarantee Coverage | The PRG covers 100% of the obligations under each eligible L/C, provided that failure to pay by the issuing bank is caused by<br>■ currency inconvertibility or transferability blockage, or<br>■ other agreed political risk events directly affecting payment. |
| Counterguarantor | Pakistan |
| PRG Facility Amount | Aggregate value of all L/Cs guaranteed under the Facility not to exceed $150 million. |
| Facility Agent | Standard Chartered Bank (Dubai) was competitively selected as Facility Agent.[1] It acts as a conduit between ADB and the confirming banks in administering and helping promote the Facility in Pakistan and overseas. |
| Availability Period | Six years. During the availability period, new eligible L/Cs may replace the L/Cs that have matured. L/Cs may have a term of up to 360 days, but may on a case-by-case basis have a term of up to 3 years. |
| ADB Direct | Loan—$150 million to Pakistan for Foreign Currency Export Facility |
| Participation | Equity—$2 million invested in Pakistan Export Finance Guarantee Agency Ltd. |
| Rationale for ADB Guarantee Support | At times of political uncertainty, offshore suppliers that sell much-needed imports to Pakistan have encountered difficulties in obtaining confirmation of L/Cs issued by Pakistani banks, or have done so at an exceptionally high cost. The PRG effectively mitigates Pakistan country risk, thus helping keep Pakistan country limits open for international banks confirming import L/Cs issued by Pakistani banks during periods of political and economic uncertainty. The Facility should ensure that Pakistani exporters have continued access to trade finance and effectively reduce the cost of imports for export production, thus enabling Pakistani exporters to compete on terms similar to those of their international competitors (without being penalized unduly for Pakistan's country risk). |

[1] http://www.standardchartered.com/pk/cib/adb/prg_main.html is the web site of the Facility hosted by Standard Chartered Bank.

### Box 4. **Political Risk Guarantee--Example 3**

**Phu My 2.2 Power Project (Viet Nam)**

| | |
|---|---|
| Type | Political Risk Guarantee (PRG) under the Coguarantee Program (CP) |
| Borrower | Mekong Energy Company Ltd. (MECO) |
| Cofinanced Amount | $25 million, under ADB's PRG coverage |
| Term | 15 years |
| Syndicate | Arranged by ANZ, Singapore Branch; Societe Generale Asia Ltd. and Sumitomo Mitsui Banking Corporation with ANZ London Branch as the Facility Agent |
| Guarantee Coverage | PRG provides against confiscation, expropriation and nationalization; currency inconvertibility and nontransferability; political violence and breach of contract. |
| Project Financing | Debt: |

| | |
|---|---|
| ADB Direct Loan | $ 50.0 million |
| Cofinanced Loan under ADB PRG | 25.0 |
| Cofinanced Loan under IDA PRG | 75.0 |
| JBIC | 150.0 |
| PROPARCO | 40.0 |
| Subtotal Debt | 340.0 |
| Equity: | |
| Sponsors | 140.0 |
| **Total** | **$480.0** |

| | |
|---|---|
| Use of Proceeds | Construction and operation of a 163 megawatt auto diesel-based combined-cycle power station. |
| Project Sponsors | Electricité de France International; Sumitomo Corporation; and Tokyo Electric Power Company International BV |
| Comments | This was the first PRG in which ADB acted as guarantor of record on behalf of a private PRI provider. The PRG was provided without the host government counterguarantee. The transaction was awarded "Project Finance Deal of the Year" by *Finance Asia* and *AsiaMoney* and "Asian Power Deal of the Year" by *Project Finance.* |

# 4 THE PARTIAL CREDIT GUARANTEE

## Key Features

Under the Partial Credit Guarantee (PCG), ADB provides comprehensive coverage to commercial cofinanciers of all commercial and political risks for a specified portion of a borrower's debt service obligation. PCGs can be used to support commercial cofinancing of both public and private sector projects. Depending on the requirements of the project, the PCG can be used to guarantee various debt instruments. For example, it can be used to guarantee part of the debt service under a syndicated loan, or under a floating rate note or bond, provided these are issued for financing the ADB-assisted project. (*Boxes 5–7 at the end of this chapter illustrate the PCG coverage*.)

PCGs are often used to guarantee debt service during the later maturities of a commercial cofinancing. This may be appropriate when lenders are not willing or able to provide a financing term long enough to match the cash flow of a project. Alternatively, PCGs can guarantee a portion of principal and interest payments payable throughout the term of a borrowing.

Consistent with ADB's policy of risk-sharing with cofinanciers, the PCG is designed to cover that portion of the debt service that the cofinanciers are not prepared to take, leaving the remaining portion to the cofinanciers on an uncovered basis.

Given the Asia Pacific region's evolving financial needs and changing risk perceptions, ADB has increased emphasis on using the PCG to support *local currency* cofinancing. This is consistent with ADB's strategy of developing local capital markets and helping project sponsors reduce the foreign exchange risks associated with cross-border loans requiring debt service in currencies different from those of the cash flow of the project.

**Amount**. There is no limit on the amount of PCGs for *public sector* projects or programs; however, all public sector PCGs must have a host government counterguarantee. For *private sector* projects that have no host government counterguarantee (or indemnity), ADB's single project exposure limit (comprising direct lending, equity investment, PCG support, or underwriting commitment) is $75 million, or 25% of project costs, whichever is less.[10]

**Fees**. For public sector PCGs, ADB charges a standard 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. For private sector PCGs, both the guarantee fee and the front-end fee are charged at market rates.[11]

Box 5. **Partial Credit Guarantee—Example 1**

**Export Financing Facility (Thailand)**

| | |
|---|---|
| Type | Syndicated loan supported by ADB Partial Credit Guarantee |
| Borrower | Export-Import Bank of Thailand |
| Cofinanced Amount | $950 million |
| Term | 5 years |
| Guarantee Coverage | The PCG covers principal and interest due for years 1 to 3, with extension to year 4 if Thailand is rated below BBB/Baa2. |
| Counterguarantor | Thailand |
| Syndicate | 68 commercial lenders (from Asia, Europe, and North America) |
| Project Cost | $1 billion (including $50 million ADB direct loan) |
| Use of Proceeds | Onlent to export-related enterprises in Thailand |
| Remarks | This was the first term financing arranged for Thailand following the onset of the Asian financial crisis in July 1997. The success of the loan and the impressive amount raised acted as a catalyst for subsequent post-crisis commercial lending to Thailand. |

10 In calculating this limit, ADB's direct lending and/or equity exposure is equal to the *face value* of the commitment, while PCG exposure is calculated based on the *present value* of the PCG guarantee obligation.

11 In the case of PCGs for private sector projects that have a host government counterguarantee, the guarantee fee and front-end fees payable to ADB are the same as for public sector PCGs.

### Box 6. **Partial Credit Guarantee—Example 2**

**Credit Enhancement Facility for Private Enterprises (Sri Lanka)**

| | |
|---|---|
| Type | Floating Rate Note (FRN) supported by ADB Partial Credit Guarantee |
| Borrower | DFCC Bank |
| Cofinanced Amount | $65 million |
| Term | 10 years |
| Guarantee Coverage | The PCG covers repayment of principal at final maturity. The Government of Sri Lanka guaranteed interest. |
| Counterguarantor | Sri Lanka |
| Syndicate | 9 financial institutions |
| Project Cost | $70 million (including $5 million ADB direct loan) |
| Use of Proceeds | Onlent to commercial clients by DFCC Bank |
| Remarks | This issue set a milestone as the longest financing tenor achieved by Sri Lanka in the capital markets. Investors received added comfort through a cross-default clause (between the FRN and ADB's direct loan), a sinking fund, and ADB's monitoring of DFC Bank's performance. |

### Box 7. Partial Credit Guarantee—Example 3

**Power Sector Restructuring Program (Philippines)**

| | |
|---|---|
| Type | Fixed Rate Yen Bond Cofinancing supported by ADB Partial Credit Guarantee (PCG) |
| Borrower | Power Sector Assets and Liabilities Management Corporation (PSALM) |
| Cofinanced Amount | Up to $500 million equivalent in Japanese yen bonds |
| Term | Two tranches of 18 and 20 years |
| Guarantee Structure | ADB PCG will cover 100% of the repayment of the principal at final maturities, plus partial coverage of up to 10 years of the back-end interest coupons.Republic of the Philippines guarantee will cover 100% of the repayment and interest payments of the bond through direct guarantee. |
| Counterguarantee | Republic of the Philippines (ROP) |
| Use of Proceeds | To meet the cash flow requirements during the initial stage of privatization. |
| Comments | ADB's PCG was vital for the successful execution of PSALM bond issue at the end of 2002, when world capital markets were very volatile. With the PCG, PSALM was able to borrow at significantly more favorable terms to extend the term by 11–13 years over an ROP stand-alone bond issue. This transaction was the largest-ever bond issue assisted by an ADB PCG. |

# 5 EXPORT CREDIT

Export credit cofinancing for both public and private sector projects is an important element of Asian Development Bank's (ADB) commercial cofinancing operations. The demand for export credit in Asia and the Pacific has shown steady growth, due in large part to the funding requirements of capital-intensive infrastructure projects, coupled with a reduced appetite on the part of commercial lenders for uncovered term financing in the period following the financial crisis.

While ADB's credit enhancement products—the Complementary Financing Scheme, Partial Credit Guarantee, and Political Risk Guarantee—provide valuable "cover" to commercial cofinanciers, export credit agencies (ECAs) can also provide significant risk mitigation.

Export credit is typically provided by ECAs either

- directly, as a loan, with repayment terms generally from 2 to 10 years, subject to the OECD Arrangement,[12] or
- indirectly, as insurance or a guarantee provided by an ECA to support a commercial loan.

Export credit usually comes in the form of a *buyer credit*, whereby credit is provided directly to the importer or buyer to fund the purchase of exported goods or services primarily from the country where the ECA is located. Export credit can also be extended through a *supplier credit*, whereby a supplier makes a sale based on deferred payment, with export credit insurance protecting the supplier (or its commercial bank) against the buyer's failure to meet its payment obligations when they become due.

Export credit is often part of a project finance package put together by a structured trade or project finance unit of a commercial bank. The mandate of most ECAs is to fill a financing "gap" and cover the risks that the commercial market is not willing to take.

[12] An agreement among the member countries of the Organisation for Economic Co-operation and Development that regulates export credit terms.

## Collaboration with ECAs in Public Sector Projects

To tap this important source of cover, and to assist public sector borrowers in obtaining affordable and competitive commercial cofinancing, ADB has in recent years strengthened its collaboration with leading OECD and non-OECD ECAs. In addition, ADB has explained the benefits of ECA support in its ongoing policy dialogue with developing member countries (DMC) governments and their executing agencies. The key features of intensified collaboration between ADB and ECAs are described below.

**Early Project Identification**. At the earliest stages of formulating its public sector projects, ADB seeks to identify those that may require a significant amount of imported capital equipment and/or services that would be eligible for export credit. Such projects and their export credit possibilities are listed in ADB's *Project Profiles for Commercial and Export Credit Cofinancing*, which is available on the ADB web site at http://www.adb.org/Documents/Profiles/Cofinancing. By identifying such projects and export credit possibilities early, procurement packaging and the financing plan can incorporate export credit cofinancing.

**Two-Bid Procedure.** Under this procedure, bid invitations for contracts eligible for export credit require the submission of two separate bids:

- a *commercial/technical bid* with a cash price, excluding any finance charges (to avoid any cross subsidy), and
- a *financial bid*, including either a supplier or a buyer credit finance package that may, at the bidder's option, include ECA cover or acceptable evidence of ECA support should the bidder be successful.

The bid invitations normally specify that the financial bid should comply with the applicable OECD terms as a minimum requirement.

**Advance Notice to ECAs**. When bid invitations are sent out, ADB notifies interested ECAs and provides them with summary project information. This allows ECAs with proactive marketing mandates to contact potential suppliers at an early stage, to help them develop their supplier/buyer credit finance package, or simply to provide them with indicative evidence of support. ADB and the borrower normally attach to the bid invitations an information memorandum based on ADB's due diligence up to that time, plus an invitation to suppliers, their banks, and ECAs to contact ADB's Office of Cofinancing Operations if they have any questions regarding the finance package requested.

From time to time, ADB contacts ECAs to determine their interest in, and pricing for, a transaction at or before the time invitations are sent out. However, firm quotes are not requested at this time.

**ADB Support of 15% Deposit Finance**. If warranted, ADB may provide support in arranging commercial financing to fund the 15% deposit required for most supply contracts, which is normally not eligible for export credit according to the OECD Arrangement. This support, if provided, is typically in the form of a Partial Credit Guarantee (PCG) to the commercial lender. ADB's PCG support is provided under separate documentation, in parallel with the ECA-supported tranche. ADB's support of the 15% deposit finance may not be offered in certain circumstances, particularly when the transaction requires additional self-financing by the borrower.

**Economy and Efficiency in Procurement**. ADB-financed contracts and cofinanced contracts with ECA cover are bid separately to allow different procurement procedures. While procurement under ADB's direct loan must follow ADB's procurement guidelines (which generally require international competitive bidding), procurement under contracts supported by export credit for ADB-assisted public sector projects will generally follow the two-bid procedure described above to ensure transparent competition among suppliers from as many countries as possible. Accordingly, under ECA financing, borrowers may retain the option of requesting revised commercial/technical bids and financial bids.

**ADB's Role during Negotiations**. ADB may act as a facilitator between the public sector borrower, the supplier, its banks, and the ECAs. ADB recognizes that ECAs and their lenders continue to have different export credit programs and work under different legal systems. Accordingly, ADB works with existing export credit documentation and does not try to impose a standardized form of documentation on the ECA-covered cofinancing.

## Collaboration with ECAs in Private Sector Projects

Mindful of the Private Sector Development Strategy, approved March 2000, which highlighted the importance of private sector-led growth to the region and how ADB can help create the enabling environment for such growth, ADB is now working very closely with OECD and non-OECD ECAs in mobilizing much needed project finance for ADB-assisted private sector projects. *(An example of ADB and ECA cooperation to finance a private sector infrastructure project is shown in Box 8.)* The objective of such cooperation, in which ADB and ECAs use their respective credit enhancement and/or insurance products, is to achieve cost-effective financing structures that mitigate risks, suit the cash flow requirements of individual projects, and promote economic development in DMCs.

## Box 8. **Export Credit Cofinancing—Example**

**North Luzon Expressway Rehabilitation and Expansion Project (Philippines)**

| | |
|---|---|
| Type | Export Credit |
| Borrower | Manila North Tollways Corporation |
| Cofinanced Amount | $137.5 million |
| Term | 13 years |
| Project Financing | Debt: |

| | |
|---|---|
| ADB Direct Loan | $ 45.0 million |
| ADB CFS Loan | 25.0 |
| IFC Loan | 45.0 |
| MIGA Guarantee [2] | 52.5 |
| Export Credit (EFIC, Australia) | 55.0 |
| Export Credit (COFACE, France) [1] | 30.0 |
| L/C Facility | 7.5 |
| Subtotal Debt | $260.0 million |
| Equity: | |
| Sponsors | 117.5 |
| **Total** | **$377.5 million** |

| | |
|---|---|
| Use of Proceeds | Rehabilitation, expansion, and operation of the existing North Luzon Expressway, including the construction and/or rehabilitation of 14 interchanges, 24 bridges, and 31 overpasses from Manila to Clark Special Economic Zone. |
| Project Sponsors | (i) First Philippine Infrastructure Development Corp., (ii) Egis Projects S.A., France, and (iii) Philippine National Construction Corporation. |
| Remarks | Cofinancing for this project was supported by the Australian and French ECAs along with political risk insurance from MIGA, and ADB's CFS. The CFS tranche augmented direct loans from ADB, IFC, and others. This financing was arranged during a period of uncertainty in the Philippines and presented a unique opportunity for ADB and its cofinanciers to provide necessary assistance. |

CFS = Complementary Financing Scheme, COFACE = Compagnie Francaise d'Assurance pour le Commerce, ECA = export credit agency, EFIC = Export Finance and Insurance Corporation, IFC = International Finance Corporation, L/C = letter of credit, MIGA = Multilateral Investment Guarantee Agency.

1 With insurance cover.
2 Consisting of political risk cover.

# 6 QUESTIONS AND ANSWERS

***What are the prerequisites for project sponsors and their bankers to obtain Asian Development Bank's (ADB) cofinancing for their projects? How and when should they discuss the matter with ADB?***

Cofinancing is possible only if ADB directly assists the project with a loan, an equity investment, or both. Private sector sponsors and their bankers should discuss the scope for ADB participation with ADB's Private Sector Operations Department (PSOD) at the earliest possible stage of project development (*see Contact Information for PSOD at the end of this booklet*). Once PSOD decides to process an ADB loan and/or equity investment for a project, the Office of Cofinancing Operations will assist in making the necessary cofinancing arrangements. The sooner a project sponsor ascertains ADB interest, the better.

***How does ADB inform potential cofinanciers of projects that require cofinancing?***

The ADB web site (*http://www.adb.org*) provides project profiles of current commercial cofinancing and export credit opportunities. These profiles can be accessed by clicking on the "Opportunities" tab in the web site and scrolling down to the section entitled "Cofinancing." The profiles are also available in hard copy in *ADB Business Opportunities* (a monthly publication sold through ADB's Office of External Relations), under the section entitled *Project Profiles for Commercial and Export Credit Cofinancing*. ADB's Office of Cofinancing Operations may also be consulted concerning projects with cofinancing potential (*see Contact Information at the end of this booklet*).

***How should potential commercial cofinanciers express their interest in cofinancing a particular project?***

They should review ADB's web site and/or *ADB Business Opportunities* regularly, and communicate their interest in cofinancing particular projects to ADB's Office of Cofinancing Operations through fax, telephone, or e-mail (*see Contact Information at the end of this booklet*).

***How are commercial cofinanciers selected?***

The selection or "mandating" process varies, depending on the nature of the project, the preferences of the borrower, and market conditions. For small- or medium-sized cofinancing transactions, ADB may act as the lead arranger and invite potential cofinanciers to participate in the syndication.

For complex or large transactions with ADB credit enhancement support, ADB normally assists the borrower in selecting one or more financial institutions through competitive bidding to underwrite and/or arrange the proposed cofinancing. In such cases, ADB may also work closely with the arrangers and assist in the general syndication as required.

### *Will ADB consider a stand-alone guarantee or CFS loan?*

No. A guarantee or Complementary Financing Scheme (CFS) loan will be considered only for a project in which ADB has some direct participation. In the case of a guarantee, ADB's direct participation could take various forms (e.g., a direct loan or an equity investment). In the case of CFS, an ADB direct loan is always required.

### *Is there any limit on the amount of ADB guarantee support?*

There is no limit on ADB guarantees for public or private sector projects that are backstopped by a host government counterguarantee. For public sector projects, a host government counterguarantee is a prerequisite for any ADB guarantee support.

For private sector projects for which there is no host government counterguarantee, the limits on ADB assistance (comprising direct participation and guarantee support) are as follows.

> *Political Risk Guarantee*: $150 million or 50% of project costs, whichever is less (with all ADB exposure calculated on a face value basis). The proportion between ADB's direct participation (e.g., in the form of a loan and/or an equity investment) and PRG support is determined on a project-by-project basis, to appropriately leverage the PRG support.
>
> *Partial Credit Guarantee*: $75 million or 25% of project costs, whichever is less, corresponding to ADB's Private Sector Operations prudential limit. (ADB's total exposure is calculated based on the *face value* of any direct debt or equity participation plus the *present value* of any PCG exposure.)

### *Do ADB's procurement guidelines apply to CFS loans or loans with ADB guarantees?*

No. However, ADB requires that (i) procurement financed from the proceeds of a commercial cofinancing benefiting from ADB credit enhancement (either in the form of CFS or guarantee support) be restricted to ADB members, (ii) the proceeds of such cofinancing be used exclusively for the project, and (iii) the procurement be carried out with due attention to economy and efficiency.

### *Can private sector PRI cover a CFS loan?*

ADB welcomes close collaboration with private sector political risk insurance (PRI) providers, recognizing that they are an important source of risk-taking capacity and bring significant experience and skills in structuring projects and mitigating associated political risks. A CFS loan can assist participating lenders in mitigating political risk relating to currency inconvertibility and currency nontransfer. However, other facets of political risks such as (i) confiscation expropriation and nationalization, (ii) political violence, and (iii) breach of contract are beyond the scope of CFS. Accordingly, ADB generally has no objection to commercial lenders in a CFS loan purchasing PRI cover only for those three specified risks that are explicitly outside the benefits pertaining to CFS, as mentioned above.

# GLOSSARY

**Breach of Contract** Refers to one of the coverages offered under the Asian Development Bank's (ADB) Political Risk Guarantee. This coverage is against losses arising from a host government's breach or repudiation of a contract with the owner of an insured project. For example, for a power project, such a breach may result from failure by a government-owned entity to make payments in accordance with the power purchase agreement between the independent power producer and the user or distributor. For a toll road project, such a breach may result from a government entity failing to comply with the agreed increase in toll levels. In the event of an alleged breach or repudiation, the investor or project company must normally be able to invoke a dispute resolution mechanism (e.g., arbitration) in the underlying contract and first obtain an award for damages. If, after a specified time, the investor is unable to implement the outcome of the dispute resolution mechanism, or if the dispute resolution mechanism fails to function because of actions taken by the host government, a Political Risk Guarantee may be called upon to pay compensation.

**CEND** Refers to *confiscation, expropriation, nationalization,* and *deprivation* coverage. This coverage is an important element of the cover offered under ADB's PRG. ADB's CEND coverage is designed to protect an offshore lender when a host government interferes with the investor's fundamental ownership rights. This may be a direct seizure of an asset, such as fixed investments or plant and equipment. It may also be an action or a series of actions, the net effect of which is expropriatory (referred to as "creeping expropriation"). Examples include the imposition of punitive or selective taxes that make a venture commercially unviable, wrongful termination of operating licenses, or refusal to grant visas to foreign managers critical to running the operation.

**CI** Refers to *Currency Inconvertibility* and/or *nontransfer* coverage offered under ADB's Political Risk Guarantee. CI coverage is intended to ensure that debt service payments (principal and interest) from an insured project are remitted or repatriated promptly from a host country and at prevailing rates. The conversion of convertible local currency into foreign currency, and the transfer of that currency out of the host country are covered for both "active blockage" (whereby a local law prevents conversion or transfer) and "passive blockage" (in which excessive delays in processing a request to convert or transfer currency by the governing monetary authority prevent repatriation). The amount of currency that could not be converted or transferred is the subject of the coverage. CI coverage does not protect against currency fluctuation, devaluation, or any pre-existing restrictions on conversion or transfer. If an investor applies to convert local currency into foreign currency and the host government's central bank not only fails to convert the currency in a predefined time, but also refuses to return the local currency to the investor, the investor would not be able to file a CI claim. In such a case, the currency will have been effectively expropriated. For this reason, CI coverage is almost always purchased in conjunction with expropriation (CEND) coverage.

**Complementary Financing Scheme (CFS)** A credit enhancement arrangement under which ADB, in addition to a direct loan from its own resources, makes a complementary (CFS) loan on market-based terms,[13] funded entirely by market institutions without recourse to ADB. Under this arrangement, the participating lenders enjoy certain benefits resulting from ADB's preferential status. In return for such benefits, the participating institutions are able to provide financing on more favorable terms.

**Cross-Default Clause** In ADB loan agreements, this clause provides that a default under other loans to the same borrower may trigger a default on ADB's loan. ADB retains the option of either declaring its loan immediately due and payable or seeking other remedies.

**Export Credit** Term finance provided by export credit agencies, either through a guarantee to commercial lenders or direct credit to borrowers. Direct credit may either be buyer's credit or supplier's credit. Export credit is usually provided as medium-term finance to supplement private sector resources, and is generally used to promote the export of capital equipment for relatively large-scale projects.

[13] Complementary loans are commonly referred to as "B-loans", to distinguish them from a multilateral lender's direct or "A-loan".

**Guarantee** A written undertaking by a guarantor to pay a stated amount to a beneficiary if the borrower fails to meet certain commitments, such as the payment of principal or interest. If a guarantee covers part of the debt service, and covers all events of nonpayment, ADB refers to it as a "partial credit guarantee." If it covers specific political risks, it is called a "political risk guarantee." In the case of a political risk guarantee, the guarantee is callable only if the default in payment of debt service is due to one of the specific risks covered.

**Joint Financing** A method of cofinancing in which the goods and services required for a particular project are financed on a pro rata basis by ADB and the cofinancier. Procurement of goods and services is governed by ADB's *Guidelines for Procurement*. Accordingly, this arrangement may only be used if the funds provided by the cofinancier are untied.

**Parallel Financing** A method of cofinancing in which a project is divided into specifically defined packages of components. Each package is financed separately, either by ADB or a cofinancier. This arrangement is generally used when a cofinancier requires that procurement be tied to the goods and services of a particular country, or that procedures different from those ADB be applied. Under this arrangement, the cofinancier administers its own financing.

**Political/Sovereign Risks** are under the control of a government. They vary depending on the circumstances and perceptions of project participants. Such risks typically include (i) confiscation, expropriation, nationalization, and deprivation (CEND), (ii) currency inconvertibility and/or nontransfer (CI), (iii) political violence, and (iv) breach of contract. ADB's Political Risk Guarantee and many political risk insurance policies provide cover against these risks (*each of which is further described under separate headings in this Glossary*).

**Political Violence** Refers to one of the coverages offered under ADB's Political Risk Guarantee. It includes cover for physical damage to an asset (held as security for a loan) as a result of politically motivated strikes, riots, civil commotion, terrorism, sabotage, war, and/or civil war. While standard construction and property insurance can cover losses due to strikes, riots, and civil commotion, damages due to war, terrorism, and sabotage are usually excluded. Political violence coverage usually applies to the lesser of repair, replacement, or fair market value. In addition, coverage for business interruption may be available for net profit lost, and compensates for defaults caused by political violence.

# APPENDIXES

Appendix 1:

# TABLES

Table 1: **Summary of Loan Cofinancing, 1970–2002** *($ million)*

| Year | Cofinancing | | | | | | | | ADB Loan Amount |
|---|---|---|---|---|---|---|---|---|---|
| | Official | | Commercial | | Export Credit | | Total | | |
| | No. of Projects | Amount | No. of Projects | Amount | No. of Projects | Amount | No. of Projects | Amount | |
| 1970–1979 | 64 | 1,474 | 5 | 22 | 5 | 87 | 69 | 1,583 | 1,608 |
| 1980–1989 | 181 | 5,351 | 37 | 1,180 | 20 | 1,113 | 217 | 7,644 | 9,545 |
| 1990 | 19 | 956 | 2 | 20 | 2 | 13 | 21 | 989 | 1,304 |
| 1991 | 17 | 950 | 5 | 272 | 3 | 706 | 21 | 1,928 | 1,755 |
| 1992 | 20 | 1,848 | 3 | 272 | 3 | 729 | 23 | 2,849 | 2,206 |
| 1993 | 19 | 1,454 | 7 | 181 | 5 | 1,443 | 23 | 3,077 | 2,082 |
| 1994 | 10 | 1,012 | 2 | 137 | 1 | 70 | 11 | 1,219 | 1,067 |
| 1995 | 17 | 2,118 | 4 | 195 | 1 | 43 | 19 | 2,356 | 1,971 |
| 1996 | 25 | 2,237 | 5 | 482 | 4 | 374 | 29 | 3,094 | 1,972 |
| 1997 | 24 | 459 | 6 | 524 | 0 | – | 28 | 984 | 1,935 |
| 1998 | 15 | 988 | 8 | 1,822 | 1 | 128 | 23 | 2,938 | 2,015 |
| 1999 | 22 | 1,733 | 7 | 700 | 1 | 120 | 26 | 2,552 | 2,658 |
| 2000 | 29 | 556 | 14 | 2,208 | 2 | 201 | 41 | 2,965 | 2,825 |
| 2001 | 20 | 382 | 7 | 913 | 1 | 20 | 25 | 1,315 | 2,077 |
| 2002 | 25 | 732 | 11 | 1,848 | 2 | 249 | 34 | 2,780 | 2,100 |
| **Total** | **507** | **22,250** | **124** | **10,776** | **51** | **5,295** | **610** | **38,272** | **37,121** |

Note: Projects with more than one source of financing are counted as one.

Table 2: **Commercial and Export Credit Cofinancing, by Recipient Country, 1970–2002** *($ million)*

| Recipient Country | Commercial Sources | | Export Credits | |
|---|---|---|---|---|
| | No. of Projects | Amount | No. of Projects | Amount |
| Bangladesh | 1 | 170 | 2 | 21 |
| Cambodia | 1 | 4 | – | – |
| China, People's Republic of | 41 | 5,554 | 2 | 171 |
| Fiji Islands | 2 | 12 | – | – |
| India | 5 | 605 | 4 | 1,051 |
| Indonesia | 6 | 199 | 10 | 1,016 |
| Kazakhstan | 1 | 3 | – | – |
| Korea, Republic of | 8 | 462 | 1 | 22 |
| Lao People's Democratic Republic | 1 | 82 | 1 | 70 |
| Malaysia | 4 | 106 | 1 | 5 |
| Nepal | 2 | 19 | 2 | 41 |
| Pakistan | 17 | 782 | 11 | 1,257 |
| Papua New Guinea | 1 | 10 | – | – |
| Philippines | 14 | 979 | 5 | 837 |
| Singapore | 1 | 5 | – | – |
| Sri Lanka | 6 | 305 | – | – |
| Thailand | 6 | 1,141 | 8 | 337 |
| Viet Nam | 6 | 339 | 4 | 468 |
| **Total** | **124** | **10,776** | **51** | **5,295** |

Table 3: **Commercial and Export Credit Cofinancing by Sector, 1970–2002** *($ million)*

| Recipient Country | Commercial Sources | | Export Credits | |
|---|---|---|---|---|
| | No. of Projects | Amount | No. of Projects | Amount |
| Agriculture and Natural Resources | 8 | 49 | 2 | 179 |
| Energy | 47 | 4,244 | 35 | 4,113 |
| Finance | 9 | 1,733 | – | – |
| Industry and Nonfuel Minerals | 22 | 673 | 6 | 213 |
| Social Infrastructure | 12 | 626 | 2 | 183 |
| Transport and Communications | 23 | 3,326 | 6 | 607 |
| Others (Environment) | 2 | 125 | – | – |
| **Total** | **124** | **10,776** | **51** | **5,295** |

Table 4: **Summary of Cofinanced Projects Receiving ADB Guarantee Support (as of 31 December 2002)** *($ million)*

| | DMC/Project [a] | ADB Loan | Commercial Cofinancing Amount | Year Approved | ADB Guaranteed Amount |
|---|---|---|---|---|---|
| 1 | *Indonesia* | | | | |
| | Financial Sector Program | 150 | 50 | 1988 | 19 |
| 2 | *Papua New Guinea* | | | | |
| | Ramu Grid Reinforcement | 20 | 10 | 1990 | 6 |
| 3 | *India* | | | | |
| | Power Finance Corporation | 380 | 110 | 1990 | 50 |
| 4 | *People's Republic of China* | | | | |
| | Shanghai Nanpu Bridge | 70 | 48 | 1991 | 17 |
| 5 | *People's Republic of China* | | | | |
| | Laiwu Iron and Steel Mill Modernization and Expansion | 133 | 25 | 1992 | 7 |
| 6 | *People's Republic of China* | | | | |
| | Shanghai Yangpu Bridge | 85 | 54 | 1993 | 12 |
| 7 | *Philippines* | | | | |
| | Northern Luzon Transmission and Generation[b] | 244 | 142 | 1995 | 142 |
| 8 | *Sri Lanka* | | | | |
| | Small and Medium Enterprises Assistance Program | 5 | 50 | 1997 | 50 |
| 9 | *Thailand* | | | | |
| | Export Financing Facility | 50 | 950 | 1998 | 730 |
| 10 | *Sri Lanka* | | | | |
| | Credit Enhancement Facility for Private Enterprises[c] | 5 | 65 | 1998 | 65 |
| 11 | *India* | | | | |
| | Power Transmission Improvement Sector | 250 | 120 | 2000 | 106 |
| 12 | *Bangladesh* | | | | |
| | AES Meghnaghat Limited[d] | 50 | 70 | 2000 | 70 |
| 13 | *Sri Lanka* | | | | |
| | Kelanitissa Power[d] | 26 | 52 | 2000 | 52 |
| 14 | *Pakistan* | | | | |
| | SME Trade Enhancement Facility[d] | 50 | 150 | 2000 | 150 |
| 15 | *Sri Lanka* | | | | |
| | SME Sector Development Program | 60 | 90 | 2001 | tbd |
| 16 | *Viet Nam* | | | | |
| | Phu My 2.2 Power Project[d] | 50 | 25 | 2002 | 25 |
| 17 | *Philippines* | | | | |
| | Power Sector Restructuring Program[b] | 300 | 500 | 2002 | 500 |
| 18 | *Viet Nam* | | | | |
| | Phu My 3 Power Project[d] | 40 | 32 | 2002 | 32 |
| 19 | *Pakistan* | | | | |
| | Financial (Nonbank) Markets and Governance Program[d] | 260 | 325 | 2002 | |
| | **Total** | **2,228** | **2,868** | | **2,033** |

[a] Guarantees for the first six projects were provided in association with Complementary Financing Scheme loans.
[b] Bond issue with Partial Credit Guarantee (PCG) covering bullet repayment of principal.
[c] Floating rate note with PCG covering bullet repayment of principal.
[d] With Political Risk Guarantee (PRG) coverage.

Appendix 2:

# PRINCIPAL RESPONSIBILITIES OF ADB'S OFFICE OF COFINANCING OPERATIONS

The principal responsibilities of the Asian Development Bank's (ADB) Office of Cofinancing Operations *in respect of commercial cofinancing and guarantees* are to

- formulate and monitor implementation of commercial cofinancing and guarantee policies;
- promote and assist in structuring and arranging commercial cofinancing and guarantee transactions;
- coordinate with public and private sector institutions on cofinancing and guarantees, consistent with ADB's policies, procedures, and practices;
- regularly consult with private capital providers, including commercial lenders, capital market institutions, guarantors, insurers, and export credit agencies;
- assist ADB country programming and project processing missions as necessary, particularly when these facilitate identification of projects and programs requiring commercial cofinancing;
- identify prospective commercial cofinanciers and risk sharers, such as guarantors, institutional investors, insurance providers, or export credit agencies;
- act as ADB's internal focal point for coordination with the Multilateral Investment Guarantee Agency;
- maintain relevant information and a database on commercial cofinancing and guarantee operations; and
- prepare periodic reports required by Management, other ADB departments and offices, commercial cofinanciers, guarantors, or export credit agencies.

Appendix 3:

# MAJOR COMMERCIAL LENDERS AND EXPORT CREDIT AGENCIES PARTICIPATING IN ADB COMMERCIAL COFINANCING TRANSACTIONS

By Amount of Participation (1993–2002)

| I. International Lenders | Country | Amount ($ million) |
|---|---|---|
| Mizuho Corporate Bank[1] | Japan | 172.18 |
| ANZ Bank | Australia | 101.80 |
| ABN-AMRO Bank N.A. | Netherlands | 88.31 |
| BNP Paribas | France | 75.30 |
| Nippon Export and Investment Insurance Inc. | Japan | 67.00 |
| Development Bank of Singapore | Singapore | 63.30 |
| Overseas Private Investment Corp. | United States of America | 50.00 |
| Bank of Communications | People's Republic of China | 48.20 |
| Bank of Nova Scotia | Canada | 47.60 |
| Industrial & Commercial Bank of China | People's Republic of China | 43.85 |
| Bayerische Vereinsbank AG | Germany | 42.97 |
| Bank of Tokyo-Mitsubishi Ltd. | Japan | 42.60 |
| BA Asia Limited | United States of America | 37.70 |
| Credit Suisse First Boston | Switzerland | 37.70 |
| Tokai Bank, Limited | Japan | 37.70 |
| Citibank Finance Limited | United States of America | 37.60 |
| KBC Bank NV | Belgium | 33.27 |
| Credit Agricole Indosuez | France | 32.54 |
| Asian Finance and Investment Corp. Ltd | Singapore | 25.61 |
| Barclays Bank | United Kingdom | 25.10 |
| Dresdner Bank AG | Germany | 23.88 |
| Generale Bank | France | 22.97 |
| Raiffeisen Zentralbank Osterreich AG | Austria | 22.50 |
| De Nationale Investeringsbank Asia, Ltd. | Netherlands | 21.56 |
| Banca Monte Dei Paschi di Sienna SpA | Italy | 20.00 |
| Natexis Bank | France | 20.00 |
| Overseas Union Bank Limited | Singapore | 20.00 |

| | | | |
|---|---|---|---|
| **II.** | **Domestic Lenders** | | |
| | China Development Bank | People's Republic of China | 2,505.30 |
| | State Development Bank | People's Republic of China | 935.40 |
| | China Construction Bank | People's Republic of China | 697.10 |
| | Agricultural Bank of China | People's Republic of China | 120.90 |
| | Infrastructure Development Company Ltd. | Bangladesh | 80.00 |
| | China Minsheng Bank | People's Republic of China | 48.30 |
| | Private Sector Infrastructure Development Corp. | Sri Lanka | 39.00 |
| | First Gas Holdings Corporation | Philippines | 36.10 |
| **III.** | **Export Credit Agencies** | | |
| | Japan Bank for International Cooperation (JBIC) [2] | Japan | 810.20 |
| | Compagnie Francaise d'Assurance pour le Commerce (COFACE) | France | 250.72 |
| | Export Import Bank of the United States | United States of America | 172.40 |
| | The Export-Import Bank of Korea | Republic of Korea | 153.00 |
| | Compañia Española de Seguros de Credito a la Exportacion,SA (CESCE) | Spain | 75.65 |
| | Export Finance and Insurance Corporation | Australia | 55.00 |
| | Multilateral Investment Guarantee Agency | United States of America | 52.50 |
| | Export Development Corporation | Canada | 35.00 |
| | Malaysian Eximbank | Malaysia | 15.00 |

1 Merger of Dai-Ichi Kangyo Bank, Industrial Bank of Japan, and Fuji Bank Ltd. effective 1 April 2002.

2 Name changed in 1999 due to merger of the Export-import Bank of Japan and the Overseas Economic Cooperation Fund, Japan.

Appendix 4:

# ADB MEMBERS

(as of 31 December 2002)

| Regional (44) | Nonregional (17) |
|---|---|
| Afghanistan | Austria |
| Australia | Belgium |
| Azerbaijan | Canada |
| Bangladesh | Denmark |
| Bhutan | Finland |
| Cambodia | France |
| China, People's Republic of | Germany |
| Cook Islands | Italy |
| Fiji Islands | The Netherlands |
| Hong Kong, China | Norway |
| India | Portugal |
| Indonesia | Spain |
| Japan | Sweden |
| Kazakhstan | Switzerland |
| Kiribati | Turkey |
| Korea, Republic of | United Kingdom |
| Kyrgyz Republic | United States |
| Lao People's Democratic Republic | |
| Malaysia | |
| Maldives | |
| Marshall Islands, Republic of the | |
| Micronesia, Federated States of | |
| Mongolia | |
| Myanmar | |
| Nauru | |
| Nepal | |
| New Zealand | |
| Pakistan | |
| Papua New Guinea | |
| Philippines | |
| Samoa | |
| Singapore | |
| Solomon Islands | |
| Sri Lanka | |
| Taipei, China | |
| Tajikistan | |
| Thailand | |
| Timor-Leste | |
| Tonga | |
| Turkmenistan | |
| Tuvalu | |
| Uzbekistan | |
| Vanuatu | |
| Viet Nam | |

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