

OPERATIONAL POLICY ON FINANCING

January 2016 (updated March 21, 2017)

I. PURPOSE; CONTENTS

1.1. Purpose. The purpose of this Operational Policy on Financing (Policy) is to set out the Bank's policy on providing Sovereign-backed Financing and Non-sovereign-backed Financing for Projects.

1.2. Contents. This Policy consists of the main text (Sections I-VI) and two annexes: Annex 1 (*Specific Provisions applicable to Sovereign-backed Financing*); and Annex 2 (*Specific Provisions applicable to Non-sovereign-backed Financing*).

II. DEFINITIONS

2.1. As used in this Policy, the following terms have the meanings set forth below. (Annexes 1 and 2 to this Policy also provide for additional definitions, and variations of these general definitions that are specific to each Annex.):

- (a) **Articles** means the Articles of Agreement of the Bank
- (b) **Bank** means the Asian Infrastructure Investment Bank.
- (c) **Board** means the Bank's Board of Directors.
- (d) **Financing** means a Sovereign-backed Financing or a Non-sovereign-backed Financing, for a Project.
- (e) **Government** means the government of a Member, and includes its political and administrative sub-divisions and all other public sector entities and instrumentalities of the Member.
- (f) **Guarantee** means a guarantee extended by the Bank out of its ordinary or special resources for a Project.
- (g) **Legal Agreements** means the legal agreements for a Project to which the Bank is a party.

- (h) **Loan** means a loan made by the Bank out of its ordinary or special resources for a Project.
- (i) **Member** means the member of the Bank (or other agency of the member which is authorized effectively to pledge the member's full faith and credit) in whose territory the Project is located or for whose benefit the Financing is provided.
- (j) **Member Indemnity** means, for a Project supported by a Sovereign-backed Financing in the form of a Guarantee, the counter-guarantee and indemnity provided by the Member to the Bank in connection with the Guarantee.
- (k) **Non-sovereign-backed Financing** means any financing extended by the Bank that is not a Sovereign-backed Financing; it includes any financing to or for the benefit of a private enterprise or a sub-sovereign entity (such as a political or administrative sub-division of a Member or a public sector entity) that is not backed by a guarantee or counter-guarantee and indemnity provided by the Member to the Bank.
- (l) **President** means the President of the Bank.
- (m) **Project** means the specific set of activities for which the Financing is made; the term may include a discrete set of activities or a program of activities.
- (n) **Sovereign-backed Financing** means: (i) a Loan to, or guaranteed by, a Member; or (ii) a Guarantee that: (A) covers debt service defaults under a loan that are caused by a Government's failure to meet a specific obligation in relation to the Project or by a borrower's failure to make a payment under the loan; and (B) is accompanied by a Member Indemnity.
- (o) **US Dollars, USD** and **\$** each means the lawful currency of the United States of America.

III. POLICY PROVISIONS

3.1. Articles Considerations

3.1.1. Purpose. The Bank's purpose is, as stated in its Articles, "to foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors... [and] promote regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions."¹

3.1.2. Functions. In furtherance of these purposes, the Bank's functions include, *inter alia*, "to promote investment in the region... for development purposes, in particular for development of infrastructure and other productive sectors;... to utilize the resources at its disposal for financing such development in the region, including those projects and programs which will contribute most effectively to the harmonious economic growth of the region as a whole... and to supplement private investment when private capital is not available on reasonable terms and conditions."²

¹ Articles of Agreement, Article I, paragraph 1

² *Id.*, Article 2

3.1.3. Operating Principles. To this end, the Articles require the Bank to conduct its operations according to certain principles, including, *inter alia*, the following³:

- (a) It “shall be guided by sound banking principles in its operations.”
- (b) Its operations “shall provide principally for the financing of specific projects or specific investment programs, for equity investment, and for technical assistance...”
- (c) It “shall not finance any undertaking in the territory of a member if that member objects to such financing.”
- (d) It “shall ensure that each of its operations complies with the Bank’s operational and financial policies, including without limitation, policies addressing environmental and social aspects.”
- (e) In considering an application for financing, it “shall pay due regard to the ability of the recipient to obtain financing or facilities elsewhere on terms and conditions that the Bank considers reasonable for the recipient, taking into account all pertinent factors.”
- (f) In providing or guaranteeing financing, it shall “pay due regard to the prospects that the recipient and guarantor, if any, will be in a position to meet their obligations under the financing contract.”
- (g) It shall “place no restriction upon the procurement of goods and services from any country from the proceeds of any financing...”
- (h) It shall “take the necessary measures to ensure that the proceeds of any financing provided, guaranteed or participated in by the Bank are used only for the purposes for which the financing was granted and with due attention to considerations of economy and efficiency.”
- (i) It shall “pay due regard to the desirability of avoiding a disproportionate amount of its resources being used for the benefit of any member.”
- (j) It shall “seek to maintain reasonable diversification in its investments in equity capital.”
- (k) In its equity investments, it “shall not assume responsibility for managing any entity or enterprise in which it has an investment and shall not seek a controlling interest in the entity or enterprise concerned, except where necessary to safeguard the investment of the Bank.

3.1.4. Financing Structures. The Articles offer the Bank flexibility in structuring its Financings. Specifically, they permit the Bank to “provide or facilitate financing to any member, or any agency, instrumentality or political subdivision thereof, or any entity or enterprise operating in the territory of a member, as well as to international or regional agencies or entities concerned with economic development of the Asia region.”⁴ Furthermore, the Articles permit the Bank to provide

³ Id., Article 13

⁴ Id., Article 11, paragraph 1(a). The Bank may provide financing to other recipients only if the Board of

financing in a variety of ways, including, *inter alia*, making loans, investing in the equity capital of an enterprise, and guaranteeing, whether as primary or secondary obligor, in whole or in part, loans for economic development.⁵ In addition, the Bank may underwrite, or participate in the underwriting of, securities issued by any entity or enterprise for purposes consistent with its purpose.⁶

3.1.5. Financing Terms and Conditions. The Articles outline certain considerations that must be taken into account by the Bank when determining the terms of its Financings. Specifically:

- (a) “In providing or guaranteeing financing, the financial terms, such as rate of interest and other charges and the schedule for repayment of principal shall be such as are, in the opinion of the Bank, appropriate for the financing concerned and the risk to the Bank.”⁷
- (b) The Bank is required to include in its contracts, in conformity with the above operating principles, “the terms and conditions for the loan or the guarantee concerned”, which must “take fully into account the need to safeguard its income and financial position.”⁸
- (c) If the loan recipient or beneficiary of the guarantee is not the member, the Bank has the discretion, “when it deems it advisable, [to] require that the member in whose territory the project concerned is to be carried out, or a public agency or any instrumentality of that member acceptable to the Bank, guarantee the repayment of the principal and the payment of interest and other charges on the loan in accordance with the terms thereof.”⁹
- (d) “The amount of any equity investment shall not exceed such percentage of the equity capital of the entity or enterprise concerned as permitted under policies approved by the Board of Directors.”¹⁰
- (e) The Bank “may provide financing in its operations in the currency of the country concerned, in accordance with policies that minimize currency risk.”¹¹

3.1.6. No Political Interference. The Articles prohibit the Bank from interfering in the political affairs of its members, specifying that “[t]he Bank, its President, officers and staff shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member concerned.”¹²

3.1.7. Relevant Considerations. The Articles require that “only economic considerations” be relevant to the Bank’s decisions. “Such considerations shall be weighed impartially in order to

Governors specifically decides in accordance with Article 11-1(b) of the Articles that such other recipient is eligible for a particular type of financing.

⁵ Id., Article 11, paragraph 2

⁶ Id., Article 16, paragraph 4

⁷ Id., Article 13, paragraph 7

⁸ Id., Article 14, paragraph 1

⁹ Id., Article 14, paragraph 2

¹⁰ Id., Article 14, paragraph 3

¹¹ Id., Article 14, paragraph 4

¹² Id., Article 31, paragraph 2

achieve and carry out the purpose and functions of the Bank.”¹³

3.2. Process applicable to all Financing

3.2.1. Project. For each proposed Project, the Bank requires that the Project meet the following conditions:

- (a) The Project has clearly defined development objectives consistent with Article 1 of the Articles, that permit appropriate evaluation of the Project’s impact.
- (b) The Project provides for specific productive activities necessary to meet these development objectives.
- (c) Alternative sources of finance, in particular private capital, are unavailable for the Project on terms and conditions that the Bank considers reasonable.
- (d) The Project is in compliance with the other requirements of this Policy (including the Annexes hereto) and other applicable policies.¹⁴

3.2.2. Choice of Instrument. In deciding the appropriate type of Financing for the Project, the Bank considers, *inter alia*, the financial costs and benefits of each type of Financing available for the Project, the availability of private and public financing for the Project, and the leverage effect of the Bank resources.

3.2.3. The Bank’s Role: The Bank is responsible for: (a) assessing the Project in accordance with this Policy and other applicable policies; (b) developing the terms and conditions of the Financing; (c) deciding whether to provide the Financing; (d) negotiating and entering into the relevant Legal Agreements; (e) after signing, determining whether the conditions of effectiveness and/or disbursement are met; (f) monitoring compliance by the other parties to the Legal Agreements with their obligations as set out in the Legal Agreements, reviewing information on implementation progress and updating the risks and related risk-management measures; (g) reviewing progress towards achievement of the Project’s development objectives and related results; (h) evaluating, ex-post, the Project’s impact; and (i) where applicable, determining whether to suspend, cancel or exit from the Financing (e.g., by accelerating a loan, exercising an option or selling its interest to a third party), increase its exposure, exercise or waive any rights the Bank has under the Legal Agreements, agree to amend the Legal Agreements, agree to changes to the Project or exercise legal remedies. The Bank is not responsible for implementing the Project.

3.3. Assessment of the Project

3.3.1. Assessment. The Bank carries out an assessment of each proposed Project, comprising the elements described below. The scope of this assessment is based on various Member and Project-specific considerations, including the Project’s development objectives and risks involved, as well as the type of Financing provided. The Bank ensures that the elements of the assessment are carried out in a coordinated manner.

¹³ Id., Article 31, paragraph 2

¹⁴ See Section VI for a non-exhaustive list of other applicable policies.

- (a) **Technical Assessment.** The Bank undertakes a technical assessment of the Project, covering: (i) the Project's development objectives, scope and design; (ii) the soundness of any material technology to be used or operated for the Project; (iii) the Project's appropriateness to the needs and capacity of the beneficiary of the Financing; and (iv) the Project's implementation arrangements, including the technical and managerial capacity of the beneficiary of the Financing to implement the Project and, as applicable, to operate and maintain its assets.
- (b) **Economic Assessment.** The Bank undertakes an economic assessment of the Project's rationale, using approaches and methodologies appropriate for: (i) the Project; (ii) the sector; and (iii) country conditions.
- (c) **Financial Assessment.** The Bank assesses the Project's costs, risks and financing plan, and the financial soundness and viability of: (i) the Project; (ii) the beneficiary of the Financing and, as appropriate, other parties (other than a Member) with which it concludes a Legal Agreement; and (iii) the proposed structure of the Financing, including a review of the sources of co-financing, if any, and the terms and conditions of the Financing and such co-financing.
- (d) **Environmental and Social Assessment.** The Bank screens, categorizes and undertakes an environmental and social due diligence of the Project in accordance with the *Environmental and Social Policy*.
- (e) **Integrity and Financial Management Assessments.** The Bank assesses: (i) the integrity of the Project's financing structure, focusing on the entities involved and the jurisdictions in which they are established; and (ii) the financial management arrangements for the Project in order to ensure that they provide reasonable assurance that the proceeds of the Financing will be used for the purposes for which they are granted.
- (f) **Legal Assessment.** The Bank undertakes a legal due diligence of the Project and, as appropriate, of other parties (other than a Member) with which it concludes a Legal Agreement.
- (g) **Procurement Assessment.** The Bank assesses the procurement arrangements for the Project to ensure that they are in conformity with the *Procurement Policy*.
- (h) **Cost/Benefit Assessment.** Guided by sound banking principles, the Bank makes a cost and benefit analysis of the Financing to the Bank, using appropriate methodologies to determine the amount of time and expenses required of the Bank throughout the process and the risks associated with these elements.
- (i) **Risk Assessment.** For each Financing, the Bank undertakes an integrated assessment of the risks (real and perceived) to the achievement of the Project's development objectives, taking into account the assessments noted above and other relevant information.

3.3.2. Reliance on Third Party Assessments. In certain cases, for instance where the Project is to be co-financed by another financier, the Bank may, instead of carrying out one or more of the above assessments, rely on such assessment carried out by a third party, provided the Bank is

satisfied with the assessment capacity and process of such third party, and with such assessment.¹⁵

3.4. Design of Financing Terms and Conditions

3.4.1. Financing Terms and Conditions. In light of the above assessment, the Bank develops terms and conditions to be included in the Legal Agreements. Specific provisions are developed on the basis of the following:

- (a) The financial terms for each Sovereign-backed Financing are governed by the provisions of Section IV of Annex 1 to this Policy (*Specific Provisions applicable to Sovereign-backed Financing*); and the financial terms for each Non-sovereign-backed Financing are governed by the provisions of Section IV of Annex 2 to this Policy (*Specific Provisions applicable to Non-sovereign-backed Financing*).
- (b) The contractual arrangements for a Sovereign-backed Financing are governed by the provisions of Section V of Annex 1 to this Policy (*Specific Provisions applicable to Sovereign-backed Financing*); and the contractual arrangements for a Non-sovereign-backed Financing are governed by the provisions of Section V of Annex 2 to this Policy (*Specific Provisions applicable to Non-sovereign-backed Financing*).
- (c) The undertakings relating to (i) environmental and social aspects of the Project, (ii) procurement of goods and services required for the Project (if applicable) and (iii) integrity, are governed by the relevant provisions of the *Environmental and Social Policy*, the *Procurement Policy* and the *Policy on Prohibited Practices*, respectively.
- (d) The conditions of effectiveness or disbursement and the undertakings, or covenants, that are included in the Legal Agreements set out the obligations of the parties to such documents with clarity and specificity. They are tailored to the specific responsibilities of the contracting party. In particular, covenants do not require the party to cause certain actions to be taken by an entity over which it does not exercise the necessary control. Covenants cover only aspects that are essential for the Financing. They are: (i) reasonable in number; (ii) realistic and reasonable in substance and in their time horizon and monitorable; and (iii) consistent with other covenants with the same parties. If a Legal Agreement is entered into with a Member, the Bank does not stipulate covenants that require the Member to enact legislation, and tries to work within existing law where possible. If enactment of specific legislation is necessary to achieve the Project's development objectives, the appropriate steps to be taken for such enactment are clearly defined, and such enactment is made a condition of negotiation, approval, effectiveness or disbursement, rather than a covenant.

3.5. Decision to Provide Financing; Oversight of the Project

3.5.1. Approval. Each Financing is approved by the Board, or as delegated by the Board to the President.¹⁶ In either case, the Bank satisfies itself prior to approval that the Member in whose

¹⁵ The *Environmental and Social Policy* and the *Procurement Policy* specify those circumstances under which the Bank may rely on the assessments of third parties for these matters.

¹⁶ All Financings are currently approved by the Board. The Board is expected to consider (in late 2016) a delegation of authority to the President to approve certain Financings and subsequent changes related to them

territory the Project is to be carried out does not object to the Financing.

3.5.2. Signing. Signing of the Legal Agreements takes place: (a) after the Financing has been approved; and (b) all required signing authorizations have been issued.

3.5.3. Material and Non-material Changes to the Project or Financing. Following approval of the Financing, as well as during implementation of the Project, the Bank may agree to make changes to the Project or its Financing to respond to changed circumstances. The Board decides whether to approve any material change to the Project or its Financing.¹⁷ A material change would include, among others, one or more of the following: (a) a modification of the Project's development objectives; or (b) a change in the Project's environmental and social category to a higher level category; or (c) an increase in the amount of the Financing or any other change to its Board-approved financial terms which would materially affect the risk profile of the Financing; or (d) any change that: (i) raises novel or complex issues; or (ii) raises a policy consideration not already covered by an approved policy; or (iii) requires a waiver of a policy requirement. The President is delegated by the Board the authority (and may further delegate this authority) to decide whether to approve non-material Project changes,¹⁸ and regularly informs the Board of these changes.

3.5.4. No Rescheduling of the Financing. Consistent with its status as an international financial institution, the Bank does not: (a) reschedule debt payments, or participate in debt rescheduling agreements, involving amounts owed to it under Sovereign-backed Financing; or (b) reschedule Non-sovereign-backed Financing where the beneficiary's inability to service its debt is due to a foreign exchange shortage in the beneficiary's country.

3.5.5. Completion Report. Upon completion of the Project, the Bank evaluates and prepares a report on the results of the Project and its Financing, as well as performance under the Project.¹⁹ The report also seeks to include an evaluation of the Project by the other parties to the Legal Agreements. If a Project's Legal Agreements are not signed or do not become effective by a specified date, or if the Financing is canceled before significant Project implementation is initiated, the President informs the Board of this fact as part of periodic reporting on Projects.

3.5.6. The Bank's Remedies. If a failure by any party to any of the Legal Agreements to comply with its contractual obligations to the Bank, or an occurrence of another event, gives rise to a legal remedy under the Legal Agreements, the Bank, where appropriate, consults with the parties concerned and requires timely and appropriate corrective measures to be taken.²⁰ The Bank pays

¹⁷ See previous footnote regarding Board consideration of a delegation of authority to the President to approve changes related to already approved Financings.

¹⁸ Examples of non-material changes would include a change in the Project description that does not involve a change in the Project's development objectives, a cancellation of an amount of a Sovereign-backed Financing in the form of a Loan, or an extension of the disbursement period of a Sovereign-backed Financing in the form of a Loan.

¹⁹ For specific environmental and social aspects of the Project that are covered in the completion report, see the *Environmental and Social Policy*.

²⁰ Consultation with the parties prior to exercise of a remedy may not be required or appropriate if exercise of the remedy is automatically triggered, as may be the case, for example with Sovereign-backed Financing in the form of Guarantees. In the case of Non-sovereign-backed Financings, such consultations would not be appropriate if they might diminish the Bank's chances of enforcing any of its rights in arbitration or court

particular attention to failures to comply with environmental, social, fiduciary (including financial management and procurement) and financial obligations. The Bank's legal remedies are specified in the Legal Agreements and exercised when warranted. Section V of Annex 1 to this Policy (*Specific Provisions applicable to Sovereign-backed Financing*) sets forth specific legal remedies applicable to Sovereign-backed Financing. In the case of Sovereign-backed Loans, Section VI of Annex 1 requires a graduated approach to suspension of undisbursed amounts of the Loan in the event of failure to pay amounts to the Bank when due. Section VI of Annex 2 to this Policy (*Specific Provisions applicable to Non-sovereign-backed Financing*) describes remedies applicable to Non-sovereign-backed Financing.

3.5.7. Disclosure of Information. The Bank discloses the following information relating to the Project in accordance with the Bank's *Public Information Interim Policy*: (a) a detailed document regarding each Project financed by a Sovereign-backed Financing, following approval of the Financing; and (b) a summary document regarding each Project financed by a Non-sovereign-backed Financing, following approval of the Financing. The Bank discloses information relating to the environmental and social aspects of the Project in accordance with the *Environmental and Social Policy* (including *Standards*).

3.5.8. Specific Provisions applicable to specific Financing. In addition to the above requirements: (a) additional requirements applicable to Sovereign-backed Financing are covered in Annex 1 to this Policy (*Specific Provisions applicable to Sovereign-backed Financing*); and (b) additional requirements applicable to Non-sovereign-backed Financing covered in Annex 2 to this Policy (*Specific Provisions applicable to Non-sovereign-backed Financing*).

3.6. Special Considerations

3.6.1. Operational Policy on International Relations. The *Operational Policy on International Relations* addresses certain circumstances involving relations among States that may require special consideration should they arise in connection with a Project. Where, in the President's view, that policy is implicated in a material way in the context of a specific proposed Financing, where feasible time-wise, he shall afford the Board with an opportunity, before the Financing is submitted to it for approval, to comment on the advisability of the Financing.

IV. WAIVERS OF THIS POLICY

4.1. The Board decides whether to approve a waiver of a provision of this Policy that is not explicitly permitted by the terms of this Policy. Such a waiver may be granted only in response to clearly delineated individual circumstances, so as to allow the Bank to proceed with processing or implementation steps that are pending at the time the waiver is requested. Such a waiver may not be granted in anticipation of future cases for which the requisite processing or implementation steps are not yet pending.

V. POLICY'S EFFECTIVE DATE

5.1. This Policy is effective January 17, 2016.

proceedings or be inconsistent with any of its obligations or impair its relations with co-financiers.

VI. RELATED DOCUMENTS

Interim Operational Directive on Sovereign-backed Loans

Operational Policy on International Relations Operational Directive
on International Relations (*under development*)

Environmental and Social Policy (including Standards)
Directive: Environmental and Social Procedures (*under development*)

Procurement Policy
Interim Operational Directive on Procurement Instructions for
Recipients
Directive: Procurement Instructions for Staff (*under development*)

Policy on Prohibited Practices

Public Information Interim Policy

Financial Policies
Sovereign-backed Loan and Guarantee Pricing Decision

General Conditions applicable to Sovereign-backed Loans

**OPERATIONAL POLICY ON FINANCING
ANNEX 1**

**SPECIFIC PROVISIONS
APPLICABLE TO
SOVEREIGN-BACKED FINANCING**

I. SCOPE

1.1. This Annex applies to each: (a) Loan to, or with the guarantee of, the Member; and (b) Guarantee that: (i) covers debt service defaults under a loan that are caused by a Government's failure to meet a specific obligation in relation to the Project or by a borrower's failure to make a payment under the loan; and (ii) is accompanied by a Member Indemnity.

II. ADDITIONAL DEFINITIONS

2.1. In general, the capitalized terms used in this Annex have the meanings set forth in Section II of this Policy. However, when used in this Annex, certain capitalized terms defined in said Section II (specifically, Guarantee, Legal Agreements, Loan) have the more detailed definitions set forth below. In addition, certain additional capitalized terms that are used only in this Annex are defined below:

- (a) **Average Maturity** means, for a Loan, the weighted average period of time between the date of signing of the Loan Agreement and the Loan's scheduled repayments.
- (b) **Effective Date** means, for a Loan, the date on which the Loan Agreement becomes effective, as defined and specified in the Loan Agreement.
- (c) **General Conditions** means, for a Loan, the general conditions applicable to the Loan, as defined in Section V, paragraph 5.1.9 of this Annex.
- (d) **Guarantee** means a guarantee extended by the Bank out of its ordinary or special resources for a Project that: (i) covers debt service defaults under a loan that are caused by a Government's failure to meet a specific obligation in relation to the Project or by a borrower's failure to make a payment under the loan; and (ii) is accompanied by a Member Indemnity.
- (e) **Guarantee Agreement** means the agreement providing for a Guarantee.
- (f) **Implementing Entity** means any entity (other than the Recipient)²¹, which is responsible

²¹ For a Loan, this definition is intended to distinguish between the legal entity receiving the Loan, i.e., the Recipient, and other legal entities involved in preparation and implementation of the Project, i.e., the Implementing Entity, even though both the Recipient and the Implementing Entity may have responsibilities relating to implementation of the Project.

for the implementation of all or part of a Project (and in the case of a Guarantee, it may include the borrower of the loan guaranteed, as well as the entity whose obligations are backstopped by the Guarantee); if more than one such entity is so responsible, the term includes all such entities.

- (g) **Interest Payment Date** means, for a Loan, each date specified in the Loan Agreement on which interest is payable under the Loan.
- (h) **Legal Agreements** means: (a) in the case of a Project supported by a Loan, the Loan Agreement, the Member Guarantee Agreement (if the Recipient is not the Member), the Project Agreement (if applicable) and all ancillary agreements for the Project to which the Bank is a party; and (b) in the case of a Project supported by a Guarantee, the Guarantee Agreement, the Member Indemnity Agreement, the Project Agreement (if applicable), and all ancillary legal agreements or documents for the Project to which the Bank is a party.
- (i) **LIBOR** means the London interbank offered rate, the benchmark interest rate that reflects what leading banks in the London interbank market estimate they would be charged for short-term loans, expressed as a percentage *per annum*.
- (j) **Loan** means a loan made by the Bank out of its ordinary or special resources to, or with the guarantee of, the Member, for a Project.
- (k) **Loan Agreement** means for a Project financed by a Loan, the agreement between the Bank and a Recipient providing for the Loan.
- (l) **Member Guarantee** means, in the case of a Loan made to a Recipient other than a Member, the guarantee provided by the Member concerned to the Bank in connection with the Loan.
- (m) **Member Guarantee Agreement** means the agreement providing for the Member Guarantee in connection with a Loan.
- (n) **Member Indemnity Agreement** means the agreement providing for the Member Indemnity in connection with a Guarantee.
- (o) **Preparation Advance** each means an advance made by the Bank for a Project in accordance with the provisions of Section III, paragraph 3.4 of this Annex.
- (p) **Principal Payment Date** means, for a Loan, each date specified in the Loan Agreement on which all or any portion of the principal amount of the Loan is payable.
- (q) **Project Agreement** means, for a Project, the agreement between the Bank and the Implementing Entity relating to the Project; and if more than one such agreement is entered into, the term includes all such agreements.
- (r) **Recipient** means the recipient of the Loan for a Project.

III. ADDITIONAL POLICY PROVISIONS RELATING TO ASSESSMENT AND OVERSIGHT OF PROJECTS SUPPORTED BY SOVEREIGN-BACKED FINANCING

3.1. In addition to the provisions of Section III of this Policy, the following provisions apply to Sovereign-backed Financing.

3.2. Roles, Responsibilities. Further to the provisions of Section III, paragraph 3.2.3 of this Policy:

- (a) If the Project is supported by a Loan, the Recipient is normally responsible for preparing and implementing the Project. If an Implementing Entity is involved in Project implementation, it is normally required to assume certain of these responsibilities. The Project's scope, objectives, and the contractual rights and obligations of the Bank and the Recipient, the Member (if the Recipient is different from the Member) and the Implementing Entity are reflected in the Legal Agreements. The Recipient and Implementing Entity are each expected to deal in a timely and effective manner with any problems encountered in Project implementation for which it is responsible.
- (b) If the Project is supported by a Guarantee, the Implementing Entity is responsible for preparing and implementing the Project. The Project's scope, objectives and the contractual rights and obligations of the Bank, the Member and the Implementing Entity are reflected in the Legal Agreements.

3.3. Conditions of Financing. The Bank requires that the Project meet the following conditions in addition to those set forth in Section III of this Policy:

- (a) The Project's impact on the Member's fiscal sustainability is acceptable.²³²²
- (b) There are acceptable oversight arrangements, including fiduciary arrangements, in place for the Project to give reasonable assurance that the proceeds of the Financing (or, in the case of a Guarantee, the proceeds of the loan guaranteed by the Bank) are used only for the purposes for which the Financing (or, in the case of a Guarantee, the loan guaranteed by the Bank) is granted, with due attention to considerations of economy and efficiency. To this end, the Bank assesses the Project's financing plan and the uses to which the proceeds of the Financing (or in the case of a Guarantee, the proceeds of the loan guaranteed by the Bank) are to be applied. The Bank develops, in all cases for a Loan, and as needed for a Guarantee, arrangements for the disbursement of the proceeds of the Financing (or, in the case of a Guarantee, of the loan guaranteed by the Bank), designed to ensure: (i) that these proceeds are disbursed against specific expenditures that are: (A) required for the Project; and (B) eligible for financing out of these proceeds; and (ii) that these proceeds are available to the loan's recipient as and when needed to cover such expenditures. The Bank may, in the case of a Loan, at the Recipient's request and in its discretion, disburse a portion of the proceeds of the Loan as an advance in order to facilitate efficient implementation of the Project.
- (c) The Legal Agreements cover, in addition to the above arrangements, the following key

²² In its determination as to the acceptability of the Project's impact on the member's fiscal sustainability, the Bank gives particular attention to debt sustainability analyses conducted by the International Monetary Fund and the World Bank.

requirements: (i) in the case of a Loan, that the Project be implemented with due diligence and efficiency; and (ii) in all cases, that appropriate: (A) arrangements are maintained for monitoring and evaluating the Project; (B) financial management arrangements for the Project are maintained; and (C) financial statements relating to the Project are prepared and audited annually by independent auditors and with terms of reference, both acceptable to the Bank, and these statements as so audited, together with the auditor's reports are furnished to the Bank. If the Financing is in the form of a Guarantee, the Bank: (i) may accept audited financial statements provided by the relevant Project participants in accordance with their legal agreements relating to the Project; and (ii) may rely on lender assessments of the financial reports of these participants.

3.4. Preparation Advances for Sovereign-backed Financing. The Bank may decide to make an advance (Preparation Advance) to finance preparatory activities for a Project to be supported by a Sovereign-backed Financing. A Preparation Advance is made only when there is a strong probability that the Financing for which it is granted will be extended, but granting a Preparation Advance does not obligate the Bank to finance or otherwise support the Project for which it is granted. The maximum aggregate principal amount of all approved Preparation Advances for any given Project may not exceed the lesser of: (a) ten percent (10%) of the total estimated amount of Financing for the Project; and (b) USD ten million (\$10,000,000) equivalent.²³ The terms of each Preparation Advance are set forth in Section IV of this Annex. The President decides whether to approve each Preparation Advance.²⁴

3.5. Approval; Signing. In addition to the preconditions related to approval and signing specified in Section III, paragraphs 3.5.1 and 3.5.2 of this Policy, the Bank may approve a Sovereign-backed Financing and may sign the Legal Agreements for a Sovereign-backed Financing, only if there are no payments overdue to the Bank by thirty (30) days or more that would preclude the approval or the signing pursuant to the provisions of Section VI of this Annex 1.

3.6. Project Monitoring; Guarantee Monitoring. Further to the provisions of Section III, paragraph 3.5 of this Policy, the Bank monitors each Project on an on-going basis until the completion of the Project. In addition, the Bank monitors each Guarantee until its expiration, paying particular attention to any Government obligations backed by the Guarantee. In the case of a Guarantee, the Bank may rely on such monitoring by another financier, provided the Bank is satisfied with the monitoring capacity and processes of such financier.

IV. FINANCIAL TERMS OF SOVEREIGN-BACKED FINANCING

4.1. In accordance with the Bank's financial policies, the following financial terms apply to Sovereign-backed Financing.

4.2. Terms of Loans

4.2.1. The terms of Loans are as follows:

²³ This ceiling will also be reviewed at the same time as the Board considers a delegation of authority to the President to approve certain Financings and subsequent changes related to them (see footnote 23).

²⁴ Contractual arrangements for a Preparation Advance are generally similar to those applicable to Loans. See Section V to this Annex.

- (a) **Currency.** Loans are committed and repayable in United States Dollars. At such time as the Bank determines that it is in a position to offer Loans in other currencies, Loans may be committed and repaid in such other currency or currencies as the Bank is able to hedge itself efficiently from time to time.
- (b) **Pricing.** The Loan pricing comprises the interest rate, front-end fee and commitment fee.
- (i) **Interest.** The interest rate consists of a market-based variable reference rate and a spread. Interest is paid on the disbursed and outstanding Loan amount. The reference rate is LIBOR, and it resets semi-annually on each Interest Payment Date. The spread is fixed, and announced as the spread determined by the Bank and in effect one day prior to the date of signing of the Loan Agreement. It comprises the following elements: (A) The Bank's projected funding cost over the life of the Loan; (B) a contractual lending spread; (C) a market risk premium; and (D) depending on the Average Maturity of the Loan, a maturity premium. The spread is set for the life of the Loan. Interest during construction may be financed out of the Loan proceeds. A default interest rate is charged in lieu of the above interest rate if any payment of principal becomes overdue by thirty (30) days, until the overdue amount is fully paid. The Bank does not charge interest on overdue interest on Loans.
- (ii) **Front-end Fee.** A one-time front-end fee is charged on the committed Loan amount. The front-end fee may be financed out of the Loan proceeds on or after the Effective Date. Alternatively, the Recipient may pay the fee no later than sixty (60) days after the Effective Date; and in this case, payment of the front-end fee is required before the first withdrawal of proceeds under the Loan .
- (iii) **Commitment Fee.** A commitment fee, payable semi-annually, is charged on the undisbursed amount of the Loan. This fee starts to accrue sixty (60) days after the Loan Agreement is signed and is payable on or after the Effective Date. The Bank does not charge a commitment fee on a Loan whose Loan Agreement does not become effective.
- (c) **Board Determination.** The Board sets the pricing for Loans from time to time, including the lending spread elements, the front-end fee, the commitment fee, and the default interest rate. The current levels of the lending spread elements, the front end fee and the commitment fee are set forth in the Sovereign-backed Loan and Guarantee Pricing Decision, which can be found at www.aiib.org. The current level of the default interest rate are set forth in the forthcoming General Conditions, which are also available at www.aiib.org.
- (d) **Repayment Terms.** The Bank determines a final maturity for the Loan that is appropriate and is consistent with the Loan's purpose, subject to an Average Maturity limit of up to twenty (20) years and a final maturity limit of up to thirty-five (35) years.
- (e) **Payment Schedules.** The first Interest Payment Date is set on a date not more than six (6) months following the date of signing of the Loan Agreement. Interest Payment Dates fall on either the 1st or the 15th day of the month (at the Recipient's option) and semi-annually thereafter. The grace period (other than for bullet payments) starts running from the date of

signing of the Loan Agreement. The first Principal Payment Date is set to fall six (6) months after the date of expiration of the grace period.

- (f) **Revisions to Approved Repayment Terms.** Repayment terms may not be changed once the Bank has approved the Loan.
- (g) **Prepayment.** A Loan may be prepaid in full or in part. The Bank may charge a prepayment premium to cover the cost to the Bank of redeploying prepaid funds.
- (h) **Cancellation.** If a Loan is fully cancelled prior to the Effective Date, no front-end fee is charged. If the Loan is partially cancelled prior to the Effective Date, the amount of the front-end fee payable is reduced on a *pro-rata* basis, and the adjusted front-end fee is payable to the Bank upon the Effective Date. If the Loan is partially or fully cancelled on or after the Effective Date, no refund of the front-end fee is made.

4.3. Terms of Guarantees

4.3.1. The terms of Guarantees are as follows:

- (a) **Currency.** Guarantees are committed and payable in United States Dollars. At such time as the Bank determines that it is in a position to offer Guarantees in other currencies, Guarantees may be committed and paid in such other currency or currencies as the Bank is able to hedge itself efficiently from time to time.
- (b) **Pricing.** The pricing of Guarantees includes several fees, determined on the basis of equivalency with Loans. Guarantee pricing comprises three components: a standby fee, guarantee fee and front-end fee. Once these fees are fixed for a specific Guarantee, they remain unchanged for the life of that Guarantee.
 - (i) **Standby fee.** The standby fee is analogous to, and is set at the same level as, the commitment fee on a Loan. The standby fee is calculated periodically and applied to the committed and undisbursed amount of the loan guaranteed by the Bank under the Guarantee (when the loan is scheduled to be disbursed in installments). The Bank does not charge a standby fee in respect of a Guarantee that does not become effective.
 - (ii) **Guarantee fee.** The Guarantee fee is set at the same level as the contractual lending spread for a Loan, and may include, as applicable, a maturity premium. The Guarantee fee is charged on the disbursed and outstanding amount of the loan guaranteed by the Bank under the Guarantee.
 - (iii) **Front-end fee.** The front-end fee is a one-time fee set at the same level as the front-end fee on a Loan and is charged up-front on the maximum amount of the Guarantee.
- (c) **Processing Charge.** The Bank may charge a processing charge, as appropriate for a specific Project, to cover its internal and external processing costs.

- (d) **Board Determination.** The Board sets the pricing for Guarantees from time to time, including the standby fee, the Guarantee fee and the front-end fee; it also sets a cap on the processing charge. The currently applicable Guarantee-related fee levels and processing charge cap are set forth in the *Sovereign-backed Loan and Guarantee Pricing Decision*, which can be found at www.aiib.org.
- (e) **Payment of Fees.** The Guarantee fee and standby fee are payable in advance; either charged and collected in advance of each fee period, or charged in a single lump-sum amount upfront calculated on a present value basis. The front-end fee is payable as a condition of effectiveness of the specific Guarantee.
- (f) **Refund of Guarantee Fee.** If, during the life of a Guarantee, the Bank's financial exposure under the Guarantee is reduced or canceled, the Bank may, in its discretion, refund to the paying party a portion of any Guarantee fee that the Bank has already received in advance, commensurate with the reduction in exposure.
- (g) **Maturity Limits.** The Guarantee maturity calculation is determined, based on the type and structure of the Guarantee, and is subject to the same average and final maturity limits as those applicable to a Loan. When justified by particular Project needs, the Board may decide to approve an exception to the average or final maturity limit.
- (h) **Accelerability.** Payment by the Bank under a Guarantee is normally not accelerable. The Bank may, in exceptional cases, agree that if payments under the loan guaranteed by the Bank are accelerated following a payment default, payments under the Guarantee are accelerable.

4.4. Terms of Preparation Advances

4.4.1. The terms of Preparation Advances are as follows:

- (a) The Preparation Advance is treated as a loan, which may be refinanced out of the proceeds of any Loan to, or guaranteed by, the Member concerned.
- (b) If the Loan out of which the Preparation Advance is to be refinanced does not materialize by the date specified in the agreement providing for the Preparation Advance, the Preparation Advance is repaid by its recipient over a period not to exceed five (5) years following this date.
- (c) Interest on the withdrawn amount of the Preparation Advance is calculated in the same manner as for a Loan.

V. CONTRACTUAL ARRANGEMENTS FOR SOVEREIGN-BACKED FINANCING

5.1. Contractual Arrangements for Loans

5.1.1. Recipient. The Bank generally prefers the entity responsible for implementing and operating the Project to be the Recipient of the Loan. By lending directly to this entity, the Bank is

better able to monitor the Project's implementation efficiently and suggest corrective steps when there are shortcomings in the Project's implementation. When direct lending to this entity is not feasible or practical (including due to legal considerations governing the Member), the Bank may lend to another legal entity if the Project can nevertheless be efficiently implemented and operated.

5.1.2. Loan Agreement. For each Loan, the Bank enters into a Loan Agreement with the Recipient. The Loan Agreement sets forth the amount of the Loan and the terms and conditions on which it is made.

5.1.3. Remedies. The Bank's contractual remedies under the Loan Agreement include: (a) suspension of disbursements of un-withdrawn amounts of the Loan; (b) cancellation of un-withdrawn amounts of the Loan; and (c) acceleration of payments due under the Loan. Suspension of disbursements of un-withdrawn amounts of the Loan in the event of failure to pay amounts due to the Bank is governed by Section VI of this Annex.

5.1.4. Member Guarantee Agreement. The Member provides a Member Guarantee for each Loan made to a Recipient that is not the Member.²⁵ Under the Member Guarantee, the Member guarantees the payment of principal and interest and other charges on the Loan, as principal debtor and not merely as a surety. Thus, the Bank may call directly on the Member as guarantor for payment, and is not required first to exhaust its remedies against the Recipient. When the Member effectively controls the entity in charge of implementing and operating the Project, the Bank may require the Member to guarantee performance as well as repayment. If the Bank requires a Member Guarantee, it enters into a Member Guarantee Agreement with the Member, which sets forth the Member's contractual obligations as a guarantor of the Loan. Additional undertakings required of the Member to facilitate the achievement of the Loan's purposes are set forth in the Member Guarantee Agreement.

5.1.5. Security Arrangements. Generally, the Bank does not require specific security from a Loan Recipient that is the Member. The Bank may require some form of specific security from a Loan Recipient that is not a Member. The Bank normally requires specific security if a co-financier of the Loan requires such security. Additional contractual documentation is required if specific security is required.

5.1.6. Negative Pledge. The Bank requires that each Loan and each Member Guarantee be subject to a negative pledge provision, which is included in the General Conditions.

5.1.7. External Debt Reporting. The General Conditions require that the Member furnish to the Bank information on the financial and economic conditions in its territory, including its balance of payments and its external debt.

5.1.8. Project Agreement. If the Bank extends a Loan to a Recipient that is not responsible for implementing and operating one or more parts of the Project, it normally enters into a Project Agreement with the Implementing Entity. The Project Agreement contains the normal undertakings regarding implementation and operation of the Project. Whether or not the Bank enters into a Project Agreement, it may require the Recipient to enter into a subsidiary agreement with the

²⁵ The requirement of a Member Guarantee also applies in the case of Preparation Advances to a recipient that is not the Member.

Implementing Entity, setting forth the respective obligations of the Recipient and the Implementing Entity with respect to the Project. The Bank may also enter into agreements with other entities that have a direct interest in the Project or in the achievement of its objectives. These agreements set forth the obligations of such parties with respect to the Project.

5.1.9. General Conditions. From time to time, the Board approves the general conditions applicable to Loans (General Conditions), which set forth conditions applicable to all Loans. The Loan Agreement, and any Member Guarantee Agreement and Project Agreement for the Project, incorporate by reference the then current General Conditions.

5.1.10. Co-financing. If a Project is co-financed by funds from another financier:

- (a) in order to ensure that these other funds will be made available when needed for the Project, the Loan Agreement includes, as necessary, cross-effectiveness clauses and events of default linked to the agreements providing for these other funds, depending on the required timing of availability, respectively, of the Loan and these other funds; and
- (b) the Loan Agreement sets out whether the co-financing is to be made on a parallel basis (i.e., the Bank and the other financier each finance separate contracts for the Project), or whether it is to be made on a joint basis (i.e., the Bank and the other financier each finance a percentage of the same contracts for the Project).

5.2. Contractual Arrangements for Guarantees

5.2.1. Guarantee Agreement. For each Guarantee, the Bank enters into a Guarantee Agreement, which sets forth the terms and conditions on which the Guarantee is extended.

5.2.2. Member Indemnity Agreement. For each Guarantee, the Bank enters into a Member Indemnity Agreement with the Member in whose territory the Project is located or for whose benefit the Guarantee is made.²⁶ The Member Indemnity Agreement sets forth the Member's obligations in respect of the Guarantee, including an obligation to reimburse the Bank for any payments the Bank makes under the Guarantee, and to indemnify the Bank for all liabilities and expenses the Bank incurs in connection with the Guarantee. Under the Member Indemnity Agreement, the Member's payment is required on demand by the Bank, or as the Bank may otherwise direct. Additional undertakings made by the Member in order to facilitate the achievement of the purposes of the Guarantee are set forth in the Member Indemnity Agreement.

5.2.3. Remedies. The Bank's remedies in respect of a Guarantee may, depending on the transaction, include the right to suspend, terminate or withhold payments under the Guarantee.

²⁶ In the case of a cross-border Project, the Bank may obtain a Member Indemnity from a different Member than the Member in whose territory the Project is located. For example, if the Project involves both construction of a power plant in the territory of Member A and the off-take by Member B of the plant's output, with the Bank Guarantee backstopping defaults on a loan for the Project that result from the failure of Member B to make payments under the off-take agreement, the Bank would normally require a Member Indemnity from Member B. The Bank may also enter into an agreement with Member A regarding particular undertakings required of Member A (e.g., agreement to provide access to the Project site or to comply with certain environmental and social undertakings).

5.2.4. Security Arrangements. The Bank generally does not require specific security in connection with a Guarantee, but may do so in specific circumstances.

5.2.5. Project Agreement. The Bank normally enters into a Project Agreement with the Project's Implementing Entity. The Project Agreement specifies the Implementing Entity's obligations regarding the implementation and operation of the Project. The Bank may also enter into agreements with other entities, which have a direct interest in the Project or in the achievement of its objectives; these agreements set forth the obligations of such entities.

5.2.6. General Conditions. Certain provisions of the General Conditions may be incorporated in the Member Indemnity Agreement between the Member and the Bank and in the Project Agreement, adapted as appropriate for a Guarantee.

5.2.7. Co-financing and Cross-Effectiveness. If the Project is co-financed with funds from another financier, then in order to ensure that these other funds will be made available when needed for the Project, the Legal Agreements for the Guarantee include, as necessary, cross-effectiveness clauses linked to the agreements providing for these other funds, depending on the required timing of availability, respectively, of the Guarantee and these other funds.

VI. SUSPENSION OF SOVEREIGN-BACKED LOANS FOR NON-PAYMENT

6.1. Graduated Approach. The Bank takes a graduated approach to suspension of Loans for non-payment, as follows:

6.1.1. Thirty Days Overdue. When a payment to the Bank under a Loan or Member Indemnity becomes thirty (30) days overdue: (a) the Bank approves no new Loans to the Recipient (and, if the Recipient is the Member, no new Loans to be guaranteed by the Member and no new Guarantees for which a Member Indemnity is to be provided by the Member); (b) the Bank signs no agreements related to previously approved Loans to the Recipient (and, if the Recipient is the Member, no agreements related to previously approved Loans guaranteed by the Member or Guarantees for which a Member Indemnity is to be provided by the Member); and (c) the Recipient loses its eligibility for any waiver of interest charges under Loans in effect at the time. To avoid the Bank's proceeding further on the process leading to suspension, the Recipient is required to pay all payments overdue by thirty (30) days or more; however, nonpayment of amounts that have been due for less than thirty (30) days does not yet cause the Bank to continue proceeding towards suspension.

6.1.2. Forty-five Days Overdue. When a payment to the Bank under a Loan or Member Indemnity becomes forty-five (45) days overdue: (a) the provisions cited in sub-paragraphs 6.1.1(a), (b) and (c) above regarding Bank approval and signing and interest waiver eligibility, apply to all Loans to all Recipients guaranteed by the Member concerned, to all Loans to the Member and to all Guarantees for which a Member Indemnity is to be provided by the Member; and (b) the Bank makes no further advances under any Loan to or guaranteed by the Member. In addition, to avoid the Bank's proceeding further on the process leading to suspension, the Member (as Loan Recipient or guarantor) and all Recipients of Loans to or guaranteed by the Member, are required to pay not only all payments overdue by thirty (30) days or more, but also all payments due as of the date the Bank receives payment, regardless of the number of days since they fell due.

6.1.3. Sixty Days Overdue. When a payment to the Bank under a Loan or Member Indemnity becomes sixty (60) days overdue, the Bank suspends disbursements under all Loans to, or guaranteed by, the Member concerned. In addition, the restrictions cited in paragraph 6.1.2 above apply until the suspension is lifted.

**OPERATIONAL POLICY ON FINANCING
ANNEX 2**

**SPECIFIC PROVISIONS
APPLICABLE TO
NON-SOVEREIGN-BACKED FINANCING**

I. SCOPE

1.1. This Annex applies to any financing extended by the Bank that is not a Sovereign-backed Financing. Non-sovereign-backed Financing is any financing to, or for the benefit of, a private enterprise or a sub-sovereign entity (such as a political or administrative sub-division of a Member or a public sector entity) that is not backed by a guarantee or counter-guarantee and indemnity provided by the Member to the Bank.

II. ADDITIONAL DEFINITIONS

2.1. In general, the capitalized terms used in this Annex have the meanings set forth in Section II of this Policy. Certain additional capitalized terms, when used in this Annex, are defined below:

- (a) **Beneficiary** means the entity or entities to or for which the Financing is provided, including the recipient of a Loan and the entity whose obligations are guaranteed by the Bank.
- (b) **Sponsor** means the entity or entities that control the Beneficiary, e.g., its largest shareholder.

III. ADDITIONAL POLICY PROVISIONS RELATING TO TYPES OF NON-SOVEREIGN-BACKED FINANCING, EXPOSURE AND ASSESSMENT OF PROJECTS

3.1. Types of Financing. The Bank may provide Non-sovereign-backed Financing in the form of Loans, Guarantees, direct equity investments, indirect equity investments and underwriting of securities. It may provide one or more of these types of Non-sovereign-backed Financing for a single Project.

3.2. Exposure. The Bank finances out of its own funds not more than thirty-five percent (35%) of the long-term capital of an obligor, estimated on a pro-forma basis; for a new Project, the Bank finances out of its own funds not more than thirty-five percent (35%) of the Project's value (including interest during construction). On an exceptional basis, if co-financing is unavailable, the Board may decide to approve a higher level of financing for the Project.

3.3. Assessment of the Project. In carrying out its assessment of each Project as required under Section III of this Policy, the Bank focuses particular attention on the following risks:

- (a) **Technical and Financial Assessment.** The Bank assesses the nature and length of ownership and operation of the infrastructure (if any), which constitutes the core of the

Project and of the proposed financing plan.

- (b) **Creditworthiness of Beneficiary and Sponsor.** The Bank assesses whether the repayment of, and a satisfactory return on, a Non-sovereign-backed Financing can be serviced out of the Project's cash flow, by reviewing the financial projections of the Beneficiary in light of relevant sensitivity analyses. Where the Project's cash flow is found to be uncertain or insufficient, the Bank may provide a Non-sovereign-backed Financing supported by the Beneficiary and/or Sponsor's other businesses and assets. If the Project involves an existing business, the Bank requires the Beneficiary, and, where applicable, the Sponsor, to provide its audited statements for a period of at least three (3) years. In all cases, the Bank requires the Beneficiary or the Sponsor (or both) to make an adequate financial contribution to the Project.
- (c) **Capacity of Beneficiary.** The Bank assesses the quality and experience of the Beneficiary's management and, if needed, its Sponsor, as a critical component of its credit analysis. If the Beneficiary of a Financing is a sub-sovereign entity, the Bank assesses the experience and implementation capacity of the entity's relevant departments. As needed, the Bank may finance measures designed to enhance such capacity. If the Government is involved in the Project in whatever capacity, the Bank analyzes the powers, competence and ability of the public authorities to play their assigned role, and the irreversibility of their commitments.
- (d) **Integrity.** The Bank assesses the existing or proposed shareholding structure of each potential Beneficiary in order to ensure that the structure does not involve vehicles to which part of the Project's cash flow could be unacceptably diverted, or jurisdictions that do not meet the relevant standards imposed by recognized international bodies. The Bank also assesses the past and present integrity of the Beneficiary and Sponsor.
- (e) **Local Environment.** The Bank assesses all relevant aspects of the country and sector environment within which the Project is to be implemented, in order to evaluate their potential impact on the Project, including: (i) the macro-economic conditions; (ii) the Member's laws and regulations affecting the Project, in particular any restrictions on property, land tenure and investment; (iii) the ability of the Beneficiary to convert domestic currency into foreign exchange and to remit earnings abroad; (iv) the structure and incidence of taxes and tariffs; (v) to the extent that the Project comprises development or expansion of new infrastructure, the availability of existing or planned infrastructure offering the same support; and in the opposite case, the extent to which there is adequate infrastructure, including energy, transport and communications, to support the Project; (vi) the existence of a sufficient demand for that infrastructure or market for the products or services to be offered by the Project; and (vii) the availability of suitable labor to operate the Project.
- (f) **Cost/Benefit Assessment.** In addition to the elements to be assessed in the cost/benefit analysis under Section III, sub-paragraph 3.3.1(h) of this Policy, the Bank assesses the return that can be expected on the allocation of the Bank's funds to the Financing and the risks associated with this.

IV. FINANCIAL TERMS AND CONDITIONS FOR NON-SOVEREIGN-BACKED FINANCING

4.1. Terms and Conditions of Financing. The Bank applies market-based principles in setting the terms and conditions of each Financing, in particular its pricing. These terms and conditions take into account the intrinsic commercial and macroeconomic risks of each Project, the cost of funds to the Bank and the need to earn an appropriate return on the Bank's capital, including funds invested in direct and indirect equity of private entities. The Bank sets these terms and conditions in a manner designed to achieve a balanced financial structure based on an appropriate allocation of risks and to ensure the continued viability of the Project throughout the duration of the Bank's involvement and beyond. The President is responsible for establishing criteria designed to price Non-sovereign-backed Financings of comparable risks in a similar and consistent manner.

4.1.1. The Bank may offer a range of options and features (maturities, grace periods, interest payments) under the Non-sovereign-backed Financing in order to: (a) meet the specific needs of the Beneficiary and the Project; (b) tailor Non-sovereign-backed Loan repayments to the Project cash flows, i.e., with the first repayment scheduled to come due as soon as positive cash flow from the Project is available; (c) fix the final maturity of a Non-sovereign-backed Loan to not more than eighteen (18) years (in exceptional cases, the Board may decide that the Non-sovereign-backed Loan may have a longer final maturity); and (d) recycle the Bank's resources in order to enable it to finance additional Projects. The Bank charges front-end fees, commitment fees and fees for appraisal, prepayment, syndication or activities and services related to the Financing, all typically at prevailing market rates. The Bank also charges standby fees, guarantee fees and front-end fees in relation to Non-sovereign-backed Guarantees, also typically at prevailing market rates.

4.2. Limited Recourse or Corporate Finance. The Bank may extend a Non-sovereign-backed Loan on a limited recourse basis, backed only by the existing and future cash flow and assets of the Beneficiary. However, if the completion risk of the Project requires mitigation, the Bank requires a specific undertaking from the Project's Sponsor to provide any needed additional funds. The Bank may also extend a Non-sovereign-backed Loan with the credit support of a third party, e.g., recourse to designated assets or the balance sheet of the Sponsor or a bank guarantee. Where the Sponsor's support is necessary, the Bank assesses the Sponsor's creditworthiness and includes the Sponsor's undertaking in the Legal Agreements. The Bank also requires undertakings from the Sponsor and third parties as necessary to ensure the continued ownership of the Project during the term of the Financing and continued sources of management, technology, supply and equipment, as required for the Project.

4.2.1. Loan Seniority and Security. Non-sovereign-backed Loans are usually extended as senior Loans. However, subject to appropriate pricing, the Bank may also extend Loans subordinated to the prior payment of other debt of the Beneficiary or subordinated in repayment in the event of the Beneficiary's bankruptcy (or both). For Non-sovereign-backed Loans, the Bank typically requires a negative pledge undertaking by the Beneficiary. The Bank may also require that senior Loans be backed by appropriate guarantee or security. If the Bank requires such credit enhancements, it normally requires that they be granted and perfected before the first disbursement of the Loan.

4.3. Credit Lines to Financial Intermediaries. The Bank may extend credit lines to financial intermediaries, for on-lending for Projects meeting the conditions of direct Financing. In those cases, the Bank's recourse is usually to the balance sheet of the financial intermediary, but the Bank

may also require an assignment, by way of security, of the sub-loans granted by the financial intermediary.

4.4. Currency Denominations.

4.4.1. Loans. Non-sovereign-backed Financing in the form of a Loan is committed and repayable in United States Dollars. At such time as the Bank determines that it is in a position to offer Loans in other currencies, the Loan may be committed and repaid in such other currency or currencies as the Bank is able to fund itself efficiently from time to time.

4.4.2. Equity Investments. The Bank's equity investments are made in the currency in which the shares of the investee company are denominated (typically the local currency).

4.4.3. Foreign Currency. The Bank requires that the Beneficiary of each Non-sovereign-backed Financing obtain all governmental authorizations and permits as may be required to import and export foreign currency into and from the country in which the Beneficiary is located.

4.5. Loan Co-financing.

4.5.1. The Bank may provide Non-sovereign-backed Financing in the form of loan participations and syndications, as follows:

- (a) **Loan Participation.** Under a loan participation, the Bank transfers the full commercial and business risk to other lenders, allowing them to partially finance the Loan. In such case, the Bank agrees to extend a Loan, but funds only a portion of the Loan (known as the A tranche) with commercial banks funding the balance (known as the B tranche). The Bank remains the lender of record for the full amount of the Loan, and the loan agreement for the full amount of the Loan is between the Bank and the Beneficiary. The Bank enters into participation agreements with the participating commercial banks that transfer commercial and business risk to them. The commercial banks' B tranche accordingly shares the benefit of the Bank's immunities and exemptions, including the withholding tax exemption.
- (b) **Loan Syndication.** Under a loan syndication, the Bank joins a syndicate of commercial banks led by itself or one of the banks, under documentation prepared by the lead bank whereby: (i) the Bank and other members of the syndicate undertake to lend specified portions of the total loan amount, and, in normal circumstances, debt service being shared among all lenders *pro rata* to their outstanding loan portions in accordance with the terms of the loan agreement; and (ii) a single loan agreement is normally entered into between the Beneficiary and the syndicate of lenders, including the Bank. The Bank, as a member of the syndicate, does not share the benefit of its immunities and exemptions noted above with the other lenders.

4.6. Direct Equity Investments

4.6.1. The Bank may make direct equity investments in private or public sector companies. It may invest either in a new enterprise or an existing enterprise. The investment may take a variety of forms, including: (a) subscriptions to ordinary shares or preference shares (or a combination of both); and (b) a loan convertible into equity. The Bank's investment may not exceed thirty percent

(30%) of the company's ownership holdings. However: (a) in exceptional circumstances, the Board may decide to approve a higher, but not controlling, share; and (b) if the Bank's investment is in jeopardy, the Bank may take control of the company in order to safeguard its investment.

4.6.2. When considering an equity investment, the Bank assesses the value of the existing or future company in accordance with market practices, using commonly accepted valuation methodologies, including reference to reliable stock market quotations, if any, and any available data on comparable companies. It assesses in particular, the value of in-kind contributions from the Sponsor and other shareholders in the company. The Bank seeks a market rate of return reflecting the risks of the investment. Individual expected investment returns may typically fall in the range of eight percent (8%) to twenty percent (20%) depending on the type of equity investment.

4.6.3. The Bank assesses the rationale for taking an equity interest in a company. In addition to the financial aspects of the investment, the Bank assesses and defines an appropriate role for it to perform so as to ensure the proper governance of the company. Where appropriate, the Bank secures the right to nominate a member on the company's board of directors. The Bank may also serve as a facilitator in obtaining shareholder agreement on a particular corporate strategy or course of action. In general, where the Bank is both an investor and lender to the company, it is required to give priority to the protection of its Loan.

4.6.4. The Bank normally invests with the objective of continuing to be an investor for the medium term but it may, in exceptional cases, be an investor for the long term. It incorporates appropriate, credible exit strategies into its investment proposal, designed so that it may exit when a reasonable price can be achieved, and it is satisfied that its role has been completed. Determination of a reasonable valuation at time of exit is based on audited accounts and made in accordance with market practices, using such relevant data as may be available, and taking into account continuing risks and maturity of markets. Achievement of a minimum return is not a necessary condition for exit; in some instances, the Bank may exit an investment in order to minimize anticipated losses.

4.7. Indirect Equity Investments. The Bank may selectively make equity investments through financial intermediaries, such as equity funds, choosing those managed by professional managers with relevant track records and remuneration arrangements in line with market practices. In each case, the Bank seeks a credible exit strategy from the fund.

4.8. Other Non-sovereign-backed Financing Arrangements. The Bank may offer other forms of Non-sovereign-backed Financing, including: (a) Guarantees: depending on the needs of its clients and the Project, the Bank may provide Guarantees against default regardless of the cause or against default arising from specified events; and (b) underwriting, or participation in the underwriting, of securities issued by a private or public sector entity in connection with a Project.²⁷ In such case, the Bank ensures that its name and reputation are appropriately used, and addresses possible joint liability that may arise between underwriters.

²⁷ The Bank may underwrite securities by subscribing to specified amounts and values of an issue by a public or privately owned enterprise. Underwriting involves market risk to the extent the price of the underwritten issue may fall between the time it is underwritten and sold (i.e., value risk) or that there may be no subsequent market for the instrument (i.e., liquidity risk). Underwriting of equity in companies is treated as an exposure to the full underwritten amount and is subject to the limits set on equity investments.

V. CONTRACTUAL ARRANGEMENTS FOR NON-SOVEREIGN-BACKED FINANCING

5.1. Legal Agreements. The Bank documents Non-sovereign-backed Financing in accordance with the practice of other relevant multi-lateral development institutions providing similar non-sovereign-backed financing, through the use, in all cases, of standard templates for term sheets, loan agreements, subscription agreements, participation agreements, security sharing agreements, project funds (or project completion) agreements, etc., in order to ensure consistency and fairness.

5.2. Governing Law of Non-sovereign-backed Financing. The Bank includes governing law provisions in the Project's Legal Agreements, in accordance with the following requirements: (i) for cross-border Loans, the governing law is a suitable law, usually other than the law of the jurisdiction in which the Loan Beneficiary is established; and (ii) for certain instruments, such as equity subscription agreements, mortgage agreements and security interests on equipment, the governing law is by necessity local law.

VI. MONITORING; REMEDIES

6.1. Monitoring. Further to the provisions of Section III, paragraph 3.5 of this Policy, the Bank monitors the Project as required, firstly to promote the objectives of the Project; and secondly to assess and (if possible) mitigate risks to Project success and to the Bank's own financial returns under the Project. While in principle monitoring is therefore required until final repayment of a Loan or exit from an equity investment, the intensity of monitoring varies with the nature of the Project, as well as its profile in terms of credit and other risks. If the Project is co-financed by another financier, the Bank may rely on monitoring by the other financier, provided it is satisfied with the monitoring capacity and processes of such financier, and provided that its interests are fully aligned with those of that financier.

6.2. Remedies. If an event of default arises under any of the Legal Agreements entered into in connection with a Financing, the Bank considers whether to waive such default (which waiver can be temporary or final) or to exercise the Bank's contractual remedies under the relevant Legal Agreement. In respect of a Loan, remedies typically include: (a) suspension of withdrawals, or cancellation, of un-withdrawn amounts; (b) acceleration of payments due; (c) exercise of the Bank's rights, if any, *vis-à-vis* the Sponsor or any other third party (e.g., under a guarantee); (d) enforcement of security, if any (e.g., mortgage, charge over assets); and (e) initiation of bankruptcy proceedings, if available. In respect of an equity investment, remedies typically include: (a) cancellation of a subscription; and (b) exercise of the Bank's rights, if any, *vis-à-vis* the Sponsor or any other third party (e.g., under a put option agreement).