Session 5

Policy Based Lending and Sector Development Program

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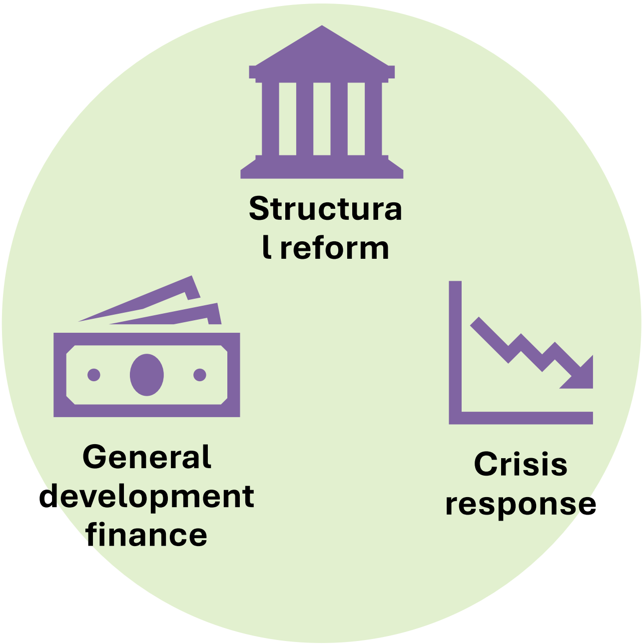
ADB

Policy Based Lending

- Promotes long-term sector-wide / economy-wide impact through structural reforms
- Requires meaningful DMC policy actions
  Except for countercyclical support facility
- Provides general budget support to DMCs
  PBL transfers loan amounts to the government's general budget instead of paying for explicit project costs
- PBL may support
  - Sectoral and intersectoral reform programs to which the government is committed
  - Rapid response to crises



POLICY-BASED LENDING

Types

CONVENTIONAL PBL

1. Stand-alone PBL
- For sector reforms over the short to medium term
- Single tranche or multitranche loan
- Policy actions approved upfront for all tranches with disbursement upon completion of actions

2. Programmatic approach
- Series of subprograms
- Policy actions approved at time of each subprogram

+ Financing Options
+ Project Loans/Sector Loans/FILs
= Sector Development Program

CRISIS RESPONSE PBL

3. Countercyclical support facility (CSF)
- For fiscal stimulus in times of economic crisis or to promote growth following exogenous shock
- Access criteria cover health emergencies and reflect ADB's priority support for vulnerable groups
- Country must have countercyclical expenditure program in place

4. Special PBL
- For times of balance-of-payment crisis
- Short-term, large, quick disbursing
- Flexible conditions, focusing on actions to reduce severity of crisis
- Part of IMF-led bailout package

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Financing options

For Conventional PBL

CONVENTIONAL PBL

1. Contingent disaster financing (CDF)

- Provides emergency budget support in the event of a disaster triggered by natural hazards, or a health emergency
- Funds disbursed only following state of emergency or equivalent (after Board approval of PBL)
- Policy matrix focused on disaster resilience or health emergency preparedness
- Several operations in the Pacific, Indonesia, and the Philippines

2. Policy-based guarantee (PBG): conventional PBL with credit enhancement product

- ADB guarantee for government-issued bonds
- For macroeconomic or fiscal reform program
- Typically more expensive but offers greater financial leverage
- Can support local capital markets

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POLICY-BASED LENDING

General Policy Requirements

1. Strong **government ownership** of the reform program

2. Implementation of substantive **policy reforms** with sector or economy wide impacts

3. **Fiduciary arrangements** need to be in place

4. Direction of **macroeconomic conditions and policies** must be deemed satisfactory

5. Adequate coordination with the **IMF**

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Suitability for Structural Reform PBLs

Facing legal, institutional, or regulatory weaknesses

- constraining the achievement of development objectives
- identified as a priority for support in the country partnership strategy

Committed to a comprehensive reform program

Needs development financing to fill gaps in medium-term fiscal and debt frameworks

Conventional PBL at a glance

Stand-alone (multitranche) PBL
establishes multiple sets of policy actions

Disbursement is available once a set of policy actions is fully completed (with ADB Management approval)

Programmatic approach
a series of single-tranche PBLs

Requires concept approval of a long-term reform plan

Includes indicative policy actions of subsequent subprograms at the processing of the 1st subprogram

General features

- Disbursed as general budget support
- Option for deferred disbursement allows fund access at end of availability period
- Tailored commitment options to reduce fees
- Full or partial disbursement available

Loan amount

Determined by development financing needs

Loan terms

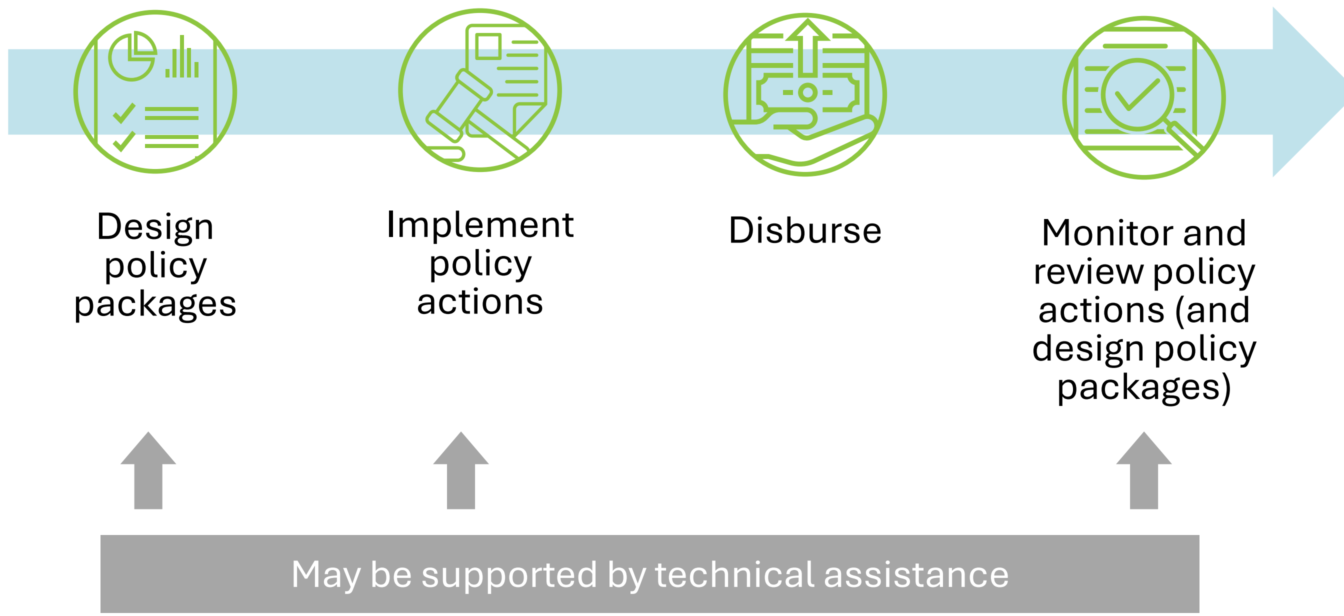
- Regular OCR: 15 years (including 3 years grace period)
- Concessional OCR (COL): 25 years (including 5 years grace period)

POLICY-BASED LENDING

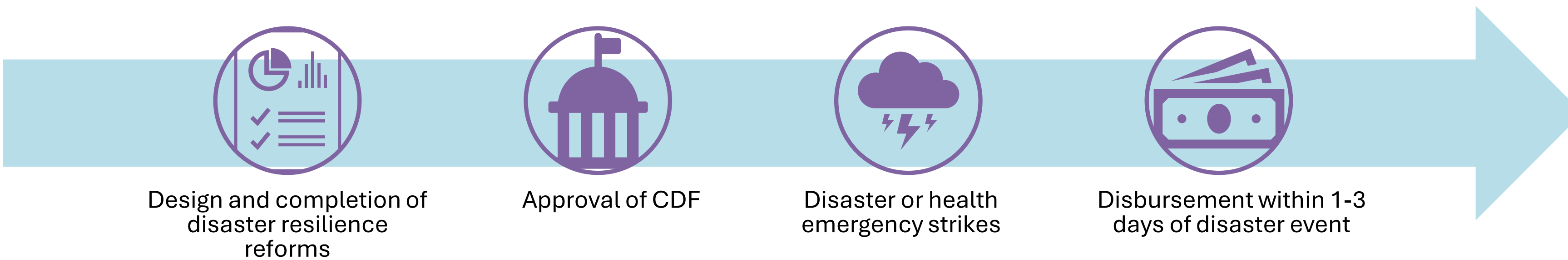
Conventional PBL Life Cycle

Conventional PBL supports design and implementation of critical reforms within a certain time frame.

A series of conventional PBLs can support medium-term and long-term reform agenda in a sequential manner.



Contingent Disaster Financing at a glance



Purpose

- Strengthens institutional preparedness for disaster triggered by natural hazard/s, or a health emergency
- Provides *quick disbursing* liquidity following a disaster
  - *CDF remains available for up to 15 years (without replenishment) and 15–25 years (with replenishment) for regular OCR, and up to 6 years (without replenishment) and 6–10 years (with replenishment) for concessional OCR and ADF*

Requirements

- Sound macroeconomic policy framework and debt sustainability
- Development constraints through in-depth sector and economic analysis
- Policy actions/reforms to address constraints (as agreed with the client)
- Government ownership of the reforms. Ideally, with long-term sector reform strategy and interagency coordination framework

Loan amount

Determined by development financing needs (may also include explanation of past fiscal costs of major natural hazards and/or health emergencies and any forecasts of expected future fiscal or economic costs as a result of climate change or other factors)

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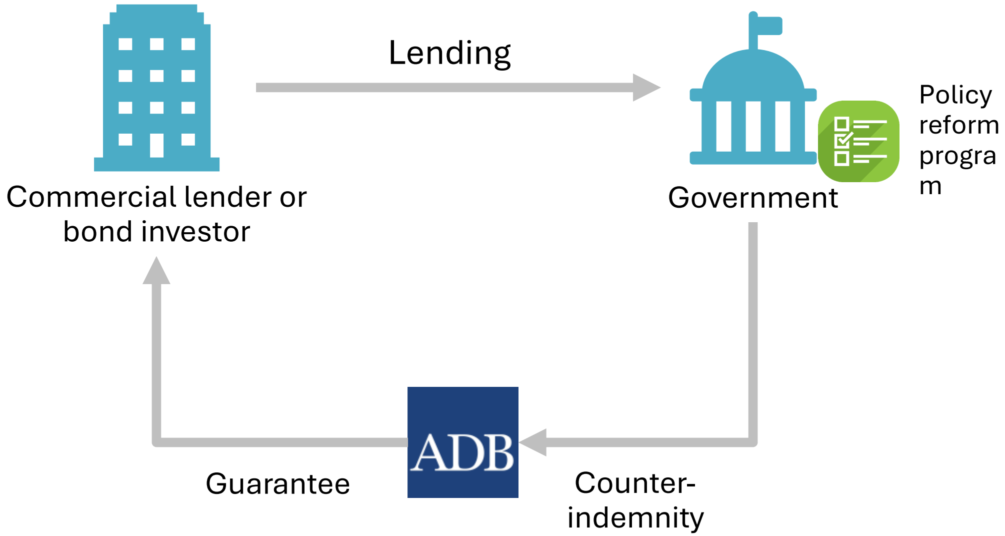
POLICY-BASED LENDING

Policy-based guarantee at a glance

Features

- Supports government's reform program as PBL
- ADB provides a partial credit guarantee to commercial lenders or bond holders instead of a direct policy-based loan
- Guarantee allows ADB to leverage higher levels of commercial financing compared with an ADB PBL
- Helps governments access international capital markets, improve their terms and conditions and gain experience with market transactions



Countercyclical Support Facility at a glance

Purpose
supports the government's macroeconomic stimulus measures during economic downturn due to external shock

Requirements

- Countercyclical expenditure program
- Meets the 7 access criteria

Not required

- IMF program
- Policy matrix

CSF access criteria

1. Adverse impact of exogenous shocks
2. Countercyclical development expenditures
3. Pre-shock record of generally sound macroeconomic management
4. Structural reforms
5. Debt sustainability
6. Coordination with the IMF
7. Monitoring and evaluation

	OCR	COL
Loan amount country ceiling	Based on 0.5% of 3-year rolling average GDP Maximum of $1.5 billion	Maximum of $250 million
Tenor	7 years, including a grace period of up to 3 years	same as conventional PBL
Pricing	75 bps plus SOFR or other cost-based rates (+rebate/surcharge); commitment charge of 15 bps for undisbursed loan balance	same as conventional PBL

Special PBL at a glance

Purpose

provides immediate liquidity support for the country's external and internal debt payment challenges due macroeconomic crisis

Disbursement is available once a set of policy actions is fully completed (with ADB Board approval)

Requirements

- IMF program
  Policy matrix is formulated based on the conditionalities of IMF program
- Follow-on structural reforms through conventional PBLs, in line with IMF program

Tenor

5–8 years, including a grace period of up to 3 years

Pricing

- A minimum of 200 bps plus SOFR or other cost-base rates (+rebate/surcharge)
- Commitment charge of 75 bps for undisbursed loan balance

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Sector Development Program

- Combines a PBL component and investment component in one program
- Addresses sector needs and development constraints in a comprehensive manner
- **A consolidated design and monitoring framework** covers the PBL component and investment component
- Fosters an integrated and long-term approach to sector needs (policies, institutions, and investments) and enhances ADB's leverage for promoting policy and institutional reforms
- Strong commitment to sector reform by the government is essential

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SECTOR DEVELOPMENT PROGRAM

At a glance

Pays for

- Budget support (PBL component)
- Project expenditures (investment component)

Disbursement

- PBL component: one or more tranches against completion of conditions
- Investment component: amounts requested to cover project expenditures

Policy requirements

Policies and procedures applicable to each component must apply in the context of the whole SDP

For detailed business process, please refer to the SDP guideline.

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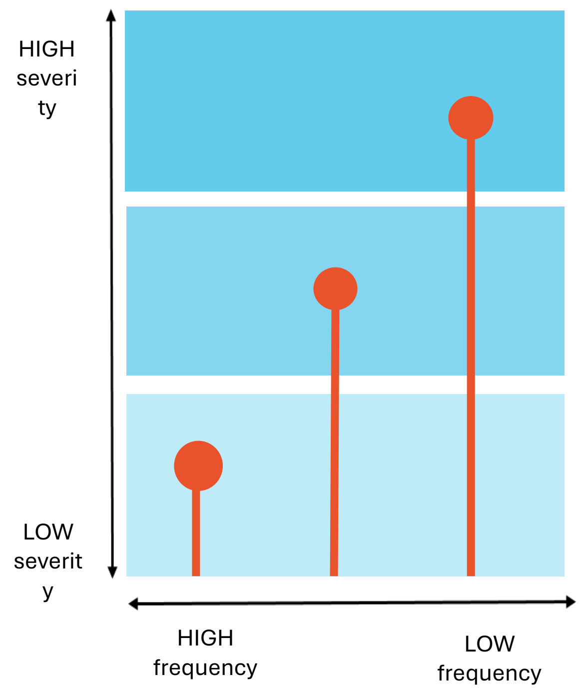
APPENDIX :
CONTINGENT DISASTER FINANCING (CDF)

1. Risk layering approach to CDF

- Risk layering breaks down disaster risk according to the frequency of a hazard occurring and the corresponding level of loss incurred (severity).
- It combines a range of ex-ante and ex-post instruments for each layer to create a comprehensive and cost-effective disaster risk financing strategy.
- **Low-level risks** (more frequent but less damaging) can be managed by risk retention tools such as disaster reserves, contingency budget and budget reallocation.
- **Medium-level risks** are best managed by contingent financing lines and insurance.
- **High-level risk** (rare catastrophic events but highly damaging) can be managed by insurance linked securities (catastrophe bonds) and international assistance.



INTERNATIONAL ASSISTANCE: ex post grants, loans and technical assistance from development partners *(including ADB emergency assistance loans and APDRF grants)*

RISK TRANSFER: ex ante insurance, reinsurance, and insurance-linked securities *(including ADB supported products)*

RISK RETENTION: ex ante annual contingency budget lines, reserves, and contingent financing *(including **ADB contingent disaster financing**)*; ex post budget reallocations, borrowing, tax increases

2. What is a CDF?

- **Ex-Ante financing option under ADB's PBL modality:**
  - Disbursements made upon trigger of pre-agreed drawdown conditions (typically declaration of a state of emergency), providing rapid liquidity to the government after a disaster event.
  - Use of the CDF does not preclude use of other ADB instruments for post-disaster response (e.g., emergency assistance loans).
- **Benefits:**
  - Provides rapid access to resources which enables the government to mitigating a disaster's economic and social impact by quickly initiating disaster response, early recovery and reconstruction efforts with minimal delays.
  - Enhances the fiscal management of disaster risk, complements contingent budget allocations and reduces funding gaps.
  - Provides a cost-effective method of managing disaster risk, addressing post-disaster funding needs that exhaust annual contingency budgets and national reserves, but are too frequent to be covered cost effectively through insurance.
  - Promotes long-term disaster resilience via linked policy actions:
    - Helping countries to design and implement tailored disaster resilience actions; and
    - Providing an important opening for dialogue and engagement with government, including with ministries of finance, on disaster risk management.

2. What is a CDF? (cont..)

- **Accessing criteria (following the same criteria as conventional PBL)**
  - Adequate macroeconomic policy framework and debt sustainability
  - Satisfactory completion of a set of substantive legal, institutional, and policy reforms to strengthen disaster resilience and disaster risk management (captured in a policy matrix, based on prior actions) and the government's commitment for continued reforms under a post-program partnership framework (PPPF) during the availability period

- **High-level CDF terms and conditions:**
  - **Availability Period**: Initial availability period of CDF financed by regular OCR, concessional OCR, and the ADF is 3 years without replenishment or 3–5 years with replenishment. Regular OCR-financed CDF can be renewed up to four times for a maximum of 15 years (without replenishment) or 15–25 years (with replenishment). Concessional OCR- and the ADF-financed CDF can be renewed once for a maximum of 6 years (without replenishment) or 6–10 years (with replenishment).
  - **Coverage**: Extreme weather, geophysical hazards and health emergencies
  - **Disbursement**: Single disbursement per disaster event – either full or partial disbursement based on a trigger (pre-specified disbursement condition, such as declaration of state of emergency")
  - **Deferred Disbursement Option**: If no disaster event occurs or if the funds are not fully disbursed, the DMC may elect to disburse the remaining amount at the end of the availability period, subject to the sufficient progress of the program in terms of (a) macroeconomic soundness, (b) continued compliance of prior actions, (c) continued progress of PPPF.
  - **Resource Commitment:** Option 1 (Committed Capital) or Option 2 (Unallocated Capital)
  - **Front-end Fee:** No Commitment Charge, but (i) OCR- 0.25% front-end fee upon loan effectiveness (Option 1) or 0.1% front-end fee (Option 2); or (ii) COL – no front-end fee
  - **Repayment:** Disbursement-linked repayment schedule

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Comparison of terms and fees of CDF

	Asian Development Bank				
	Regular OCR	**Regular OCR**	**Regular OCR**	**COL**	**ADF**
	Standard PBL	**Proposed CDF PBL (Committed capital)**	**Proposed CDF PBL (Unallocated capital)**	**Proposed CDF PBL**	**Proposed CDF PBL**
Eligibility[a]	Regular OCR-only and OCR blend	Regular OCR-only and OCR blend	Regular OCR-only and OCR blend	COL-only and ADF blend	ADF-only and ADF blend
Currency	Regular OCR terms	Regular OCR terms	Regular OCR terms	SDR, USD, EUR, JPY, and GBP	USD
Renewal	Nil	Availability period may be extended four times, for a total of 15 years	Availability period may be extended four times, for a total of 15 years	Availability period may be extended once, for a total of 6 years	Availability period may be extended once, for a total of 6 years
Repayment terms[b]	Regular OCR terms	Regular OCR terms	Regular OCR terms	Regular COL terms	Nil
Upfront fee	Nil	0.25% of the allocated loan amount (where allocation precedes the disaster)	0.10% of the allocated loan amount (where allocation follows a disaster)	Nil	Nil
Renewal fee	Not applicable	0.25% of undisbursed loan amount	0.25% of undisbursed loan amount[c]	Nil	Nil
Commitment fee	0.15% of undisbursed loan amount	Nil	Nil	Nil	Nil

Two resource commitment options. For regular OCR and COL-financed operations, DMCs may avail of one of the two resource commitment and pricing options outlined below. The selected option will be fixed during the life of the loan, including any renewal periods.

(i) **Option 1: Committed capital.** Upon loan effectiveness, the committed CDF amount will be available for disbursement immediately after a disaster occurs.

(ii) **Option 2: Unallocated capital.** ADB will approve a maximum CDF amount requested by the borrower from its resources available for commitment (RAC) but will not allocate it. Approved but unallocated CDF amounts for both regular OCR and COL will remain available for regular country programming allocations. To meet the financing needs for CDF in the event of a disaster and subsequent disbursement request, the borrower will be required to allocate resources from within its existing available resources for that year. If a DMC's RAC has been fully allocated that year and no additional resources are available, the DMC may elect to delay projects that are under preparation but not yet approved and allocate available funds for CDF commitment and disbursement.

Note: For details, please refer to ADB's Policy Paper titled Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards (2019).

3. ADB's Past Experience of CDF

- From 2016 to 2023, ADB approved 26 CDF operations to 12 DMCs in the Pacific and Southeast Asia with a total value of $1.21 billion. Discussions are on-going with other member countries.
- CDFs provided quick disbursement upon disasters. ADB was able to disburse funds within approximately 1 week from an official request from DMCs. For example, disbursements occurred in February 2018 for Tonga triggered by Cyclone Gita and in January 2020 for Tuvalu triggered by Cyclone Tino.
- Special policy variations were permitted during the pandemic to support health emergencies, and this variation has been mainstreamed in 2022 and the disaster covered by CDF now includes health emergency as well.

Palau (October 2018)

- Aligned with development objectives to enhance safety, resilience and preparedness of communities in Palau. It supports the implementation of the Palau Climate Change Policy for Climate and Disaster Resilient Low Emissions Development 2015 (PCCP) by strengthening disaster and climate risk management.

Philippines (August 2020)

- Aligned with the Philippine Development Plan (PDP), 2017 - 2022 in supporting the integration of disaster resilience in various sectors of the economy and providing better access to healthcare, particularly in light of the vulnerabilities exposed by the coronavirus disease (COVID-19) pandemic.

Indonesia (September 2020)

- Aligned with the National Medium-Term Development Plan, Rencana Pembangunan Jangka Menengah Nasional (RPJMN) 2020 - 2024. It supports reforms in disaster risk management and health services, and will help manage the fiscal risks arising from future disasters triggered by natural hazards and pandemics.

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Examples of policy actions used in previous CDFs: Philippines

Policy Actions were designed around strengthening disaster resilience and response to pandemics through 3 main areas:

1. **Policy and institutional arrangements for disaster risk management, including social protection**
   - Submit a consolidated bill for the establishment of a dedicated Department of Disaster Resilience to improve disaster resilience policymaking and coordination at the national level
   - Adopt COVID-19 testing capacity policy which prioritizes frontline workers
   - Funding for children at risk of child labor and parents of child laborers included in Budget 2021
   - Issue guidelines on implementing plans and programs that respond to the gendered impact of COVID-19 (discrimination, gender-based violence, etc)
   - Upgrade climate budget tagging policy with mandatory budget tagging for all national agencies and local governments
   - Accurate tagging of disaster risk reduction and climate change adaptation budgets and expenditure
2. **Resilience of national government assets and local government units to disaster and climate risks**
   - New guidelines for integrating disaster risk reduction and climate change action in training tools
   - Adopt a local government performance management system and monitoring framework
3. **Disaster risk financing**
   - Approve city-level parametric disaster insurance scheme for earthquake and/ or typhoon cover
   - Increase indemnity disaster insurance coverage to include volcanic eruption and storm surge

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