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Policy-Based Lending and Sector Development Program

19-23 August 2024 | ADB Headquarters, Philippines



ADB

Sovereign lending and grant modalities



Project lending



Financial intermediation lending



Conventional Policy-based lending



Results-based lending



Sector lending



Emergency assistance lending



Contingent disaster financing



Project readiness financing



Credit enhancement products



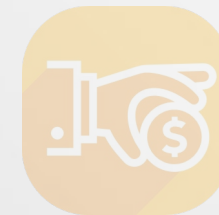
Multitranche financing facility



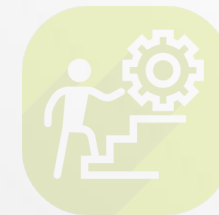
Sector development program



Special PBL & countercyclical support facility



Small expenditure financing facility



Technical assistance

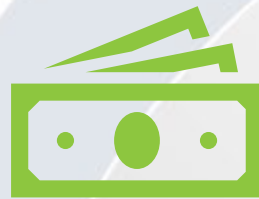
What is policy-based lending (PBL)?

- Provides general budget support to DMCs. PBL transfers loan amounts to the government's general budget instead of paying for explicit project costs.
- Supports sectoral and intersectoral reform programs that the government is committed to or provide immediate financial supports in response to crisis
- Requires meaningful policy actions by the DMC (except for countercyclical support facility)
- Promotes long-term sector- and/or economy-wide impact



Support structural reform

through a program of policy reforms provided through general budget support



Address development financing needs

in DMC's medium-term fiscal and debt frameworks



Crisis response

rapidly-disbursing financing for actual or anticipated financing requirements of domestic or external origins

Strategic consideration for PBLs



Structural reform

- 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



Crisis response

or

Refer to the slides on Countercyclical support facility (CSF) and Special policy-based loan (SPBL)

+ Unique requirements for PBL types and financing options

General Policy Requirements

- Strong government ownership of the reform program is essential
- Implementation of substantive policy reforms with sector or economy wide impacts
- Fiduciary arrangements need to be in place
- Direction of macroeconomic policies must be deemed satisfactory
- Adequate coordination with the IMF

PBL types

Conventional PBL

1. Stand-alone

- For reforms in a sector 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

- For structural reforms over the medium term
- Comprises a series of subprograms with policy actions approved at time of each subprogram

+ Financing Options
+ Project Loans (= Sector Development Program)

Crisis PBL

3. Countercyclical support facility

- For fiscal stimulus in times of economic crisis for growth following exogenous shock, with access criteria that cover health emergencies and reflect ADB's prioritization of support for vulnerable groups
- Country must have countercyclical expenditure program in place

4. Special PBL

- For times of BOP crisis
- Short-term, large, quick disbursing
- Flexible conditions, focusing on actions to reduce severity of crisis
- Part of IMF-led bailout package

Close coordination with the IMF required



PBL financing options

Conventional PBL with Contingent Financing

Contingent Disaster Financing

- PBL option that provides emergency budget support in the event of a disaster triggered by natural hazards, and a health emergency
- PBL approved by Board, but with funds only disbursed following state of emergency or equivalent
- Several operations in the Pacific, Indonesia, and the Philippines
- Policy matrix focused on disaster resilience or health emergency preparedness

Conventional PBL with Credit Enhancement Product

Policy-Based Guarantee

- 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

Sector development program (SDP)

WHAT IS IT?

SDP combines a PBL component and investment component in one program.

FEATURES

- Addresses sector needs and development constraints in a comprehensive manner
- A consolidated results-monitoring framework to cover 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





Conventional PBL

Standalone (multitranche) PBL establishes multiple sets of policy actions for the program's approval. Once a set of the policy actions is fully completed, disbursement is available upon the ADB's Management approval.

Programmatic PBL a series of single-tranche PBLs that require concept approval of a long-term reform plan including indicative policy actions of subsequent subprograms at the processing of the 1st subprogram.

ASSESSMENTS BY ADB

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

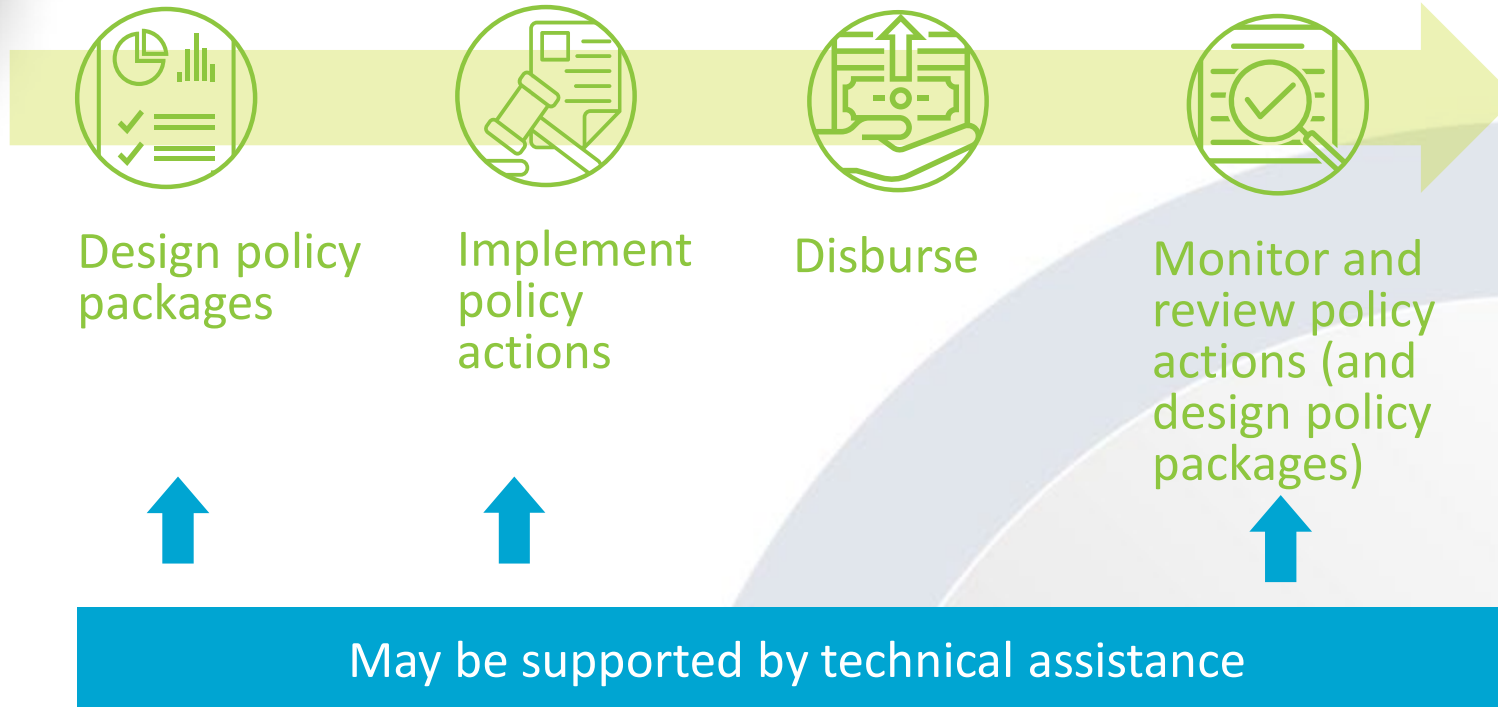
LOAN AMOUNT

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)

Life Cycle of Conventional PBL



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.

Countercyclical support facility (CSF)

PURPOSE

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

REQUIREMENTS

- Countercyclical expenditure program is a requirement
- policy matrix not required, but 6 accessing criteria need to be met
- IMF program not required

LOAN AMOUNT COUNTRY CEILING

OCR: based on 0.5% of 3-year rolling average GDP (for Bangladesh: \$1.5 billion)

COL: \$250 million

TENOR

OCR: 7 years, including a grace period of up to 3 years

COL: same as conventional PBL

PRICING

OCR: 75 bps plus SOFR or other cost-based rates (+rebate/surcharge); commitment charge of 15 bps for undisbursed loan balance

COL: same as conventional PBL

CRITERIA FOR ACCESSING CSF

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 International Monetary Fund
7. Monitoring and evaluation



Crisis response PBL (OCR only)

Special policy-based loan (SPBL)

PURPOSE

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

TENOR

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

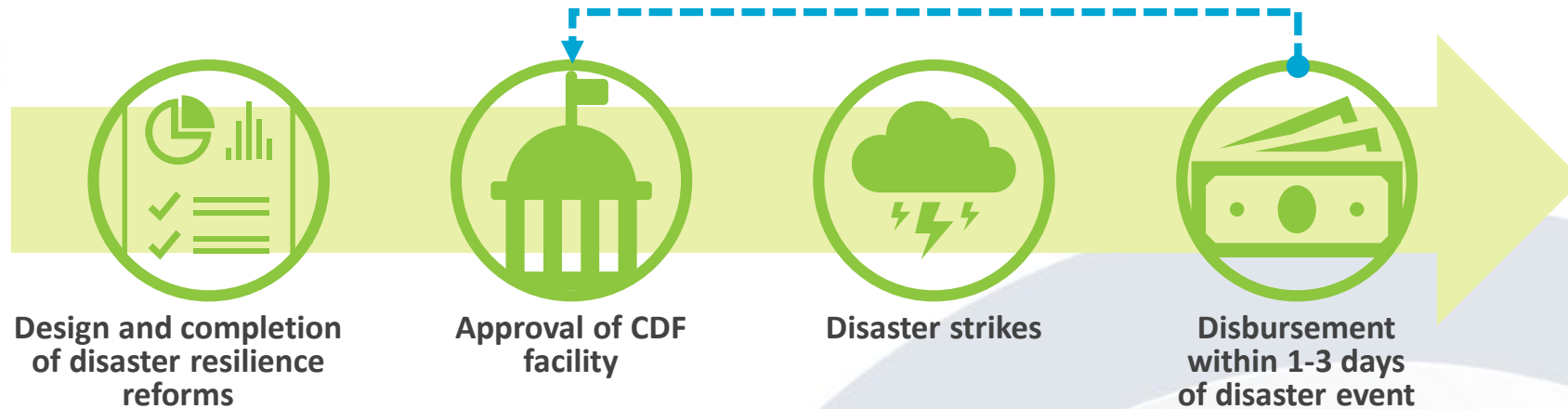
REQUIREMENTS

- IMF program required. Policy matrix is formulated based on the conditionalities of IMF program.
- Follow-on structural reforms through conventional PBLs are expected in line with IMF Program.

PRICING

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

Contingent disaster financing (CDF)



PURPOSE

- Strengthen institutional preparedness for disasters
- Provide *quick disbursing* liquidity following a disaster
- Remains available for up to 15 years for regular OCR, and up to 6 years for concessional OCR and ADF

FEATURES

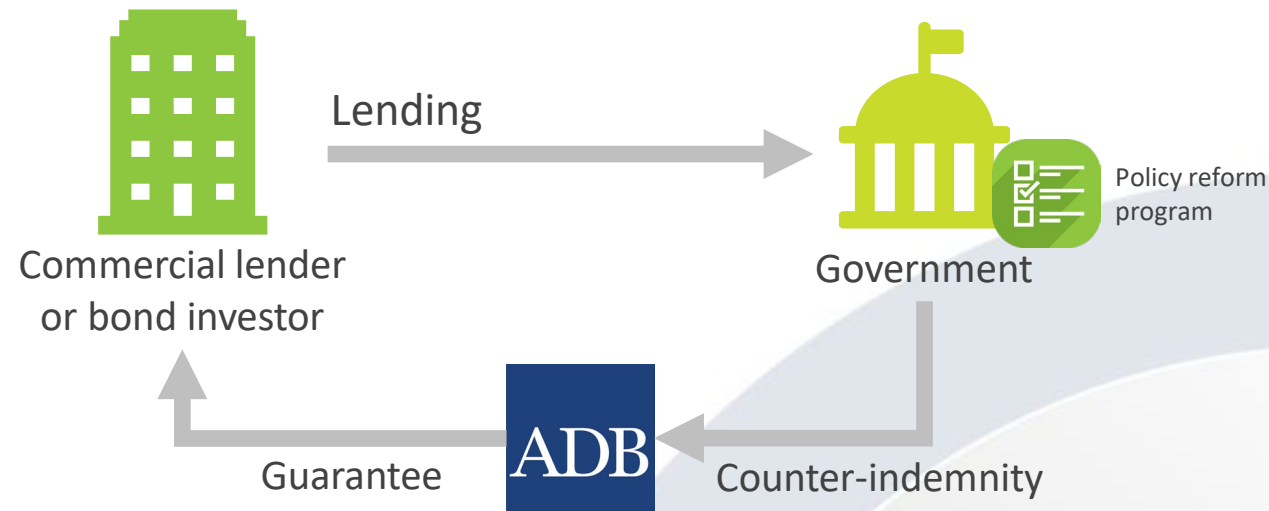
- Sound macroeconomic policy framework and debt sustainability
- Development constraints through in-depth sector and economic analysis
- Policy actions/reforms to address constraints (as agreed with the client)
- Government ownership of the reforms. Ideally, with long-term sector reform strategy and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

LOAN AMOUNT

Determined by development financing needs, including for disasters

PBL financing option

Policy-based guarantee (PBG)



FEATURES

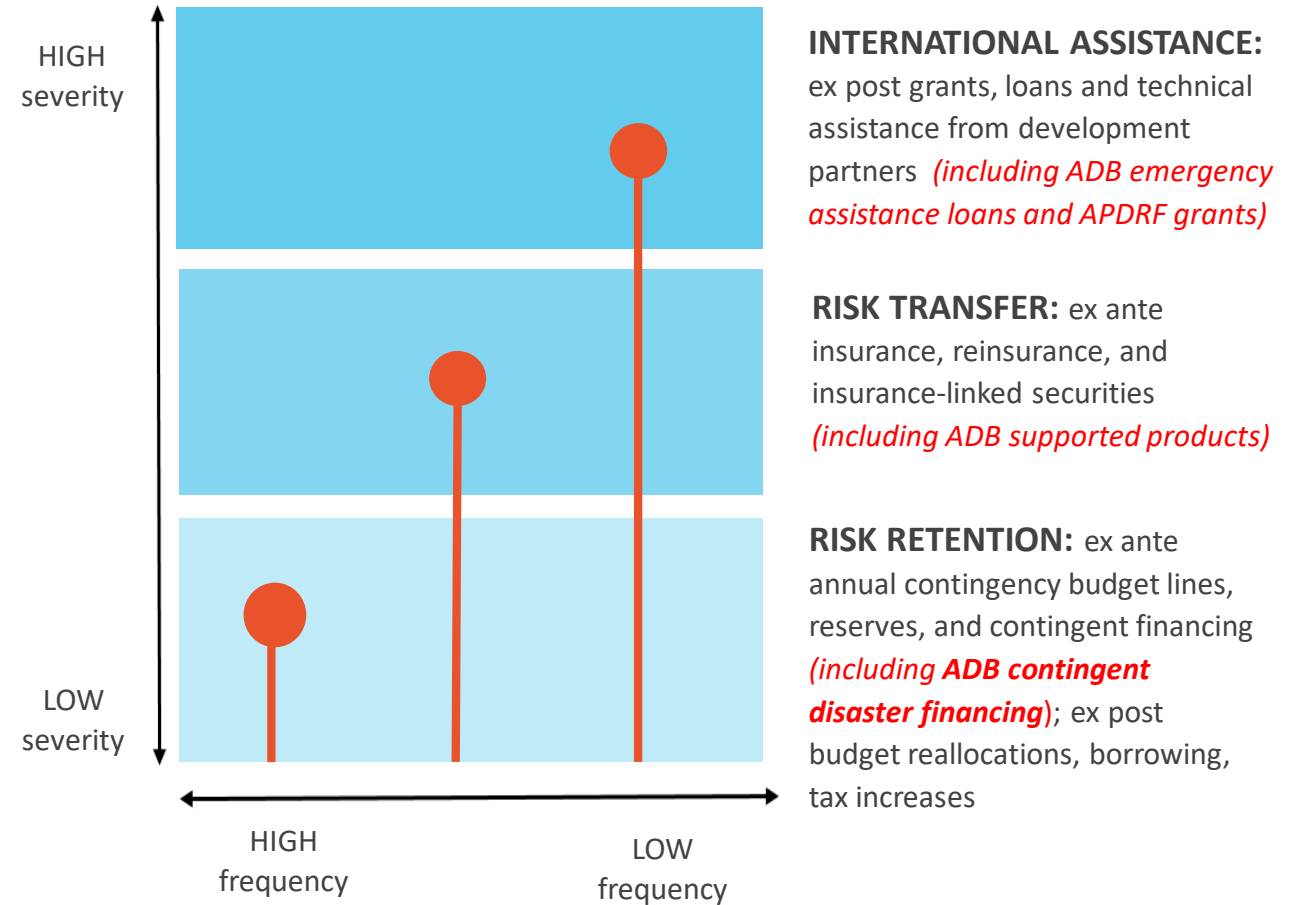
- Support government's reform program as PBL but ADB provides a partial credit guarantee to commercial lenders or bond holders instead of a direct policy-based loan
- Assists governments to access international capital markets, improve their terms and conditions and gain experience with market transactions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



Appendix : Contingent disaster financing option

1. Risk layering approach to disaster risk financing (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.



2. What is a CDF Facility?

- **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 facility (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 facility terms and conditions:**
 - **Availability Period:** (i) Initial availability period of 3 years with option to extend for another 3 years (up to a total of 6 years for COL and 15 years for OCR)
 - **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

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.

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.

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

Examples of policy actions used in previous CDFs: Palau

Policy Actions were designed around the government's ongoing reforms in 3 main areas:

1. Strengthening policies and institutions for disaster and climate resilience

- Mid-term review of the action plan of the Palau Climate Change Policy for Climate and Disaster Resilient Low Emissions Development 2015
- Mass Rescue Operations Contingency Plan, setting out institutional roles of government agencies

2. Improving capacity and planning for disaster and climate risk management

- Community disaster plan template for hamlets, based disaster risk reduction toolkit
- Training workshops on risk reduction toolkit
- Training manuals for horticulture and livestock producers, including climate and disaster resilience measurers
- Geographic information system layers for households, businesses, farms, roads, utilities and major infrastructure to identify vulnerable structures
- Updated school emergency management plan
- Revised science curriculum in public schools incorporating climate change and disaster risk management (DRM)

3. Expanding financing for disaster and climate risk management

- \$1.265m appropriated for the General Fund Reserve in FY2018
- Pristine Paradise Environmental Fee of \$100 per tourist – resource for community level DRM