COFINANCING

A Strategy for Resource Mobilization

ASIAN DEVELOPMENT BANK

1999

About The Bank

The Asian Development Bank, a development finance institution consisting of 57 member countries (as of end-1998) is engaged in promoting the economic and social progress of its developing member countries (DMCs) in the Asian and Pacific region.

The Bank started operations in December 1966 with its Headquarters in Manila, Philippines. It is owned by the governments of 41 countries from the region and 16 countries from outside the region.

The Bank's principal functions are: (i) to make loans and equity investments for the economic and social advancement of DMCs; (ii) to provide technical assistance for the preparation and execution of development projects and programs and advisory services; (iii) to promote investment of public and private capital for development purposes; and (iv) to respond to requests for assistance in coordinating development policies and plans of DMCs. The Bank is also required to give special attention to the needs of the smaller or less developed countries and give priority to regional, subregional and national projects and programs that will contribute to the harmonious economic growth of the region as a whole.

The financial resources of the Bank consist of ordinary capital resources, comprising subscribed capital, reserves and funds raised through borrowing; Special Funds, comprising contributions made by member countries, accumulated net income and amounts previously set aside from the paid-in capital. Loans from ordinary capital resources, which account for 72 percent of cumulative Bank lending, are generally made to DMCs that have attained a somewhat higher level of economic development. Loans from the Asian Development Fund are made on highly concessional terms and almost exclusively to the poorest borrowing countries.

The Bank actively pursues cofinancing activities with official as well as commercial and export credit sources.

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Notes: In this brochure, "$" refers to US dollars.

The term 'country', as used in the context of the Bank, refers to members of the Bank and does not imply any view on the part of the Bank as to their sovereignty or independent status.

INTRODUCTION

The cofinancing operations of the Asian Development Bank (the Bank) play a catalytic role in mobilizing financial resources to developing member countries (DMCs). The Bank's revised strategy on cofinancing adopted in April 1995 has enlarged the scope for assisting DMCs by using various cofinancing modalities and guarantees. In line with the enhanced level of cofinancing operations, the Bank's Cofinancing Division was upgraded to the Office of Cofinancing Operations in July 1996.

This publication explains the rationale, the strategy, and the modalities of the Bank's cofinancing and guarantee operations. This is addressed to all those interested in cofinancing with the Bank for public or private sector projects. Additional information is available in separate brochures entitled Official Cofinancing and Commercial Cofinancing and Guarantees.

The Office of Cofinancing Operations welcomes inquiries on the Bank's cofinancing and guarantee operations. Information on contacting the Bank is set forth at the back of this brochure.

1 Catalytic Role of Cofinancing: Bridging the Region's Resource Gap

The economies of the Asian and Pacific Region (the Region) experienced widespread and deep contraction in 1998 — a direct result of the decrease in consumption and investment brought about by the currency crisis in 1997. Both economic growth and net private capital flows fell dramatically, bringing about a financial crunch aggravated by the weak banking and governance systems in several countries. Many countries responded to the crisis with conventional strategies to reverse capital outlays. However, the social cost of the Asian financial crisis has been high. There has been a sharp decline in human development indicators in the most seriously affected countries, and the poor have suffered disproportionately. In this environment, the Bank's role of assisting its DMCs in expediting their policy reforms and restoring investor confidence has become increasingly important. At the same time, the strain on the Bank's financial resources — exacerbated by the crisis itself

It appears appropriate that the Bank assumes the role of a catalyst development institution which uses its project investments to leverage policy change, capacity development, and greater private sector investment.

– The Bank's Medium-Term Strategic Framework (1995–1998)

T-SP1

(Men working on infrastructure project.)

The Asian and Pacific Region needs massive investments in infrastructure facilities and services. The demand for additional infrastructure cannot be met by the public sector alone. Participation by the private sector becomes essential.

— has highlighted the importance of resource mobilization as one of the mainstream functions of the Bank.

Thus, the developmental role of the Bank has become more critical than ever in triggering the flow of resources to the Region. The Bank considers that the total financing resources mobilized for the projects it assists are as important as the volume of its own financing. Accordingly, cofinancing

Cofinancing not only enhances the Bank's leverage for policy reforms in DMCs, but also supports the Bank's strategy to address the cross-cutting issues of poverty reduction, human development, improving the status of women, and protecting the environment.

N-SD3

(Women in conference)

has become essential for the Bank to leverage its own resources and is now an integral aspect of the Bank's strategy for resource mobilization for its DMCs. The basic objective of cofinancing operations is to help leverage the Bank's resources and expand the Bank's catalytic role in directing official and private financial flows to its DMCs. ❑

Bank Strategy:
Key Elements and Advantages

2

The Bank derives its cofinancing funds from (i) official aid agencies, (ii) export credit agencies, and (iii) market institutions. The Bank provides cofinancing and guarantees, as appropriate, only to projects and program it assists. The Bank's cofinancing strategy is characterized by its flexibility in addressing the changing needs of its DMCs. A recent review of the Bank's cofinancing operations since the 1960s showed the need for (i) exploring new sources of official cofinancing and securing maximum concessional assistance from official sources, and (ii) increasing private funds to DMCs through commercial cofinancing operations.

For every dollar lent by the Bank in 1998, an additional 49 cents have been mobilized by way of cofinancing.

In light of the review, the Bank approved a new cofinancing and guarantee strategy in 1995 (*Box 1: Bank Strategy: Key Elements*). The main thrust of the strategy is to increase the flow of private capital to DMCs; and to do so, the strategy aims at enhancing the advantages to official and

T-WS

(Water supply and sanitation)

The regulatory environment of some sectors, such as ports, water supply and sanitation, needs further improvement in many DMCs to ensure adequate private sector participation.

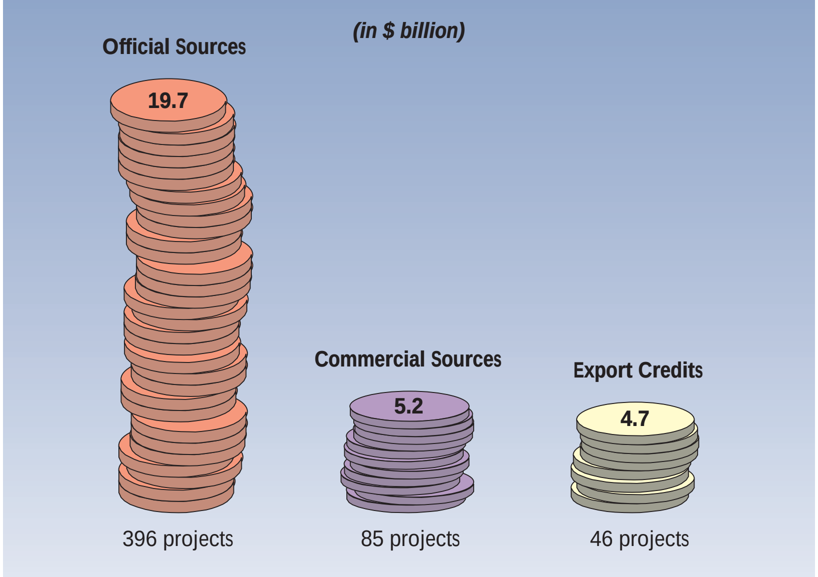
Box 1: ***Bank Strategy: Key Elements***

- *cofinancing from official sources on concessional terms for those DMCs which have yet to gain easy access to commercial money, and in the "soft" sectors, and nonconcessional resources for growth-oriented projects*
- *cofinancing from market sources on a parallel basis for public sector projects suitable for commercial borrowings*
- *partial credit guarantees for public sector projects in DMCs to extend the maturities of commercial loans and help lower spreads; also for private sector projects with a counter-guarantee from the government*
- *partial risk guarantees to commercial cofinanciers for private sector projects, usually with government counter-guarantee*
- *Complementary Financing Scheme for commercial cofinanciers for private sector projects*
- *proactive measures to promote export credit financing on the best possible terms for Bank-assisted projects*

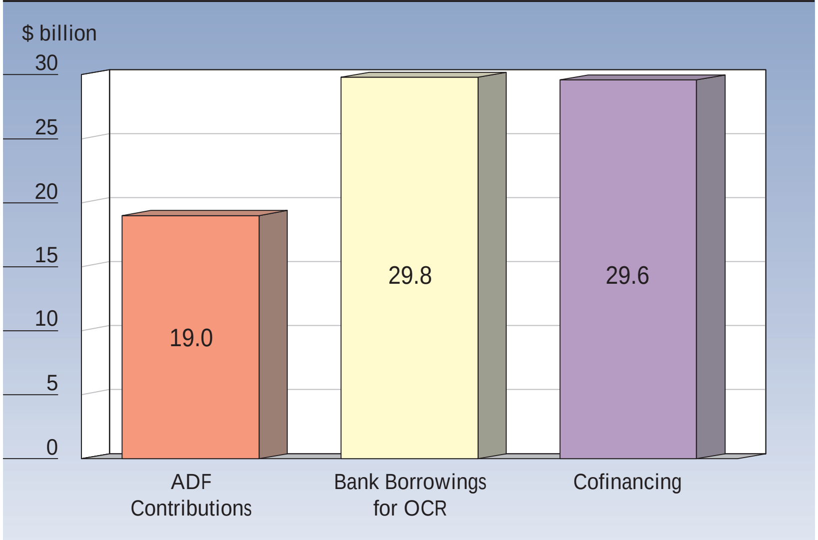
commercial cofinanciers as well as to DMCs (*Box 2: Working with the Bank: Advantages*).

Since 1970, about 500 Bank-assisted projects and programs have utilized cofinancing. Cofinancing totaled $29.6 billion during 1970-1998. This amount consisted of $19.7 billion from official sources, $4.7 billion from export credit sources, and $5.2 billion from commercial sources. The total cofinanced amount compares well with the overall funds mobilized by the Bank for financing its development projects and programs. The resources

BANK COFINANCING: VOLUME AND NUMBER OF PROJECTS
(1970–1998)



RESOURCE MOBILIZATION: ROLE OF COFINANCING
(1970–1998)



Box 2: *Working with the Bank: Advantages*

To Official Cofinanciers

- *sharing of country and sector studies regularly undertaken by the Bank*
- *support in the due diligence exercised by the Bank through detailed appraisal of its projects*
- *sharing of information on the project and the scope for cofinancing at all stages of project processing*
- *participation in Bank appraisal missions and review missions*
- *for untied cofinancing, the Bank can administer and supervise cofinanced loans*
- *better coordination, which prevents duplication of work and promotes consistent policies*
- *integrated approach to development*

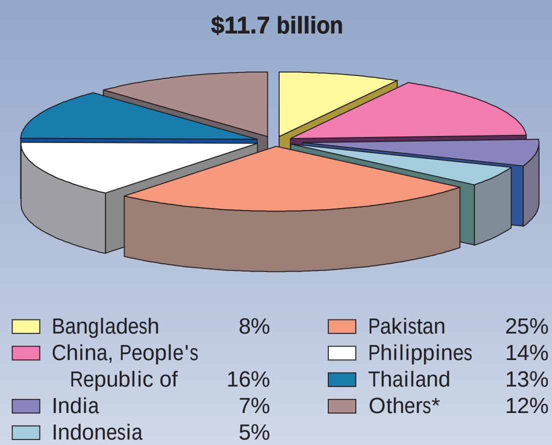
To Commercial Cofinanciers

- *comfort from the involvement of the Bank in the project*
- *sharing of the Bank's preferred creditor status under the Complementary Financing Scheme and benefiting from immunities and privileges applicable to such loans*
- *guarantee on longer maturities under the Bank's partial credit guarantee facility*
- *guarantee on political risk under the Bank's partial risk guarantee facility*

To Developing Member Countries (DMCs)

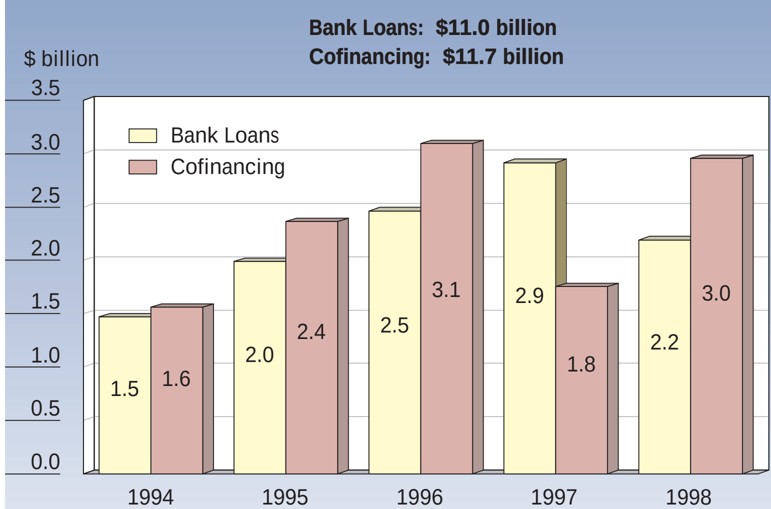
- *additionality, when cofinancing is from market-based or nontraditional sources*
- *enhanced ability to finance large-scale projects that are unlikely to be financed by any one donor*
- *minimize duplication and promote more effective coordination of external assistance and more flexibility in planning assistance programs*
- *access to the Bank's experience and expertise in arranging borrowings from market-based sources on the best possible terms*
- *extended maturities and lower spreads on public sector borrowings from market sources through the Bank's partial credit guarantee*
- *guarantee support for domestic bond issues in DMCs, which provides benefits in terms of longer maturities and lower interest rates*
- *concessional official development assistance and grant assistance, particularly directed to DMCs which have yet to gain easy access to commercial money*
- *assistance in securing export credit financing on favorable terms*

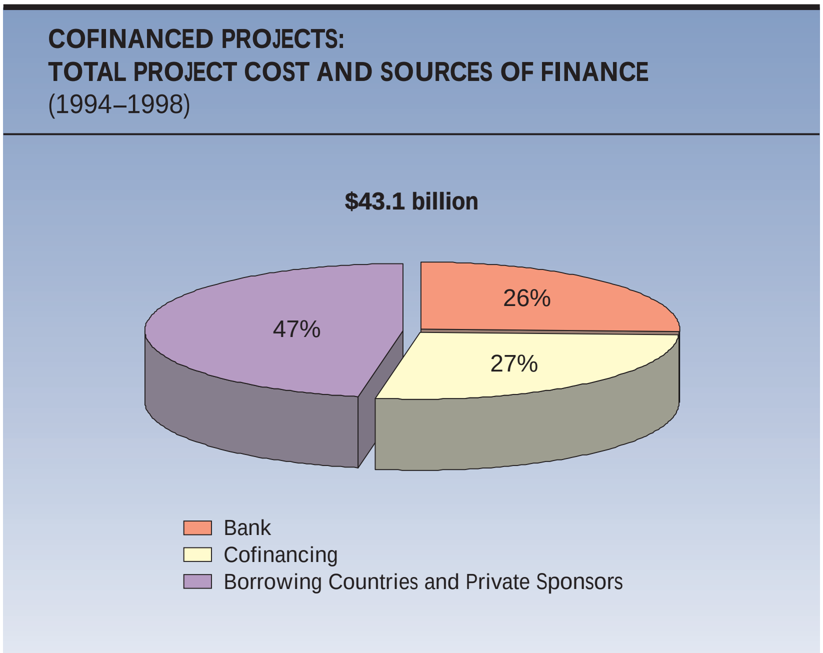
LOAN COFINANCING BY RECIPIENT COUNTRY
(1994–1998)



* Includes Cambodia, Kyrgyz Republic, Lao PDR, Maldives, Mongolia, Nepal, Sri Lanka, Vanuatu, and Viet Nam

COFINANCED PROJECTS: BANK LOANS AND COFINANCING
(1994–1998)





mobilized by the Bank from borrowings from the international capital markets for its ordinary capital resources (OCR) amounted to $29.8 billion. The resources obtained from Asian Development Fund (ADF) donors for concessional lending totaled $19.0 billion. Annual cofinancing from various sources has exceeded the one billion dollar mark since 1988, reaching over $2.9 billion in 1998.

Cofinancing activities are being actively pursued at various stages of the Bank's operational cycle, and the Programs and Projects Departments of the Bank are taking proactive steps to identify projects with cofinancing possibilities. ❑

3 OFFICIAL COFINANCING

Sustained official development assistance through cofinancing will enable the Bank to enhance its package of development services to DMCs.

Official cofinancing is an arrangement under which the Bank and official agencies — bilateral as well as multilateral — cofinance Bank projects. Funds from external agencies may be loans or grants. Official cofinancing can be arranged in two forms — joint or parallel (*Box 3: Two Forms — Joint and Parallel*).

Official cofinancing is an important component of the Bank's strategy for mobilizing resources for its development projects in DMCs. Historically, official agencies have been the largest sources of cofinancing. During 1994–1998, official cofinancing averaged 66 percent of the total amount cofinanced by the Bank. In 1998, official sources contributed about $1.0 billion out of a total cofinanced amount of about $3.0 billion.

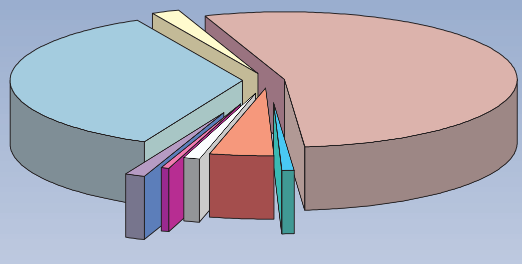
The energy sector has received 40 percent of the loan cofinancing during 1970–1998, followed by transport and

Box 3: ***Two Forms — Joint and Parallel***

Official cofinancing can be arranged in two forms — joint or parallel. Under joint cofinancing, the Bank and cofinanciers pool their funds to finance a common list of goods and services for the project. This mode of cofinancing is applicable when cofinanciers do not tie their assistance and agree to follow the Bank's procurement guidelines. Under parallel cofinancing, the project's components are financed separately by the Bank and cofinanciers follow their own procurement policies and procedures.

OFFICIAL LOAN COFINANCING BY SOURCE
(1994–1998)

$7.8 billion

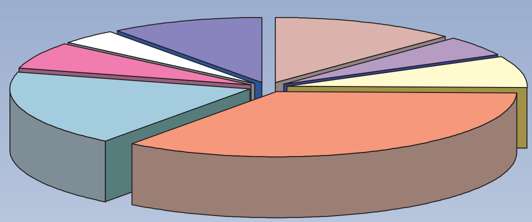


Japan	53%	Netherlands	1%
France	1%	United Kingdom	1%
Germany	5%	Multilaterals	36%
Norway	1%	Others*	2%

*Includes Australia, Belgium, Canada, Denmark, Republic of Korea, Kuwait, Spain, Sweden, Switzerland, and United States

OFFICIAL LOAN COFINANCING BY RECIPIENT COUNTRY
(1994–1998)

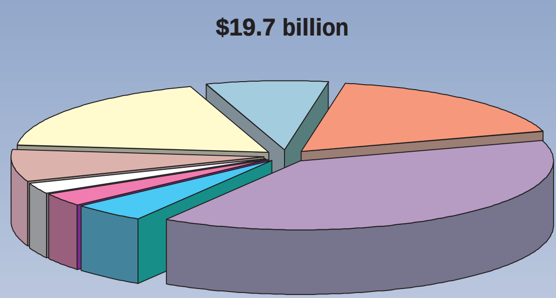
$7.8 billion



Bangladesh	12%	Philippines	19%
India	5%	Thailand	7%
Indonesia	8%	Viet Nam	4%
Pakistan	35%	Others*	10%

* Includes Cambodia, People's Republic of China, Kyrgyz Republic, Lao PDR, Maldives, Mongolia, Nepal, Sri Lanka, and Vanuatu

OFFICIAL LOAN COFINANCING BY SECTOR
(1970–1998)



Agriculture and Natural Resources	17%	Multisector	2%
Energy	40%	Social Infrastructure	7%
Financial	5%	Transport and Communications	18%
Industry and Nonfuel Minerals	3%	Others	8%

communications (18 percent), agriculture and natural resources (17 percent), and other sectors (25 percent). The availability of resources for Bank-assisted projects enhances the Bank's leverage for policy and institutional reforms in DMCs. It also enables the Bank to address effectively crosscutting issues (such as environmental protection, gender and development, human resources, and poverty alleviation) in Bank-assisted projects. Official cofinancing can secure additionality by attracting increased resources to the Region through well-designed development projects and programs.

An Element of Concessionality

Official donor agencies provide concessional loan assistance to DMCs. Bilateral sources have accounted for 69 percent of the concessional lending to Bank-assisted projects during 1994–1998 as against 31 percent by multilateral sources.

In nonconcessional lending, bilateral sources provided more than multilateral sources during the same period. Concessional lending from both sources accounted for $4.6 billion, as against nonconcessional lending of $3.2 billion.

The DMCs which received over 10 percent of the total official loan cofinancing during 1994–1998, are Bangladesh, Pakistan, and Philippines.

A Partnership Approach

Official cofinancing strengthens a partnership approach to development. Cofinanciers derive several advantages by working with the Bank. In particular, cofinancing agencies can have the benefit of the Bank's project appraisal and supervision services, as well as its country and sector analyses that provide the basis for Bank assistance to DMCs. Coordination facilitates the evolution of a rational framework for prioritization of investments without duplication. ❑

4

GRANT COFINANCING

Grant cofinancing has not only led to well-designed projects, but also supported capacity building activities in DMCs.

In line with its role as a catalyst for overall development and investment, the Bank provides technical assistance (TA) to its DMCs mostly by way of grants. Bank TA helps DMCs in project preparation and developing a pipeline of potential projects with proven technical feasibility and economic viability. Advisory and operational TA is provided for project implementation; institutional strengthening; studies on policy, sector, and other issues; and formulation of national development plans. TA grants support capacity building aimed at strengthening "good governance" and human resource development. Regional TA grants are provided to finance regional studies and activities.

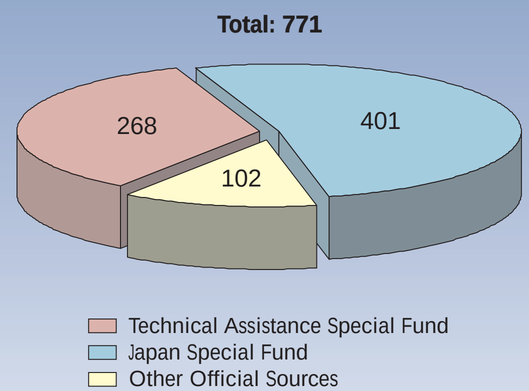
Funding for the grants comes from contributions to the Bank's Technical Assistance Special Fund (TASF) and from the Japan Special Fund (JSF).

T-SM

(Ladies working on computer.)

Grants from official sources help DMCs in capacity building and development of human resources, besides assisting them in project preparation and implementation.

TECHNICAL ASSISTANCE GRANTS (1994–1998)
(in $ million)



(Figures show actual grant commitments.)

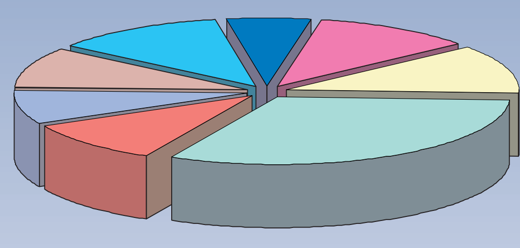
Established in 1967, the TASF is financed by voluntary contributions from both developed and developing member countries, allocations from the Bank's OCR net income, and investment income from TASF itself. Until 1996, TASF received allocations from ADF also.

JSF was established in 1988 as a bilateral fund by the Government of Japan for supporting the Bank's TA program. Over 982 TA grants had been approved by the end of 1998, amounting to $593 million, besides one equity investment of $3 million. Over half of the approved TA projects have been completed. An important feature of JSF assistance has been its role in formulating loan projects in DMCs. Over half the completed project preparatory technical assistance (PPTA) projects supported by JSF have led to loan projects. About $97 million provided through such PPTAs have triggered project investments totaling $24.4 billion.

In addition to TASF and JSF, several member countries provide support to the Bank's TA programs, largely under channel financing agreements. Currently, the Bank has signed such agreements with Australia, Belgium, Finland, France, Netherlands, Norway, Sweden, and Switzerland. These are important sources of grant assistance. The grants under the channel financing agreements are untied. The grants support the Bank's TA to DMCs for conducting project feasibility and other studies. In addition, the grants support measures aimed

TECHNICAL ASSISTANCE GRANTS
Bilateral and Multilateral Sources (1994–1998)
(in $ million)

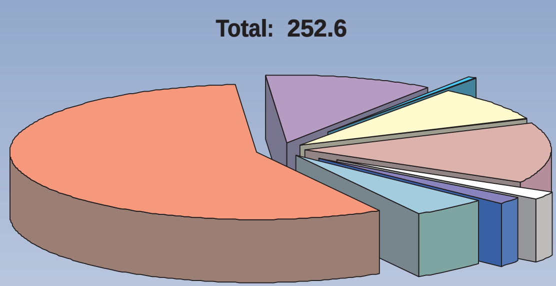
Total: 102



Denmark	6	Norway	10
France	11	Switzerland	8
GEF	12	UNDP	10
Netherlands	33	Others*	12

* Includes ADBI, Australia, Belgium, Finland, New Zealand, Sweden, United Kingdom, United States, and World Bank

TECHNICAL ASSISTANCE COFINANCING BY SECTOR (1970–1998)
(in $ million)



Agriculture and Natural Resources	148.62	Social Infrastructure	32.87
Energy	26.48	Financial	5.13
Industry and Nonfuel Minerals	0.93	Multisector	3.45
Transport and Communications	22.31	Others	12.82

at better planning and improving the efficiency of selected sectors. Cofinanciers identify the countries and sectors they prefer to assist.

In carrying out TA grant programs, the Bank maintains close collaboration with the United Nations Development Programme, the Food and Agriculture Organization, the United Nations Industrial Development Organization, the Economic and Social Commission for Asia and the Pacific, and other international organizations.

In addition, the Bank receives untied grants from several member countries on an ad hoc basis under letters of agreement. The grants finance the Bank's TA program, as well as "soft" components of Bank-assisted loan projects. The grants that finance the "soft" components of loan projects generally support capacity building and training. The projects supported by the grants include biodiversity conservation, participatory livestock development, rural livelihood, primary education, poverty reduction, urban development, and project management. During 1994–1998, such grant assistance was provided by Australia, Belgium, Denmark, Finland, France, Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and the United States.

The Bank administers the grants if they are untied. DMCs welcome grant funds even if they are tied in view of the crucial areas supported by the TA.

The Bank normally seeks to recover the incremental cost it incurs in supervising the implementation of the grants. The amount of reimbursement depends on the incremental cost incurred by the Bank in performing its role as administrator. Other factors, such as the cofinancing modality, amount of cofinancing, nature of the services required, views of the cofinanciers, and the fee structure in similar multilateral institutions, are also considered in determining the cost to be reimbursed. The Bank has been undertaking a comprehensive review of its cost recovery structures. Pending completion of such review, the Bank has adopted a number of fee structures for meeting different requirements, with the consent of cofinanciers. ❑

DONOR COORDINATION

5

The scope for cofinancing needs to be identified at an early stage in the processing cycle to enable donors to program their operations in accordance with their own priorities and schedules. Ideally, the project processing cycles of the donors, DMCs, and the Bank should be synchronized. Closer coordination between the Bank and donor agencies, as well as early decision-making by DMCs, would help synchronize to the maximum extent possible their schedules and preferences, thus enhancing the scope of cofinancing.

Early involvement of interested donors in the project cycle enhances the scope for cofinancing.

The Bank has taken several proactive measures to identify cofinancing opportunities early in the country planning and programming cycle, and consider the scope for cofinancing at several subsequent stages. Donor coordination is envisaged right from the beginning of the Bank's country programming cycle, when the basic planning document, the Country Operational Strategy (COS), is prepared for each DMC. Along with country economic and sector work, the COS provides the basis for formulating country assistance plans. The scope for cofinancing is explored as early as the country programming phase, when the project is first identified for consideration by the Bank.

Inquiries on cofinancing can be routed through the Bank's resident missions in Almaty, Colombo, Dhaka, Hanoi, Islamabad, Jakarta, Kathmandu, New Delhi, Phnom Penh, and Tashkent; the Bank's regional mission in Vanuatu; as well as the Bank's representative offices in Frankfurt, Tokyo, and Washington. Resident representatives participate in donor coordination meetings.

Box 4: **Greater Mekong Subregion**

The Greater Mekong Subregion (GMS) comprises Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam, and Yunnan Province of the People's Republic of China. The six countries entered into a Bank-assisted program of subregional economic cooperation in 1992. Seven priority sectors have been identified for investments: transport, energy, telecommunications, environment, human resource development, trade and investment, and tourism. Sector studies or master plans, many undertaken under Bank technical assistance, have recommended almost 100 subregional projects and initiatives in the seven sectors. The recommendations have been endorsed for priority implementation by the GMS governments. The projects provide investment opportunities to donor agencies as well as market institutions. In several priority areas, public-private partnership ventures are possible as well.

The Bank keeps potential cofinanciers fully informed of the cofinancing possibilities in DMCs (subject to its disclosure policy) and welcomes donor participation in the formulation, appraisal, and implementation of projects with the consent of the DMC concerned. In addition, cofinancing provides opportunities for coordination among cofinanciers on sector policies and project-specific issues.

Regional Cooperation and Cofinancing

The Bank's program in DMCs to build a viable pipeline of projects that reflects their priorities and preferences will help potential cofinanciers choose their area of assistance. In most DMCs, the Bank's sector studies have laid the groundwork for prioritization of projects that need other donor assistance.

As part of its efforts to promote regional cooperation, the Bank attempts to underwrite some of the managerial and technical risks and uncertainties associated with such cooperation. Cofinancing offers an effective means of coordination with multilateral and bilateral agencies as well as the private sector for developing "bankable" projects as regional cooperation increases. In this regard, the Greater Mekong Subregion (GMS) offers considerable scope for cofinancing (*Box 4: Greater Mekong Subregion*). ❑

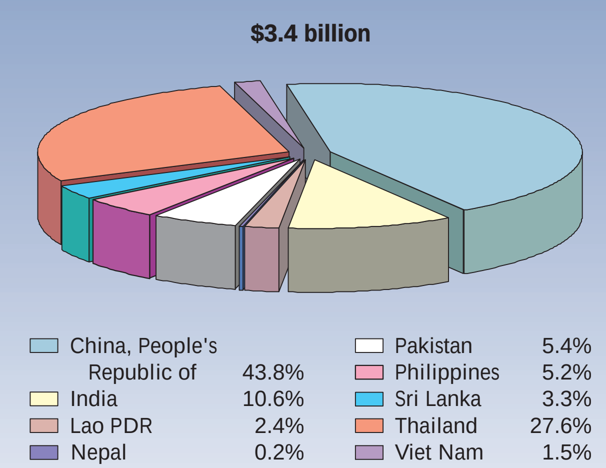
6 COMMERCIAL COFINANCING

Rationale and Strategy

Any significant increase in the volume of cofinancing will have to be from private capital sources through financial markets.

The Bank is in a unique position to play a key role in mobilizing term finance from market sources to help fund projects in DMCs. On the one hand, the Bank has built a solid reputation for its knowledge and experience from working in the developing countries of the Region. The Bank has a regular program to ascertain the resource needs of DMCs and explore the best means of financing them. At the same time, association with the Bank is valued by leading market cofinanciers, such as major commercial banks, life insurance companies, pension funds, and other financial institutions, that are considering investment in DMCs.

COMMERCIAL COFINANCING BY RECIPIENT COUNTRY
(1994–1998)



The Bank's commercial cofinancing strategy, which is in line with the Bank's policy of increasing the development impact of its lending operations, is designed to play a catalytic role in mobilizing additional private capital for its DMCs.

The Bank arranges cofinancing only if it directly assists one of its programs or projects in the public or private sector. Private sector sponsors and their bankers may explore the scope for Bank participation (by way of a loan or equity investment, or both) by contacting the Bank's Private Sector Group.

Flexibility

The Bank can provide a range of services to help DMCs and project sponsors raise financing from market sources, if warranted. The Bank can make its credit enhancement facilities (Complementary Financing Scheme and guarantees) available to cofinanciers. These facilities can be structured to suit the unique requirements of each project. The enhancements ensure long-term financing, which is often critical to a project's viability.

DMCs that can attract private capital on favorable terms on their own are encouraged to seek parallel commercial cofinancing for their projects without any credit enhancement from the Bank. The Bank can assist these DMCs in arranging cofinancing in the form of syndicated loans, floating rate notes (FRN), or bonds, depending on project requirements and cofinanciers' preferences.

DMCs that are unable to obtain parallel commercial loans on their own can avail themselves of the Bank's partial credit guarantee facility. With the support of such guarantees, DMCs can extend the final maturity of commercial loans and improve their terms to suit the requirements of the project.

For private sector borrowers, the Bank can provide credit enhancement through its CFS (page 27) or partial credit or risk guarantee. The provision of a risk guarantee for private sector borrowers would generally require a counter-guarantee from the government. A credit guarantee for a private sector borrower, without the government's counter-guarantee, will be provided at a market-determined price.

The modality of borrowing depends on a project's requirements and market opportunities. The Bank can arrange:

- syndicated loans (without credit enhancement);
- FRN/bond issues (without credit enhancement);
- syndicated loans with the Bank's partial guarantee;
- FRN/bond issues with the Bank's partial guarantee; and
- CFS loans.

Loan Syndication

DMCs and private sector borrowers can benefit from the Bank's syndication capabilities and knowledge of the markets. The Bank can take the lead role in arranging commercial banks' participation or in selecting one or several market institutions to underwrite and arrange the cofinanced loan or bond. The Bank works closely with the borrower in determining the optimal structure of cofinancing and the best strategy on participation, underwriting, and arranging.

The services offered by the Bank cover a wide spectrum:

BA-AT

(Electric plant)

The Bank's lending for the energy sector stands at around $1.5 billion a year. Some $100 billion will be needed annually to meet the sector's growth.

- due diligence (appraisal of the project to be cofinanced);
- market surveys/soundings;
- structuring the financing needed, with the optimal use of credit enhancements;
- syndication strategy;
- assistance in preparing the invitation letter to potential cofinanciers seeking their financial offers;
- evaluation of the offers received and mandating;
- negotiation and documentation; and
- loan administration.

Since 1970, the Bank has arranged commercial cofinancing for 85 projects totaling $5.2 billion (as of end of 1998). Since 1994, annual commercial cofinancing for both public and private sector projects has averaged $200-500 million, and reached over $1 billion in 1998.

COMMERCIAL COFINANCING

T-SH

(Road infrastructure)

I-RS

(INO-Curved Road)

The external capital needed for the transport sector is estimated at $300–350 billion in the next few years. The Bank plays a catalytic, demonstrational, and developmental role in supporting BOO/BOT projects in DMCs.

Recent trends reveal the emphasis on commercially cofinanced large-scale infrastructure projects. Syndicated loans, bonds, and FRN issues have emerged as useful instruments in financing such projects *(Table 1)*.

The Bank's credit enhancement facility can also assist small and medium enterprises through its guarantees. For instance, a partial credit guarantee of the repayment of principal can enable a DMC development bank to borrow from the market. Such a facility would be useful for small and medium enterprises to gain access to long-term commercial funding from international lenders or the international capital market.

COMPLEMENTARY FINANCING SCHEME

The Bank's CFS is a participatory cofinancing arrangement. It involves the prearranged sale to commercial lenders of participation in a complementary Bank loan, but without credit recourse to the Bank for debt service. The Bank is the lender-of-record, as the complementary loan is made in the name of the Bank.

The Bank arranges and administers (including disbursement and debt-servicing) the cofinanced or complementary loan with the same care it accords to its own loans. The CFS is similar to the International Finance Corporation's "B" loan program.

Though funded by commercial lenders, the cofinanced loan gets the benefit of the Bank's preferred creditor status since the Bank is the lender-of-record. The loan enjoys the same privileges and immunities as those applicable to the Bank's main loan:

- immunity from withholding tax and exemption from restrictions on remittance of interest and moratoria on repatriation of capital;
- most unlikely to be rescheduled in the event of an external debt crisis in the borrowing country;
- exemption from special debt provisioning requirements in some countries; and
- a cross-default clause that provides further comfort to lenders.

Maturities of CFS loans (on a project financing basis) typically vary from 7 to 8 years for industrial and manufacturing

TABLE 1: **COMMERCIAL COFINANCING: RECENT PROJECTS**

Year	Country	Project
1994	PRC	Anqing Acrylic Fiber Project/ Guanzhou Pumped Storage Stage II Project
1995	PRC	Qitaihe Thermal Energy Project and Environmental Improvement
1995	PHI	Northern Luzon Transmission and Generation Project
1996	PAK	Fauji Kabirwala Power Project (Private Sector)
1996	PRC	Henan Power Project
1997	SRI	Small & Medium Enterprises Assistance Program
1998	THA	Export Financing Facility
1998	VIE	Nghi Son Cement Corporation (Private Sector)
1998	SRI	Credit Enhancement Facility for Private Enterprises
1998	PRC	Fujian Pacific Electric Co., Ltd. (Private Sector)

Note: PRC - People's Rep. of China; PAK - Pakistan; PHI - Philippines; THA - Thailand; SRI - Sri Lanka

Amount and Term	Credit Enhancement
$78 million 15-year syndicated loan	CFS loan
$55 million 15-year syndicated loan	Commercial loan without credit enhancement
Yen 12 billion 20-year bond issue	Bank guarantee covering bullet repayment at maturity
$60.5 million 12-year syndicated loan	CFS loan
$40 million 15-year syndicated loan	Commercial loan without credit enhancement
$50 million 10-year syndicated loan	Bank guarantee covering bullet repayment at maturity
$950 million 5-year syndicated loan	Syndicated loan with Bank guarantee covering principal repayments and interest in first 3 years
a) $26.5 million 8.5-year syndicated loan	CFS loan
b) $26.5 million 8.5-year syndicated loan	IFC "B" loan
c) $30.0 million 10.5-year direct loan	IFC "A" loan
d) $54.6 million	J-Exim subordinated loan with guarantee by the Ministry of Finance of Viet Nam
$65 million 10-year floating rate note	Bank guarantee covering bullet repayment at maturity
a) $150 million 12-year syndicated loan	CFS loan
b) $129 million 16-year export credit cofinancing	COFACE & CESCE insured facilities
c) $218 million 12-year syndicated loan	Commercial loan without credit enhancement
d) $30 million 10-year syndicated loan	Commercial loan without credit enhancement for working capital

projects and from 10 to 12 years for build-own-operate (BOO) or build-operate-transfer (BOT) infrastructure projects, in which host governments have some involvement.

As of 31 December 1998, 33 CFS loans for 30 projects had been arranged in 8 DMCs for a total of $846 million. ❑

Mitigating Risks: Role of Guarantees

7

In 1995, the Bank adopted a new policy on the use of guarantees. Earlier, the Bank provided partial credit guarantees for public sector projects, but only in exceptional cases. The 1995 policy provides for an expanded use of guarantees that includes credit guarantees as well as risk guarantees. The Bank only provides partial guarantees, as risks should be shared between the Bank and private cofinanciers.

The Bank is in a key position to provide sovereign risk mitigation to private investors.

Types of Guarantee

Under the partial credit guarantee scheme, the Bank provides full coverage of all commercial and sovereign risks for a portion of the debt service. Under this scheme, the Bank typically guarantees later maturities of principal or principal repayments and interest payments falling due during the later maturities, depending on the requirements of the borrower and cofinanciers.

Sovereign contractual obligations vary from country to country and project to project. Compliance with such obligations by the host governments is, however, critical to the viability of a project. The partial risk guarantee covers all (or part) of the debt service against a specific and well-defined list of sovereign risk events. The Bank agrees to pay the lender the guaranteed debt service, if a default that occurs on the payment of the debt service is due to any of the sovereign risks specified in the list of risk events.

The Bank will require a counter-guarantee or indemnity from the host government, to cover partial credit guarantees for public sector borrowers and partial risk guarantees for private sector borrowers. The Bank's partial risk guarantee is designed to enhance the likelihood of a government's compliance with the undertakings it has already given to an investor and to project cofinanciers. Since the sovereign risks covered by the Bank's guarantee are under direct or indirect control of the host government, the counter-guarantee is intended to provide further assurance to cofinanciers and the Bank of a government's commitment to the project.

Sovereign risk guarantees are applicable to private sector projects. The rationale of a sovereign risk guarantee is that commercial lenders can take on project risks themselves, but need the assistance of multinational finance institutions (such as the Bank) for managing sovereign risks. Following are some of the sovereign risks that can be covered under the Bank's partial risk guarantee:

- unavailability of foreign currency or convertibility problems;
- expropriation or nationalization of project assets, which may include adverse changes in the agreed regulatory environment or tax regime or other discriminatory government actions;
- strikes and civil disturbances that affect the project;
- nondelivery by state-owned entities of inputs (such as fuel supply) or nonpayment for outputs;
- failure to provide complementary infrastructure;

IA-NM

(Energy plant)

The overall aim of Bank assistance in the energy sector is to encourage DMCs to develop appropriate market structures and foster greater competition.

- interruptions or delays caused by government actions;
- other obligations treated as political risks.

Public or private entities which are eligible to receive Bank loans may also receive the benefit of the Bank's guarantees. All member countries, including those which receive only the Bank's Asian Development Fund assistance, are eligible for Bank guarantees. However, certain countries considered marginally creditworthy for Bank lending may not qualify for guarantees at a particular time. The guarantee scheme is particularly useful for large infrastructure projects assisted by the Bank in the public as well as in the private sector, especially BOO and BOT projects. The scheme can also support external borrowings of development finance institutions for their onlending operations.

The Bank should have a direct stake in the project, either by way of a loan or equity investment; accordingly, it cannot provide a stand-alone guarantee.

In the case of a private sector project that is not supported by a counter-guarantee by the host government, the Bank's guarantee counts against the Bank's exposure limit of $50 million or 25 percent of the project cost, whichever is lower. No limit on the guarantee applies to private or public sector projects, if a counter-guarantee is provided by the host government.

The Bank is compensated for the risks it takes in providing the guarantee. Separate fee structures apply to public and private sector borrowers. The pricing is nondiscriminatory among public sector borrowers in DMCs, and is market-based for private sector projects.

Support for Bond Issues

As part of the Bank's cofinancing strategy, the Bank's guarantee facility can be used to enable DMCs to access capital markets for long-term debt financing. A bond issue is an ideal means of raising long-term funds at a fixed interest rate. Credit enhancement through a credit guarantee by the Bank would enable a DMC government to extend the maturity of bonds well beyond what the market would provide without such a guarantee, and to improve pricing and other terms. ❑

EXPORT CREDIT 8

With the increasing emphasis on capital-intensive infrastructure projects, the demand for export credit cofinancing is increasing in the Region. During 1970-1998, the Bank arranged export credits of $4.7 billion to support 46 Bank-assisted projects.

Capital-intensive infrastructure projects and the recent financial crisis have increased the demand for export credit in the Region.

From the standpoint of the export credit agencies (ECAs), cofinancing with the Bank can provide comfort because of the due diligence the Bank exercises in project identification, design, appraisal, and implementation, and ECAs can rely on the project-related information provided by the Bank. As ECAs in most countries work closely with commercial banking institutions, cofinancing through export credits can supplement the commercial cofinancing operations of the Bank.

The Bank's cofinancing strategy calls for proactive measures in promoting export credit for the benefit of DMCs. To help its public sector borrowers obtain export credit more efficiently, the Bank has begun implementation of an ECA collaboration strategy. The key features of the strategy include: (i) early identification of projects, (ii) advance notice to ECAs, (iii) a two-bid procedure, (iv) Bank assistance in evaluating finance bids, (v) Bank support for the 15 percent deposit finance, (vi) economy and efficiency in procurement, and (vii) Bank assistance during negotiations. Under the two-bid procedure, bidders for contracts eligible for export credit will be asked to submit two bids – a commercial/technical bid with a cash price, and a financial bid to propose export credit or other financing.

(For more details, please refer to the Commercial Cofinancing and Guarantees Brochure.)

In addition to working with ECAs to obtain much needed export credits for its projects, the Bank is exploring other ways to collaborate with ECAs, especially in the area of support for local currency loans and extended political insurance covering contract repudiation.

The Bank's quarterly publication *Project Profiles for Commercial and ECA Cofinancing* provides information on Bank-assisted projects that would be of interest to commercial financing institutions and ECAs. ❑

Towards a Conducive Environment

9

Significant additional resources needed for the Region's accelerated growth will have to come from commercial cofinancing and export credit sources. The Bank's cofinancing strategy is designed to leverage additional financial resources to the DMCs from external sources, particularly market sources. However, the success of the Bank's efforts will depend to a large extent on the policy environment of DMCs.

The Bank can play a key role in arranging finance for large bankable projects in DMC governments and to seek alternative sources of finance for economic growth.

To attract commercial cofinancing, projects should be relatively large in size and bankable. In other words, such projects should generate revenue and have a sustainable cash flow to service commercial borrowings. A critical element determining commercial viability will be the policy environment, which varies from country to country.

A conducive environment needs a deliberate resolve on the part of all parties, particularly DMCs, to promote private participation and/or partnership with public entities. The Bank's policy dialogue with DMCs — conducted in the context of policy-based sector and project loans and TA — provides an accepted framework for a continuous improvement of the environment for the operation of the private sector.

The policy dialogue enables DMCs to review their policies on appropriate legal frameworks; institutional and administrative frameworks; pricing, tariff, and subsidy issues; commercialization, corporatization, or privatization policies; human resource development; and development of the capital market and finance sector.

TOWARDS A CONDUCIVE ENVIRONMENT

T-RT1

(Man in the telephone booth)

T-RT1

(Telecommunication tower antenna)

The ongoing technological revolution in telecommunications is yet to benefit large parts of the Region. Several DMCs have already encouraged private participation in the development of the sector.

In providing project finance, the Bank seeks to play a catalytic role by enhancing the credibility of projects. For example, the Bank's policy on financing BOT projects envisages a fair allocation of risks, a reasonable return on investment, and proactive measures for domestic capital market development. The Bank's special relationship with DMC governments and its expanded guarantee policy will help to attract private capital.

DMC governments play a key role in bringing about a policy environment suitable for formulating large-scale infrastructure projects. A conducive environment that will inspire the confidence of international investors can emerge only from a long process of vision and revision. The Bank's cofinancing strategy is fully committed to help DMCs meet this challenging task. ❑

QUESTIONS AND ANSWERS 10

Can project sponsors and their bankers get Bank cofinancing for their projects? If so, how and when do they have to discuss the matter with the Bank?

Yes, but cofinancing is possible only if the Bank directly assists the project with a loan, an equity investment, or both. Private sector sponsors and their bankers should, therefore, explore the scope for Bank participation through discussions with the Bank's Private Sector Group at an early stage of project development. Once PSG decides that they will process the project for a loan or equity, then the Office of Cofinancing Operations can make cofinancing arrangements for the project. The sooner a sponsor checks the possibility of the Bank's interest, the better. It is helpful if sponsors have a prefeasibility study completed before approaching the Bank.

How does the Bank inform potential cofinanciers of suitable projects for cofinancing?

The Bank's quarterly publication, *Project Profiles for Commercial and ECA Cofinancing* (available without charge on request), lists projects that require cofinancing from market sources. Consultations with the Bank's Office of Cofinancing Operations will also indicate the potential for cofinancing. In addition, ADB Business Opportunities, a monthly publication that is sold through the Office of External Relations, includes a list of commercial cofinancing possibilities. The information in these publications is also available on the Internet.

How can potential cofinanciers express their interest in cofinancing a specific project?

They are encouraged to check the Bank's *Project Profiles for Commercial and ECA Cofinancing* regularly, and register their interest in cofinancing one or more of the projects with the Bank's Office of Cofinancing Operations through fax, telephone or e-mail.

How are cofinanciers selected?

The mandating process varies depending on the nature of the project and the preferences of the market and the borrower. For moderate-size private sector project financing deals under CFS, for example, potential cofinanciers are invited to participate, with the Bank acting as the lead arranger. An Information Memorandum is made available to invited institutions. For complex and large-size deals under CFS, the Bank is open to having one or several institutions underwrite/arrange the entire amount through a competitive bidding process and will help with the general syndication. In some cases, the Bank can work with other market institutions as coarrangers. For commercial cofinancing for public sector borrowers, a competitive bidding process is usually called for to mandate the underwriter and arranger.

Will the Bank consider a stand-alone guarantee or CFS loan?

No. A guarantee or CFS loan will be considered only in the context of a Bank-assisted project. Bank assistance can take the form of a loan, an equity investment, or both.

Is there any limit on the amount of the guarantee?

There is no limit on guarantees for public sector borrowings or when government counter-guarantees are obtained. The Bank's involvement in a private sector project, by way of loan, equity, or guarantee, is limited to 25 percent of the total project cost or $50 million, whichever is lower.

Will the Bank's Procurement Guidelines apply to CFS loans?

No. However, the Bank will require that (i) procurement financed out of a CFS loan be restricted to the Bank's member countries, (ii) the proceeds of such a loan are used exclusively for the project, and (iii) the procurement is with due attention to economy and efficiency.

How does the Bank promote its coordination with donors?

When formulating the Bank's operational strategy in a country, the Bank regularly coordinates with other donors, noting their aid strategies and operational objectives. Cofinancing possibilities on specific projects are explored when country assistance plans are formulated and later, if required, when project preparatory TA is provided. At practically all stages of project processing, the Bank seeks opportunities for cofinancing. The Bank also welcomes participation of cofinanciers in appraisal missions as well as in project implementation.

How can donors enhance the value of their grant contribution?

Several donors provide grant assistance to support specific components of Bank-assisted projects. These components generally relate to capacity-building measures that streamline the skills and quality of human resources. The benefits lead to a better utilization of external assistance and result in permanent assets to DMCs in crucial sectors. The Bank welcomes regular contributions from donors for grants in the so-called "soft" areas which are of great value to DMCs.

How can DMCs help increase official cofinancing?

DMCs play a crucial role in determining the scope for official cofinancing. DMCs can help by identifying projects for cofinancing early in the project processing cycle of donors as well as the Bank. DMCs can also take proactive measures seeking financial assistance from bilateral donors for projects with cofinancing possibilities. ❑

GLOSSARY

Channel Financing Cofinanciers channel their funds to DMCs, through the Bank, to support the Bank's technical assistance operations. In this mode, cofinanciers accept the Bank's guidelines and procedures on recruitment of consultants, procurement, loan disbursement, and project supervision.

Cofinancing From the Bank's perspective, the term refers to financing from sources external to the borrowing country or external to the project proponents, arranged to fund Bank-assisted projects or programs jointly or in parallel with a Bank loan. Accordingly, cofinancing will include (i) financing arranged in parallel or jointly with a Bank loan, to cover part of the project scope, and included in the financing plan of the project (including retroactive financing arranged to replace part of the Bank loan); (ii) debt financing from sources external to a Bank-assisted project and project proponents; (iii) grant financing from sources external to the borrowing country; and (iv) equity financing for a private sector project provided from market institutions and not by the project sponsors.

Complementary Financing Scheme A participation modality under which the Bank, in addition to the loan from its own resources, makes a complementary loan on market-based terms, funded entirely by participation from market institutions without recourse to the Bank. Under this arrangement, the participating market institutions enjoy a preferred creditor status under the Bank's CFS umbrella. In return for the privileges accorded, the participating institutions provide financing which otherwise would not be possible at affordable terms.

Cross-default Clause Through this clause, default on one loan or several loans would trigger a default on the Bank's main loan. Multilateral development banks retain the option of either declaring their loans immediately due and payable or seeking other remedies under the optional cross-default clause.

Export Credit Term finance which is provided by export credit agencies, either through their guarantee to commercial lenders or direct credit to borrowers. Such credit takes the form of either buyer's credit or supplier's credit. Export credit is usually provided in medium-term finance as a supplement to resources of the private sector, and generally for export promotion for capital equipment in relatively large-scale projects.

Guarantee A written undertaking by the guarantor to pay a stated amount to a beneficiary if the borrower fails to meet certain commitments such as loan repayment. If a guarantee covers part of debt servicing, and covers all events of nonpayment, it is called a partial credit guarantee. If it covers a specific sovereign risk, it is called a partial risk guarantee. In case of the latter, the guarantee is callable only if the default on debt-servicing is due to the specific risk covered.

Joint Financing The funds of the Bank and cofinanciers are pooled to finance a common list of goods and services required for the project in agreed-upon proportions. Under this mode, the Bank's Guidelines for Procurement govern the procurement of goods and services. This mode is suitable only when cofinanciers do not tie their assistance or impose any special procurement restriction and agree to follow the Bank's procurement guidelines.

Parallel Financing The funding arrangement in which project is divided into specific and identifiable packages of components. Each package is financed separately, either by the Bank or by cofinanciers. This mode is generally used on a tied basis when the cofinanciers have procurement policies and procedures different from those of the Bank and administer their loans themselves.

Political/ Sovereign Risk Risks under the control of a government. They vary depending on the circumstances and the perceptions of project participants. The risk may relate to foreign currency convertibility, performance of government-owned entities (including the input and off-take agreement), regulatory environment, and issuance of critical permits (by customs, environment, and other agencies), and/or political force majeure.

Preferred Creditor Status The preferred creditor status of a multilateral financial institution (MFI) is not, strictly speaking, a legal concept, but the result of a common understanding among a borrowing DMC, its commercial creditors, and official creditors on preferential allocation of foreign exchange among creditors in the event of a default. Accordingly, in the event of a shortfall in foreign exchange needed to service a DMC's external debt-service obligations, the borrower will be allowed to make a preferential allocation of foreign exchange to service its debts owed to MFIs without triggering remedial action on the part of other creditors. In addition, preferred creditor status may also accord tax exemptions and other immunities to creditors.

Office of Cofinancing Operations: Principal Responsibilities

The principal responsibilities of the Bank's Office of Cofinancing Operations are to:

- *act as the Bank's focal point for planning, promoting, and arranging cofinancing, in consultation with borrowers for Bank-assisted projects and programs, and for formulating policies on cofinancing operations;*
- *act as the focal point within the Bank for Headquarters-level contacts with other international development institutions such as multilateral and bilateral aid agencies, export credit agencies, commercial banks, and other private financial institutions, and to coordinate on matters regarding cofinancing sources and modalities consistent with the Bank's operational policies, procedures and practices;*
- *arrange regular consultations on cofinancing, and to maintain close relations with syndicated loan and capital markets in consultation with other Departments and Offices concerned;*
- *assist in resource mobilization through participation in country programming and project appraisal missions, where necessary, leading to the identification of loan and technical assistance projects and programs requiring cofinancing in cooperation with other concerned work units;*
- *identify appropriate cofinancier(s) and to assist operational units in formulating financial "packages" for projects and programs requiring cofinancing, and in administering the cofinancier's loan(s);*
- *establish and manage technical assistance grant funds entrusted by donors to cofinance/exclusively finance technical assistance projects on a grant basis, and to assist in arranging grant financing of technical assistance components included in Bank-assisted projects;*
- *coordinate the process of seeking fund commitments from the Japan Special Fund and administer Bankwide utilization of such Fund; and*
- *maintain Bankwide information and a database on cofinancing and to prepare periodic reports required by Management, other Departments and Offices, and cofinanciers.*

THE BANK'S MEMBERS

REGIONAL (41)	NONREGIONAL (16)
Afghanistan	Austria
Australia	Belgium
Bangladesh	Canada
Bhutan	Denmark
Cambodia	Finland
China, People's Republic of	France
Cook Islands	Germany
Fiji	Italy
Hong Kong, China	Netherlands
India	Norway
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	
Micronesia, Federated States of	
Mongolia	
Myanmar	
Nauru	
Nepal	
New Zealand	
Pakistan	
Papua New Guinea	
Philippines	
Samoa	
Singapore	
Solomon Islands	
Sri Lanka	
Tajikistan	
Taipei,China	
Thailand	
Tonga	
Tuvalu	
Uzbekistan	
Vanuatu	
Viet Nam	

CONTACTING THE BANK

For further information on the Bank's cofinancing operations, the following staff may be contacted:

OFFICE OF COFINANCING OPERATIONS

Fax No. (632) 636-2456

Mr. Jeremy H. Hovland *Chief*	Tel. No. (632) 632-6314
Mr. Woo Chull Chung *Assistant Chief*	Tel. No. (632) 632-6276
Mr. T. David Hodgkinson *Senior Cofinancing Officer* *(Commercial Cofinancing)*	Tel. No. (632) 632-6273
Mr. Haruya Koide *Senior Cofinancing Officer* *(Official Loan Cofinancing)*	Tel. No. (632) 632-6124
Mr. Riccardo Loi *Senior Cofinancing Officer* *(Official Grant Cofinancing)*	Tel. No. (632) 632-6204
Mr. M. Zeki Kiy *Cofinancing Officer* *(Official Cofinancing)*	Tel. No. (632) 632-6149
Ms. Sangme Lee Coghlan *Cofinancing Officer* *(Commercial Cofinancing)*	Tel. No. (632) 632-6275
Mr. Martin P. Endelman *Cofinancing Officer* *(Export Credits/Commercial Cofinancing)*	Tel. No. (632) 632-6102

PRIVATE SECTOR GROUP

Mr. J. Antonio M. Quila *Senior Manager*	Tel. No. (632) 632-6400

Information on the Bank's cofinancing operations is available on the Internet. The Bank's web site is located at ***http://www.adb.org*** .

The Bank's postal address is ***P.O. Box 789, 0980 Manila, Philippines***.