ASIAN DEVELOPMENT BANK

OFFICE OF THE PRESIDENT

30 May 2001

Ms. Daniele Nouy
Secretary General of the Basel Committee
on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
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Switzerland
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Comments on the January 2001 draft of The New Basel Capital Accord

Dear Ms. Nouy,

The Asian Development Bank (ADB) strongly supports the efforts of the Basle Committee on Banking Supervision to prepare the New Basel Capital Accord (the New Accord). We believe that the New Accord has a number of important implications for multilateral financial institutions such as ADB. This is particularly true with respect to cofinancing programs in which the multilateral institution acts as lender-of-record on behalf of commercial financial institutions.

In ADB, lender-of-record cofinancing is known as the Complementary Financing Scheme or CFS. Under CFS, participating financial institutions share fully in the credit risk of projects but also enjoy ADB's preferences as a multilateral financial institution. The CFS loan structure is described in Attachment 1. The structure is analogous to the "B-loan" cofinancing programs offered by other multilateral institutions.

We note that the January 2001 draft of the New Accord provides clear guidance with respect to the risk weightings of lending in certain financial structures, such as mortgages (paragraph 37), and guarantees (paragraph 117 et seq.), that require lower regulatory capital. On the other hand, we are concerned that there is a lack of guidance regarding country risk in the context of CFS or B-loans.

ADB, as a multilateral development institution, enjoys a de facto preferred creditor status in its member countries. This means that member governments grant ADB's loans preferential access to foreign exchange in the event of a country foreign exchange crisis. The preferred creditor status that participating financial institutions share through the CFS program is an effective political risk mitigant as substantiated by the following:

- Since ADB's lending program began in 1968, no ADB loan has been included in any general country rescheduling.

- During times of foreign exchange rationing or debt moratoria, ADB borrowers have been able to obtain access to foreign exchange reserves necessary to effect payment in US dollars on ADB loans (including CFS loans) and such payments have been able to be transferred out of the country.

- ADB's preferred creditor status is a key factor in ADB's AAA ratings (as noted in Attachment 2, Moody's Investors Service *Global Credit Research on ADB*, dated April 2001, and Attachment 3, Standard and Poor's *Special Edition on Supranationals*, dated September 2000).

- During the Asia crisis beginning in 1997, ADB did not experience any delays in remittances on its loans (including CFS loans) attributable to restrictions on foreign exchange transactions in those countries with limited foreign exchange at the time (including Thailand and Indonesia).

- In August, 1998 Pakistan imposed severe restrictions on remittances because of the lack of foreign exchange reserves. ADB's preferred access to foreign exchange was, nonetheless, respected.

- The value of the CFS/B-loan mechanism has been consistently recognized by G-10 bank regulatory agencies, which exempt banks participating in CFS/B-loans from specific mandatory country risk provisioning where such provisioning is required.

Extensive experience has demonstrated that the CFS/B-loan product has worked as an effective mitigant of political risk comparable to political risk insurance. Attachment 4 contains Standard & Poor's research on the subject published in April 2001.

ADB has a portfolio of approximately $1.02 billion in CFS loans to its developing member countries. The CFS loan program allows banks (and other financial institutions) to lend to private sector companies in countries where they would not be able or willing to do so without the benefit of the preferred creditor status of a multilateral institution.

In view of the considerations outlined above, we recommend that:

- Multilateral development banks (as referred to in paragraph 28) be included as eligible guarantors/protection providers under paragraphs 129 and 143 of the New Accord.

- Multilateral CFS and B-loans to emerging market borrowers be assigned under the New Accord (paragraph 133 and following, paragraph 182) a capital quotient in financial institutions' ratings systems no greater or more costly than that assigned to "equivalent" mitigation products.

It is important to note that the preferred creditor status enjoyed by ADB and other multilateral development banks and shared with banks and other financial institutions participating in CFS/B-loans is accorded as a matter of custom rather than as an entitlement. Nevertheless, it has proven over time to be an effective country risk mitigant since it is based on the mutual self-interest of governments that agree to treat multilateral development banks as preferred creditors to ensure that such institutions continue lending in bad times as well as good.

We would very much appreciate your consideration of the issues outlined above when revising the current wording of the draft New Accord. We believe that these issues are material not only for multilateral institutions, but are also of great importance generally for emerging market countries seeking access to long term capital investment.

Sincerely yours,

for Tadao Chino
President
Asian Development Bank

Attachments:

1. Structure of ADB CFS loans
2. Moody's Investors Service *Global Credit Research on ADB*, April 2001
3. Standard and Poor's *Special Edition on Supranationals*, September 2000
4. *"'B' Loans and Political Risk Insurance: Different Roads to the Same Destination"*, Standard & Poor's Ratings Direct, April 2001

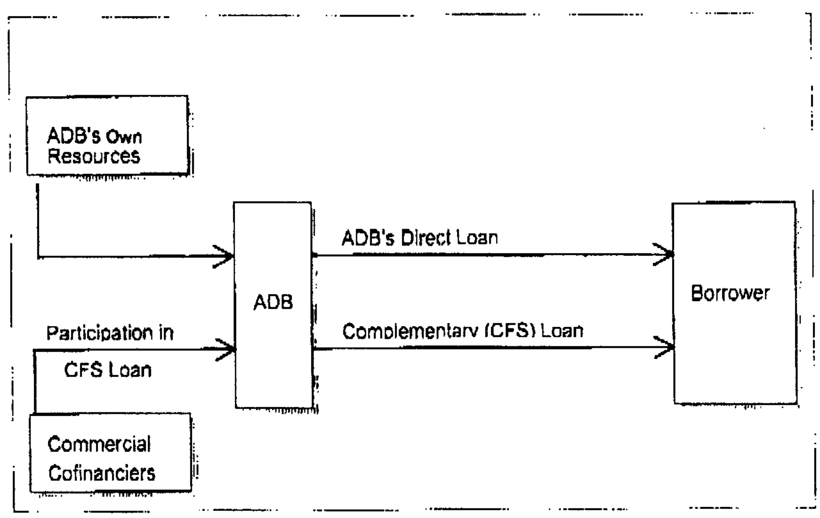
cc: Mr. E. Iglesias, President, Inter-American Development Bank
Mr. J. Lemierre, President, European Bank for Reconstruction and Development
Mr. P. Woicke, Executive Vice President, International Finance Corporation

Attachment 1

THE COMPLEMENTARY FINANCING SCHEME

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

Figure 1: The Complementary Financing Scheme



When participating in a CFS loan, financial institutions enter into a relationship different from that of a typical loan syndication. In a traditional loan syndication, each bank makes a direct loan to the borrower and decisions relating to the management of the loan are made by votes of the members of the syndicate. In addition, banks have direct access to the borrower for information. In a CFS loan, ADB administers the entire loan, collects all payments from the Borrower and distributes them to the participants. ADB maintains a high degree of discretion in the administration of CFS loans, granting participants consent rights over decisions only in limited circumstances, as defined in a Participation Agreement between ADB and the CFS lenders.

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[1] Complementary loans are sometimes referred to as "B" loans to distinguish them from the direct, or "A" loans, provided by multilateral institutions such as ADB or the International Finance Corporation.

Attachment 2

Moody's Investors Service
Global Credit Research

Asian Development Bank

April 2001

Ratings and Contacts

Category	Moody's Rating	Analyst	Phone
Issuer Rating	Aaa	Thomas J. Byrne/New York	1.212.553.1653
Senior Unsecured	Aaa	Brian Oak/New York	
Commercial Paper	P-1	Vincent J. Truglia/New York	

Operating Statistics

Asian Development Bank

Return on Earning Assets (%)	1995	1996	1997	1998	1999	2000
Asian Development Bank	**2.87**	**2.48**	**1.93**	**1.59**	**1.29**	**1.73**
African Development Bank	0.83	1.23	1.42	1.37	1.52	—
Inter-American Development Bank	1.53	1.04	1.15	0.99	1.22	1.61
World Bank	1.07	0.96	1.12	0.92	1.17	1.44
Interest Coverage Ratio (x)						
Asian Development Bank	**1.70**	**1.66**	**1.56**	**1.39**	**1.32**	**1.40**
African Development Bank	1.16	1.24	1.28	1.31	1.36	—
Inter-American Development Bank	1.29	1.21	1.23	1.21	1.27	1.33
World Bank	1.22	1.20	1.24	1.20	1.25	1.30

Capital Adequacy

Asian Development Bank

Risk Asset Coverage Ratio (%)[1][2][3]	1995	1996	1997	1998	1999	2000
Asian Development Bank[4]	**623.5**	**801.4**	**280.8**	**217.9**	**198.1**	**195.2**
African Development Bank	104.7	116.1	119.2	123.9	144.4	—
Inter-American Development Bank	173.8	210.8	223.7	200.9	168.9	189.2
World Bank	153.1	178.0	188.4	142.3	145.4	147.9
Usable Capital/Risk Assets(%)[2][3]						
Asian Development Bank[4]	**162.0**	**186.8**	**69.0**	**54.3**	**52.4**	**55.8**
African Development Bank	38.6	42.4	46.6	49.9	53.6	—
Inter-American Development Bank	39.1	39.3	40.3	35.8	29.9	35.7
World Bank	34.1	39.4	40.7	31	31.8	33.3

[1] Usable capital plus callable capital of Aaa/Aa-rated countries/Risk assets. [2] Usable capital includes all capital payments received in freely convertible currencies less amounts required to maintain the value of currency holdings plus all reserves plus all unallocated net income. [3] Risk assets are defined as loans to countries considered by Moody's to be below investment grade. [4] The deterioration in the ratio in 1997 was caused by the downgrades of the ratings of Indonesia, Thailand, and Korea from investment grade to below investment grade in 1997.

Balance Sheet Statistics [1]

Asian Development Bank

Net Loans (end of period, US$ mil.)	1995	1996	1997	1998	1999	2000
Asian Development Bank	**17,492**	**16,070**	**18,789**	**24,698**	**28,271**	**28,155**
African Development Bank	9,849	9,479	8,816	9,012	8,762	—
Inter-American Development Bank	25,774	25,223	26,479	31,687	37,385	40,563
World Bank	119,759	106,906	102,595	103,336	113,668	116,704
Liquid Assets (end of prd., US$ mil.)[2]						
Asian Development Bank	**6,153**	**8,427**	**7,117**	**8,138**	**8,272**	**7,598**
African Development Bank	2,400	2,076	1,784	2,010	1,722	—
Inter-American Development Bank	9,506	10,293	10,269	11,059	13,572	14,285
World Bank	21,179	16,197	18,534	26,169	30,378	24,973

[1] Data for fiscal years. World Bank ends 6/30, others 12/31. [2] Liquid assets do not include restricted cash, where applicable.

Opinion

Rating Rationale

Moody's Aaa rating for long-term debt issued by the Asian Development Bank (AsDB) and the Prime-1 rating for short-term obligations are based on the following factors: (1) solid support—much of the subscribed capital is pledged by non-borrowing member countries rated Aaa/Aa; (2) preferred creditor status that borrowing countries afford the bank; and (3) the bank's strong financial fundamentals and prudent risk management. Under the terms of its charter, AsDB's commitments for loans, guarantees, and equity investments cannot exceed subscribed capital, reserves and surplus. The Bank also limits new borrowings to no more than 95 percent of the callable capital pledged by member countries with convertible currencies. The bank has traditionally operated well within those restrictions and has never resorted to a capital call.

With no losses on its public sector loans and negligible arrears on its private sector loans (which are only a very small portion of its portfolio), the AsDB still maintains a loan portfolio performance equal to the best in its peer group of multilateral development banks.

The increase in loan charges and reduction in new lending following the Bank's exceptional response to the Asian crisis reversed the downward trend in key financial ratios and has relieved impending constraints on lending and borrowing headroom.

Rating Outlook - Stable

The AsDB's strong member support and healthy financial condition ensure a stable near-term outlook, even with continued adjustment in some of the Bank's major borrowing countries. Potential pressures on the Bank's capital base and income outlook may pose challenges on the Bank's financial intermediation capacity over the medium term.

Author	Associate Analyst	Production Associate
Tom Byrne	*Mary O'Donnell*	*Alba Ruiz*

Rating Rationale And Outlook

The Aaa rating of the Asian Development Bank (AsDB) is underpinned by its strong support from highly creditworthy shareholders and by the financial soundness of its operations. The AsDB's risk-bearing capacity, for example, has remained very resilient and is exceptionally high compared with the other multilateral development banks (MDBs). In addition, borrowing countries recognize that sound financial management maximizes access to available AsDB resources while lowering borrowing costs, thereby providing strong incentives to confer preferred creditor status to the AsDB.

The AsDB's financial risk management ratios and asset quality were maintained at or above the relatively conservative internal policy guidelines during the Asia crisis and the ongoing recovery phase. Moreover, the decline in net income was reversed last year with the increase in loan charges and improved investment portfolio returns. The AsDB has not suffered any losses of principal on its public-sector loans either before or after the onset of the Asian crisis-only one small loan is in nonaccrual status. Although non-accruals on private sector loans are higher, they do not meaningfully affect the Bank's performance because the total private sector loans comprise only about 1 percent of the Bank's lending portfolio.

Over the longer term, the Bank remains concerned over the maintenance of a strong income position as well as avoiding constraints on its financial intermediation capacity-ensuring that its lending and borrowing headroom remains adequate to meet unexpected needs of its borrowing member countries. Internal sensitivity analysis has concluded that the recent increase in loan charges is critical for maintaining risk management ratios above minimum policy levels, even though the Bank recognizes that some borrowing countries have been critical of the increase in loan charges. The introduction of the new, Financial Accounting Standards Board practice (FAS 133) as of January 1, 2001 is not expected to have any material change on the Bank's income because of its limited use of derivatives to date.

The recent reduction in loan growth has made the potential need for a capital increase less urgent. However, in consideration of an increasingly interconnected and volatile global financial system and in consideration of the long lead time required to secure a general capital increase (the previous GCI in 1995 took three years to conclude), the Bank is continuing to study internally whether its capital structure will be adequate. In May 2000, the Board of Governors authorized the Board of Directors to initiate a study on the Bank's resource requirements. The study will, among various subjects, also assess the Bank's lending and borrowing headrooms as well as the adequacy of its equity base. Upon its completion, the requirements and timing of the next general capital increase will be determined.

Recent Operations And Lending Trends

The AsDB has two lending vehicles. This report is solely concerned with Ordinary Capital Resources (OCR), which carry interest charges related to borrowing costs. The other lending vehicle, the Asian Development Fund (ADF), is the AsDB's concessional loan window, the balance sheet and operations of which are completely segregated from those of the OCR.

After the AsDB's extraordinary expansion during the Asia crisis, lending continued to decline in 2000. New loan approvals of $4.2 billion and new loan disbursements of $2.9 billion were not only below crisis level activity but also below 1999 levels and planned activity for 2000. The net resource transfer was again in negative territory, amounting to almost $0.8 billion in net repayments to the Bank in 2000 (gross disbursements and equity investments less repayments of principal, interest and other charges). This, however, reflects the improved economic fortune of the region. The bulk of new loan commitments continued to be directed to a handful of the AsDB's members-Indonesia, Philippines, China, India, and Pakistan received almost 90 percent of last year's total. Again, reflecting improved economic performance in the region, Korea and Thailand did not receive any new loan commitments in 2000 and repaid the Bank on net last year-in contrast to their prominent place in new lending by the Bank in 1997 and 1998. The high degree of loan portfolio concentration inevitably reflects the economic realities of the region.

The AsDB has never suffered any losses on loan principal made to the public sector. In contrast, the World Bank, the African Development Bank, and the Inter-American Development Bank have had nonperforming public-sector loans. The AsDB has not made loan loss provisions for public sector loans, but

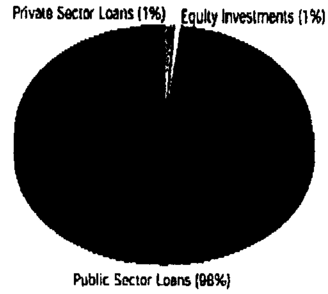
the AsDB's ample general reserves mitigate potential risks. The AsDB has about $1 million in public sector loan non-accruals arising from lending to Myanmar. The excellent loan repayment performance by member countries reflects the following factors:

- The AsDB's premier credit status lowers loan costs.
- AsDB-supported projects are part of a country's investment budget and plan.
- The AsDB's consistent positive, net transfer of resources and technical assistance.
- A tested record of preferred creditor status—official Paris Club debt reschedulings for the Philippines in the 1980s and Pakistan in 1999 excluded AsDB loans.

Bank policy continues to restrict private sector exposure, limiting unguaranteed operations at $1.5 billion. Private sector loan non-accruals totaled about $62 million out of a stock of disbursements of $898 million as of the end of 2000. Loan loss provisions have been made for the private-sector portfolio.

The AsDB will increasingly shift its lending focus towards poverty reduction and away from conventional, infrastructure projects, although this will take into account the basic economic needs of each borrowing member country. Potentially riskier economic adjustment and reform loans are limited to 20 percent of cumulative lending commitments over a moving three-year period for OCR and ADF combined. The Bank is reluctant to engage in repeated, jumbo quick-disbursing loans as made to Korea in 1997, but it also recognizes that it must remain responsive to future needs, should another crisis occur.

Public Sector Dominates AsDB Operations

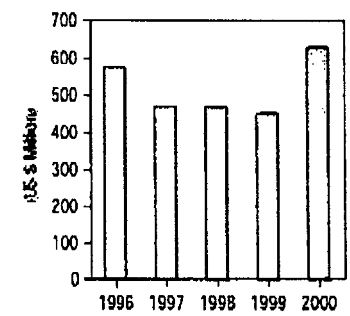


The new Asian Currency Crisis Support Facility (ACCSF) is operated outside the AsDB's OCR and ADF lending vehicles, with funding provided entirely by Japan under its New Miyazawa Initiative. The objective of the ACCSF is to complement regular AsDB assistance and help in mobilizing private sector resources for countries affected by the Asian economic crisis. ACCSF funds will be used to help pay interest charges on AsDB OCR loans, to provide technical assistance grants, and to provide guarantees in support of reform and social safety net programs. As of December 31, 2000, the government of Japan contributed $241 million to this facility and also deposited a 360 billion yen ($3.2 billion) promissory note to meet a call on any guarantees issued under the ACCSF.

Financial Performance And Risk Management

The downward trend in net income was reversed in 2000, rising almost 40 percent from the previous year. This was due largely to an increase in loan charges effective as of January 1, 2000, as well as to improved returns on the Bank's investment portfolio, and decline in new lending. The change in loan charges increased the effective annual spread to 115 basis points from 74 basis points (lending spreads were raised 20 basis points to 60 basis points and a 1 percent front-end fee for new loans was introduced). The increase in net income for 2000 boosted the interest coverage ratio (ICR) to 1.40 in 2000 from 1.31 (the Bank's internal minimum policy guideline of 1.30 is to ensure that ICR does not fall below the level of 1.31 times). The Reserve to Loan Ratio (RLR) also bounced back in 2000, rising to 27.26 percent from a low of 25.97 percent in 1999 that was also barely above the internal policy guideline of 25 percent.

Net Income Improves



Credit rating downgrades of some borrowing member countries in the late 1990s also contributed to a decline in the AsDB's risk asset coverage ratio, but this too improved in 2000 to 218 percent from a low of about 200 percent in 1999 and a high of about 800 percent in 1996 according to Bank calculations. The AsDB still has one of the strongest risk asset coverage ratio among the MDBs, although it is no longer the undisputed strongest. Loans to countries that Moody's rates below investment

grade amounted to about 60 percent of the AsDB's total loans in 2000 compared with 29 percent in 1996. The two largest exposures in terms of undisbursed and outstanding loans are to Indonesia (25 percent) and China (20 percent).

Asset/Liability Management

The recovery in Asia and decline in crisis lending allowed the AsDB to scale back its gross borrowings to $1.7 billion in 2000 from $5.2 billion in 1999 and $9.6 billion in 1998. Total outstanding borrowings (primarily fixed-rate bonds) and guarantees amounted to $25.7 billion, almost all of which was long-term. The gap in average maturity of the AsDB's borrowings compared with its loans remains comfortable, given the relative size of the AsDB's balance sheet capital. The liquidity ratio was at 52 percent in 2000, well above the Bank's policy that liquid assets are at least 40 percent of total pool-based undisbursed loan commitments.

The bank avoids exchange risks by matching the currency composition of its assets and liabilities. Outstanding borrowings (after swap transactions) at the end of 2000 were concentrated in two currencies: U.S. dollars (67.5 percent) and in Japanese yen (28.9 percent). The same currencies also made up virtually all of receivables on outstanding loans. The currency concentration on both borrowing and lending stems from the AsDB's policy to keep the nominal lending rate as low as possible.

Capital Adequacy

The Bank is studying internally whether the future expected loan program and budget framework could lead to capital adequacy constraints that would adversely affect its capacity for financial intermediation. Near-term constraints are unlikely, but the Bank is studying whether unexpected borrowing requirements by member countries could be met over the medium- to long-term. The previous general capital increase (GCI IV) provided for a 100 percent increase in authorized capital in 1994, although two years elapsed before subscriptions were fully submitted.

Subscribed capital was $45 billion at the end of 2000-of which about $3 billion is paid in (subscriptions are made in IMF SDRs, reducing the impact of exchange rate fluctuations on the AsDB's lending capacity). The rest, callable capital, functions as a backup in the unlikely event that the AsDB is unable to meet its own borrowing obligations (the AsDB has never made a capital call). Callable capital is a full faith and credit obligation of each member government; if needed, the Bank would make pro rata capital calls on all members whose obligations are independent of action by other members. If a member fails to meet its obligation, the Bank would make successive calls to obtain the amount needed.

The AsDB's charter conservatively limits commitments for loans, guarantees, and equity investments to 100 percent of its total unimpaired subscribed capital, plus its ordinary reserve and surplus. Total borrowings and guarantees chargeable to OCR may not exceed callable capital stock. Furthermore, internal policy limits outstanding borrowings and guarantees to 95 percent of callable capital of member countries with convertible currencies. Lending was 81 percent of its charter limitation and was 72 percent of its self-imposed borrowing limitation in 2000.

Governance

The largest shareholders are Japan and the United States-each hold 13% of total voting power. Non-borrowing OECD countries account for 60 percent of AsDB's total subscribed capital and control about 54 percent of total voting power. In contrast, non-borrowing members are minority shareholders in other regional MDBs. The practice of the Bank is to have a president from Japan and reach board decisions by consensus.

Rating History

Date	Commercial Paper	Long-Term Issuer Rating
02/06/1990	P-1	—
12/21/1994	P-1	Aaa

Asian Development Bank

Balance Sheet Summary (US$ Million)	1995	1996	1997	1998	1999	2000
Assets						
Total	30,033	29,268	32,820	41,653	45,295	43,857
Cash [1]	84	94	76	63	73	63
Investments	6,069	6,332	7,042	8,076	8,199	7,533
Gross Loans Outstanding	17,530	16,109	18,839	24,760	28,344	28,231
Less: Accumulated Provision for Loan Losses	39	39	50	62	73	76
Net Loans Outstanding	17,492	16,070	18,789	24,698	28,271	28,155
Net Equity Investments	164	230	174	186	211	203
Other Assets	6,225	6,541	6,740	8,630	8,541	7,902
Liabilities						
Total	20,762	19,603	23,518	31,590	34,731	33,023
Total Borrowings	14,599	13,664	17,494	23,744	26,285	25,367
Other Liabilities	6,163	5,939	6,023	7,846	8,446	7,656
Capital and Reserves						
Total	9,272	9,666	9,302	10,063	10,563	10,834
Net Paid-in Capital	3,027	3,022	2,893	3,103	3,122	3,050
Ordinary Reserve	5,003	5,523	5,867	6,211	6,689	7,166
Special Reserve	178	179	179	182	182	182
Accumulated Translation Adjustments	307	80	(393)	(200)	(78)	(376)
Unrealized Investment Gains	26	61	31	27	3	69
Surplus	70	230	257	277	197	117
Net Income after Appropriations	660	572	467	464	450	626
Total Liabilities, Capital and Reserves	30,033	29,268	32,820	41,653	45,295	43,857
Composition of Assets (% of total assets)						
Cash	0.3	0.3	0.2	0.2	0.2	0.1
(Unrestricted Cash)	0.3	0.3	0.2	0.0	0.0	0.0
Investments	20.2	21.6	21.5	19.4	18.1	17.2
Loans Outstanding	58.2	54.9	57.2	59.3	62.4	64.2
Other Assets	21.3	23.1	21.1	21.2	19.3	18.5

[1] Members may restrict the use of their currencies to payments for goods or services produced in their territories.
In 2000, $45,000 (1999 = $23,000) of cash was so restricted.

Asian Development Bank

Composition of Capital and Loans (US$ Million)	1995	1996	1997	1998	1999	2000
Capital Structure						
Total Subscribed Capital	**43,078**	**49,368**	**46,411**	**48,456**	**47,597**	**45,271**
Less Total Callable Capital (CC)	**39,643**	**45,896**	**43,147**	**45,042**	**44,249**	**42,087**
(CC of Aaa/Aa Countries) [1]	23,438	28,189	26,501	27,545	26,975	25,591
(CC of Investment Grade (IG) Countries) [2]	36,094	41,777	34,426	34,379	33,640	32,965
Equals Paid-in Capital	3,435	3,472	3,264	3,414	3,348	3,184
Less Paid-in Subscriptions Not Due	337	382	307	245	160	72
Less Capital Transfers to ADF [3]	71	68	64	67	65	62
Equals Net Paid-in Capital	**3,027**	**3,022**	**2,892**	**3,103**	**3,122**	**3,050**
Less non-negotiable, non-interest-bearing demand obligation receivable from members	325	364	326	350	382	384
Less net notional amounts required to maintain value of currency holdings [4]	318	361	450	471	368	399
Plus total reserves and net income	5,841	6,273	6,514	6,857	7,320	7,974
Equals Usable Equity	8,225	8,569	8,630	9,138	9,693	10,241
Capitalization (% of Total Capitalization)						
Borrowings	23.1	19.7	24.6	29.9	32.3	32.1
Reserves	8.2	8.2	8.5	8.0	8.4	9.3
Net Income	1.0	0.8	0.7	0.6	0.6	0.8
Subscribed Capital						
Paid-in Capital	4.8	4.4	4.1	3.9	3.8	3.9
CC of Aaa/Aa Countries [1]	37.0	40.6	37.3	34.6	33.1	32.4
CC of Investment Grade (IG) Countries [2]	20.0	19.6	11.2	8.6	8.2	9.3
Loans						
Total Loan Commitments Outstanding	31,427	30,564	35,271	39,019	41,938	42,088
Less Loans Not Yet Effective	3,535	3,126	3,325	2,601	1,920	3,129
Less Undisbursed Balances of Effective Loans	10,362	11,329	13,108	11,658	11,674	10,728
Plus/(Minus) Currency Adjustments	—	—	—	—	—	—
Equals Loans Outstanding	**17,530**	**16,109**	**18,839**	**24,760**	**28,344**	**28,231**

[1] CC = Callable Capital. AsDB member countries viewed by Moody's as having credit standing of Aaa or Aa.
[2] CC = Callable Capital. AsDB member countries viewed by Moody's as having credit standing of Baa or above.
[3] ADF = Asian Development Fund.
[4] Notional amounts: receivable minus payable.

Asian Development Bank

Income (US$ Million)	1995	1996	1997	1998	1999	2000
Total Gross Income	1,745	1,562	1,450	1,833	2,028	2,301
Interest on Loans	1,264	1,119	1,077	1,392	1,626	1,808
Commitment Fees	47	48	49	48	48	47
Other Loan Income	1	3	2	1	1	7
Investment Income	419	360	312	383	344	400
Other	14	32	10	9	9	40
Total Gross Expenses	1,085	990	982	1,366	1,578	1,675
Borrowing Costs	963	878	853	1,206	1,447	1,577
(Interest Expenses)	940	863	839	1,188	1,426	1,561
Administrative Expenses	108	109	96	122	106	93
Other (Provision for Losses)	14	3	33	37	25	6
Net Income	660	572	468	467	450	626

Asian Development Bank

Financial Ratios	1995	1996	1997	1998	1999	2000
Performance Statistics (%)						
Return on Total Assets	2.3	1.9	1.5	1.3	1.0	1.4
Return on Earning Assets	2.9	2.5	1.9	1.6	1.3	1.7
Return on Equity [1]	7.7	6.2	4.9	4.7	4.3	5.7
Return on Usable Equity	8.3	6.8	5.4	5.3	4.8	6.3
Interest on Loans/Loans Outstanding	7.2	7.0	5.7	5.6	5.8	6.4
Interest Coverage Ratio	1.7	1.7	1.6	1.4	1.3	1.4
Undisbursed Loans/Total Effective Loans	37.2	41.3	41.0	32.0	29.2	27.5
Capital Adequacy Ratios (%) [2]						
Usable Equity as % Risk Assets	162.0	186.8	69.0	54.3	52.4	55.8
Usable Equity + CC of Aaa/Aa % Risk Assets	623.5	801.4	280.8	217.9	198.1	195.2
Usable Equity + CC of IG Members as % Risk Assets	872.7	1097.6	344.2	258.5	234.1	235.4
Liquidity Ratios (%)						
Liquid Assets % Total Assets	20.5	22.0	21.7	19.4	18.1	17.2
Liquid Assets % Total Borrowings	42.1	47.0	40.7	34.3	31.5	29.9
Liquid Assets as % of Debt Maturing Next Five Years	138.6	130.3	71.4	120.6	105.9	97.3
Liquid Assets (excl. Special Reserve) as % Undisbursed Loans	43.0	43.2	42.2	55.8	59.5	53.5
Coverage of Debt Service (%) [3]						
Liquid Assets as % CMLTD + Interest Paid	409.3	387.8	137.8	350.9	306.6	268.3
Liquid Assets + Net Income + Interest Paid as % CMLTD + Interest Paid	515.8	474.4	163.1	422.3	376.1	345.5
Liquid Assets + Net Income + Interest Paid as % Interest Paid	824.7	910.9	1,003.7	824.6	711.8	626.8
Maturity Of Outstanding Borrowings (% of total)						
One Year	3.9	5.8	24.7	4.8	4.8	5.0
Two to Five	26.5	30.3	32.2	23.7	24.9	25.7
More than Five Years	69.9	64.1	43.8	125.0	122.5	122.8
Reserves To Loans Ratio (%) [4]						
Total Reserves + Unallocated Net Income as % Net Loans Outst. + Net Equity Investments	33.5	39.9	35.7	28.7	26.4	28.5
Lending Limitations (%) [5]						
Loan Commitments + Equity Investment as % Subscribed Capital + Ordinary Reserves + Surplus	65.0	55.6	67.9	71.7	77.4	80.7
Borrowing Practice Limitation (%) [6]						
Total Borrowings Outstanding & Guarantees as % CC in Convertible Currencies	47.0	33.8	45.9	60.1	67.6	72.3

[1] Equity equals total paid-in capital + reserves + unallocated net income.

[2] Risk assets are defined as loans to countries considered by Moody's to be below investment grade. The deterioration in the ratio in 1997 was caused by the downgrades of the ratings of Indonesia, Thailand, and Korea from investment grades to below-investment grades in 1997.

[3] CMLTD is currently maturing long-term debt.

Asian Development Bank

LENDING OPERATIONS

Loan Commitments to Member Countries by Sector (%)

	1995	1996	1997	1998	1999	2000	Annual Average 1995-00	Annual Average 1968-95
Energy	38.9	20.1	6.3	8.8	14.9	24.3	17.0	33.8
Social Infrastructure	22.1	12.6	15.0	10.5	28.3	21.7	17.7	14.2
Transport & Communications	16.4	31.8	9.2	22.0	16.3	28.5	19.3	22.2
Finance	13.8	1.5	58.6	32.5	0.9	1.5	23.9	12.5
Agriculture & Agro-industry	8.2	11.0	7.0	4.1	7.7	10.0	7.8	14.4
Industry & Non-fuel Minerals	0.5	5.7	0.5	0.1	8.9	8.2	3.4	4.4
Multi-Sector and others	0.2	17.3	3.3	22.0	23.0	5.9	11.0	1.6
Total (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (US$ mil.)	4,050	3,879	7,794	4,995	3,908	4,258	4,814	1 235

Loan Commitments by Country (%)

	1995	1996	1997	1998	1999	2000	Annual Average 1995-00	Annual Average 1968-95
Indonesia	24.7	22.8	13.8	36.8	26.1	14.9	22.3	29.6
Philippines	13.1	6.5	4.2	16.9	2.3	12.1	8.9	12.0
India	15.6	20.3	7.2	5.0	16.0	31.2	14.5	14.9
Pakistan	4.0	8.6	3.2	0.0	7.9	10.6	5.2	9 3
China, People's Republic of	29.7	28.4	8.4	24.1	32.2	20.5	21.8	11.6
Thailand	8.1	8.5	7.1	12.6	9.3	0.0	7.6	8 1
Malaysia	1.8	0.7	0.5	0.0	0.0	0.0	0.5	5 3
Korea	0.0	0.0	51.5	0.0	0.0	0.0	13.9	6 6
Others	3.1	4.3	4.0	4.6	6.3	10.7	5.3	2 7
Total (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (US$ mil.)	4,050	3,879	7,794	4,995	3,908	4,258	4,814	1 235

Asian Development Bank

Disbursed Loans Outstanding by Country (%) [1]	1995	1996	1997	1998	1999	2000
Indonesia	33.4	27.7	22.5	22.3	24.4	24.7
Philippines	14.8	14.8	12.4	10.9	9.5	9.0
India	13.7	16.3	15.7	14.7	16.7	14.9
Pakistan	12.6	12.0	9.5	8.3	8.0	7.9
China, People's Republic of	11.1	15.2	15.3	15.0	16.0	18.1
Thailand	6.2	6.5	8.0	8.3	8.6	7.1
Malaysia	3.2	3.0	2.4	2.0	1.9	1.8
Korea	3.4	2.8	12.4	16.4	14.4	14.1
Others	1.6	1.8	1.8	2.0	0.5	2.4
Total (%)	100.0	100.0	100.0	100.0	100.0	100.0
Total (US$ mil.)	17,530	16,109	18,839	24,760	28,344	28,231

[1] Before allowance for loan losses and adjustment for translation into US dollars.

Capital Subscriptions and Voting Power (as of December 31, 2000)

		Par Value of Shares (US$ Mil)			Voting Power
10 Largest Subscribers	**% of Total**	**Total**	**Callable**	**Paid-in**	**% of Total**
Japan	15.1	7,195	6,691	503.9	13.1
United States	15.1	7,195	6,691	503.9	13.1
China, People's Rep. of	6.2	2,971	2,763	208.1	5.6
India	6.1	2,919	2,714	204.4	5.5
Australia	5.6	2,668	2,481	186.8	5.1
Indonesia	5.3	2,511	2,335	175.8	4.8
Canada	5.1	2,412	2,243	168.9	4.6
Korea	4.9	2,322	2,160	162.6	4.4
Germany.	4.2	1,994	1,855	139.7	3.9
Malaysia	2.6	1,255	1,167	91.0	2.6
10 Largest Subscribers	70.3	33,440.7	31,098.8	2,345.0	62.5
Total - All Members	100	47,596.8	44,249.2	3,347.7	100

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Attachment 3

CREDIT RATING
AAA/Stable/A-1+

RATING HISTORY
Ratings affirmed at 'AAA' and 'A-1+' 1999
Short term rating of 'A-1+' assigned 1990
Senior debt rating of 'AAA' assigned 1971

BASIC DATA (1999)
Total assets (including undisbursed loans) ..... US$50 billion
Capital (callable plus paid-in) ..... US$47 billion
Number of shareholders 58

PURPOSE
To provide loans and equity investments that promote the economic and social advancement of its members states and to encourage public- and private-sector investment for development purposes. Special consideration is given to smaller and less-developed countries and projects that foster regional economic growth.

GENERAL CAPITAL
Authorized capital was US$47.6 billion and subscribed capital amounted to US$47.6 billion as of year-end 1999.

ISSUER WEBSITE
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ANALYST
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ASIAN DEVELOPMENT BANK

RATIONALE

The ratings on the Asian Development Bank (AsDB) are based on its:

- Very strong financial profile,
- Conservative financial policies, and
- Strong shareholder support.

Founded in 1966, AsDB promotes the economic and social development of its member states in the Asia-Pacific region through loans, investments, and guarantees. The bank continues to enjoy strong shareholder support from both donor and borrowing members, as indicated by the increase in its subscribed capital to US$47.6 billion at the end of 1999 from US$23 billion in early 1994.

The bank had adjusted assets of US$38.2 billion (US$50.0 billion including undisbursed loans) in 1999, more than double the size of African Development Bank, but less than two-thirds that of Inter-American Development Bank. Based upon assets, the AsDB is the fourth-largest multilateral development bank (MDB).

AsDB's financial profile and policies compare very favorably with those of other MDBs. Member states with investment-grade debt ratings account for about 72.5% of callable capital, greater than that of International Bank for Reconstruction & Development (World Bank) and other regional development banks outside Europe. AsDB's leverage and gearing ratios are among the lowest of MDBs. Asset quality remains strong despite regional economic problems, reflecting not only the bank's preferred creditor status, but also its prudent financial management.

The bank has been an integral part of international efforts to restructure Asian economies since the early stages of the regional financial crisis, participating in assistance programs in Korea, Thailand, and Indonesia. Nevertheless, AsDB plans to gradually shift back to its original focus on poverty alleviation, human capital development, and environmental and social welfare, while maintaining support for economic and financial sector reform in some of the member countries affected by the crisis.

Total loan disbursements from the bank's ordinary capital resources decreased by 34% to US$3.7 billion in 1999, after having risen to US$5.6 billion in 1998 on the back of emergency program loans extended to cope with the Asian financial crisis. Loan growth will likely remain moderate in the medium term, but the bank is expected to complement its own lending by continued mobilization of additional resources into the region through cofinancing operations.

OUTLOOK

The ratings on AsDB are expected to remain unchanged in coming years, as Asian economies recover from the financial crisis. Despite significant private-sector debt restructuring in some of its borrowing countries, the bank's portfolio of mostly sovereign-guaranteed loans should remain serviced fully and on time. The bank's financial strength and solid shareholder support should allow it to play a larger role in bringing capital back into the region, especially through its cofinancing operations. The large funding needs of the weakened financial sectors in many countries will sustain loan demand in coming years. Moreover, the bank's regional presence will gradually expand, with the planned opening of new missions this year in the Lao and Kyrgyz Republics.

Asian Development Bank Financial Statistics

(Mil. US$)	1999	1998	1997	1996	1995
Balance sheet assets	38,238.8	34,509.3	27,336.9	24,015.4	25,224.6
Net disbursed loans	28,271.2	24,698.4	18,788.5	16,070.4	17,491.6
Liquid assets	8,271.7	8,138.1	7,117.3	6,426.6	6,153.0
Subscribed capital	47,596.8	48,456.0	46,411.5	49,368.0	43,077.8
Paid-in capital + reserves	10,174.2	9,693.5	8,967.5	9,293.6	8,939.8
Net operating income	449.9	464.3	467.5	571.7	660.1
(%)					
Disbursed loans/Paid-in capital + reserves	277.9	254.8	209.5	172.9	195.7
Disbursed loans/Subscribed capital + reserves	51.4	44.6	35.6	28.7	35.5
Loans to rescheduling countries/'AAA' callable capital + paid-in capital + reserves	30.2	25.8	0.0	0.0	0.0
Nonaccrual loans outstanding/Disbursed loans outstanding	0.3	0.2	0.2	0.1	0.2
Nonaccrual loans outstanding - loan-loss provisions/'AAA' callable capital + paid-in capital + reserves	0.0	0.0	0.0	0.0	0.0
Net operating income/Average total assets	1.2	1.5	1.8	2.3	2.7
Adjusted net income/Average total assets	1.2	1.5	1.8	2.3	2.7
Debt/Paid-in capital + reserves	258.4	244.9	195.1	147.0	163.3
Debt/'AAA' callable capital + reserves + paid-in capital	89.4	80.8	62.8	46.5	57.1
Net debt/'AAA' callable capital + reserves + paid-in capital	51.3	53.1	37.3	24.6	33.0
Liquid assets/Undisbursed loans + one-year debt service	44.4	39.2	48.1	50.1	47.7

Attachment 4

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Commentary

"B" Loans and Political Risk Insurance: Different Roads to the Same Destination

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Lenders taking foreign-currency credit exposure to private-sector issuers in emerging market countries have long been concerned that foreign exchange controls might prevent these issuers from servicing their obligations. Two means of mitigating this risk—participations in loans made by select multilateral institutions (so-called "B" loans) and "political risk insurance"(or, more specifically, transfer and convertibility insurance)—have become more prominent since both were tailored to meet the requirements of the capital markets (see "How Preferred Creditor Support Enhances Ratings," RatingsDirect, June 15, 1999, also at www.standardandpoors.com under ResourceCenter-RatingsCriteria-Sovereigns; and "Political Risk Insurance May Enhance Emerging Market Structured Transactions," RatingsDirect, Nov. 2, 1999, also at www.standardandpoors.com under ResourceCenter-RatingsCriteria-StructuredFinance in Securitization in Latin America 2000).

Neither the "B" loan structure nor T&C insurance enhances the underlying creditworthiness of an issuer; consequently, neither elevates the local currency rating of the obligor. However, both can mitigate transfer and convertibility risk, allowing an obligation to receive a foreign currency rating as high as the issuer's local currency rating.

"B" Loans and T&C Insurance

Both means of mitigating sovereign risk are well established. The International Finance Corporation (IFC), the pioneer in developing the "B" loan structure, was making "B" loans in the 1970s, and the Inter-American Development Bank, the European Bank for Reconstruction and Development, and the Asian Development Bank have more recently established their own "B" loan programs. Under these structures, the multilateral institution makes a loan to a private-sector borrower in an emerging market country, thereby becoming the "lender of record," i.e., the sole contractual lender on the books of the borrower, with this status acknowledged by the government of the borrower's country. However, instead of maintaining all of the loan on its own books, the multilateral maintains only a portion—the "A" loan—and participates the remainder—the "B" loan—to commercial banks and/or institutional lenders, either directly or through a securitization.

Multilateral lending institutions have historically enjoyed treatment as so-called "preferred creditors." As such, not only have governments made foreign exchange available to private-sector issuers (with sufficient local currency) for servicing loans from these institutions while withholding it from these same issuers for servicing loans from other lenders; but they have provided that foreign exchange even while defaulting on their own foreign currency obligations. Carefully drafted documentation ensures, through pro rata sharing provisions, that both "A" and "B" loans receive identical treatment, so that there is no way to default on a "B" loan without also defaulting on an "A" loan. Therefore, if a government is to accord preferred creditor treatment to the multilateral lender's "A" loan, it must also do so to each participant's "B" loan, in effect passing on the preferred access to foreign exchange to nonpreferred-creditor lenders (placing them "under the umbrella" of the multilateral lender).

The first rated securitization of a "B" loan was done in 1995 by the IFC for Apasco, the Mexican cement company. The $85 million portion of the IFC's $100 million loan that was securitized received a foreign currency rating of 'BBB+', equal to Apasco's local currency rating and four notches above

'BBB+', equal to Apasco's local currency rating and four notches above Mexico's 'BB' long-term foreign currency rating at the time. It was this transaction that brought the rating enhancement capabilities of the preferred creditor status of multilateral lenders to the attention of the capital markets.

Government-sponsored and some private insurers have been selling political risk insurance, including T&C insurance, for many years—the U.S. government's Overseas Private Investment Corporation (OPIC), for instance, has been underwriting political risk insurance since 1971. However, only in 1999 was the first rated capital markets transaction benefiting from transfer and convertibility insurance (from OPIC) completed, this being the placement of $105 million of obligations of Otosan, the Ford-Koc Group joint venture automobile manufacturer domiciled in Turkey.

Standard & Poor's has rated numerous other "B" loan obligations. Last year, it rated the OPIC T&C-insured obligations of TGN, an Argentine gas pipeline company; a Multilateral Investment Guarantee Agency (MIGA, a member of the World Bank Group) T&C-insured pool of lease payments for medical equipment in Brazil; and an ACE Bermuda Insurance Ltd. T&C-insured sale of hydrocarbon royalty payments by the Argentine province of Salta. In all cases, the foreign currency ratings assigned were equal to the local currency sovereign credit ratings of the issuers, although this need not be the case. However, despite the equivalent ratings enhancement provided by "B" loan structures and T&C insurance to date, there are fundamental and important differences between them.

1. "B" loan enhancement stems from incentives for the government to provide the necessary foreign exchange; T&C insurance enhancement stems from the prospect of continued payment of debt service when a covered event of interference actually occurs.

The first distinction, critically important to those taking a strictly legal perspective, is the difference in the manner in which "B" loans and T&C insurance provide their sovereign risk mitigation. The country risk mitigation of the "B" loan structure depends completely upon the willingness and ability of a borrower's government to accord preferred creditor treatment in a time of severe financial stress and to provide foreign exchange so that loans made and participated by multilaterals may be serviced. If the government is unwilling or unable to do so, holders of "B" loans have no recourse to the multilateral lender or any third party. In such a situation, of course, the multilaterals, in addition to suffering the nonpayment of their "A" loans, also experience damage to their preferred creditor status. As a consequence, these institutions work diligently to ensure that foreign exchange is made available. For instance, the IFC, through its own operations and with the support of the World Bank, brings pressure on the borrower's government to meet its obligations. Nonetheless, had there been "B" loans to Iraqi borrowers outstanding in 1990, it is unlikely that participants would have benefited, since Iraq would in all likelihood have ceased to accord preferred creditor treatment to IFC following the invasion of Kuwait and the sanctions that were subsequently imposed, as it did to the World Bank.

It is also possible that a country otherwise disposed to respect preferred creditor status may find its foreign exchange position sufficiently dire that it makes the political decision not to meet its obligations to multilaterals, including the obligation to provide foreign exchange to private-sector borrowers with sufficient local currency to purchase foreign exchange at a rate reflective of severe financial stress. This appears to have been the case of Pakistan in 1998. While the government explicitly acknowledged IFC's preferred creditor status, it argued that it simply did not have the foreign exchange to provide to borrowers from the IFC. Once negotiations for a new loan from the World Bank were completed in early 1999 the foreign exchange situation eased, and foreign exchange for the payment of all IFC obligations was quickly provided.

In rating the "B" loan obligations created by IFC, Standard & Poor's looked closely at the historical record of treatment of obligations to the IFC, which has been very good. To date, no IFC loan has been included in a general rescheduling of a country's debts, nor has IFC, or any participant in its loans, been requested to put up new money in the context of a general country debt

been requested to put up new money in the context of a general country debt rescheduling. Moreover, while there have been occasional sovereign-induced delays in servicing of IFC loans, these have ordinarily been short.

Standard & Poor's recognizes that there could be failures to accord preferred creditor treatment, and, as a consequence, always explicitly considers three factors in rating these transactions:

- The historical and expected future treatment of preferred creditor institutions by the government of the country of domicile of the borrower;
- Whether the current political regime has good relations with multilateral institutions and is integrated into the global trade and financial systems; and
- Whether debt to preferred creditor institutions—along with debt from structured finance transactions, which also may claim the most senior status—is an uncomfortably large percentage of external debt. In this regard, the multilaterals have generally demonstrated prudence in managing their preferred creditor exposure levels in individual countries and in aggregate.

By contrast, claims payments from a T&C insurance policy are made following an event of sovereign interference with the conversion of local currency to foreign currency or the transfer of that foreign currency abroad. As long as the terms of the policy are satisfied, payment depends entirely upon the willingness and ability of the T&C provider to pay claims in a timely manner and is not contingent upon the behavior of the government of the issuer. Thus, in the examples of both Iraq and Pakistan, assuming that the requirements of the policy and the claims process were satisfied and that the insurer was willing and able to meet its obligations, lenders would have received debt service payments in a timely manner up to the limit of the policy.

2. "B" loan enhancement covers all debt service and related payments; T&C insurance may only cover a portion.
By virtue of its lender-of-record status and the associated loan and participation agreements, all debt service and other transaction-related payments are typically made directly to the multilateral lender, including all payments destined for "B" loan participants. Accordingly, all payments including principal, interest, fees, and penalties enjoy the benefit of the institution's preferred creditor status.

By contrast, what payments and how much of these payments are covered by T&C insurance depends upon the terms of the policy, which can vary substantially from transaction to transaction. For instance, on the Otosan transaction mentioned above, OPIC insured 100% of principal and interest on the rated securities. However, in some subsequent transactions, insurance applicable to only a portion of total debt service has been proposed. Standard & Poor's criteria now permit the rating of a foreign currency obligation to be elevated, sometimes as high as the local currency rating of the obligor, even when the insurance covers less than 100% of interest and principal (see "New Rating Approach Gives Private-Sector Issuers Credit for Partial Coverage of T&C Risk," RatingsDirect, Oct. 19, 2000; also available at www.standardandpoors.com under ResourceCenter-RatingsCriteria-Sovereigns). The degree of elevation will depend upon the country of domicile of the issuer, how much transfer and convertibility insurance is provided relative to the debt service payments, the pattern of debt service payments, the expected timing and duration of any sovereign interference, and the rating of the insurance provider.

3. Multilateral lenders are invariably concerned about the commercial success of the borrower; nonmultilateral insurers have little cause for concern.
While "B" loans may not enhance the underlying creditworthiness of an issuer, multilateral lenders have a different relationship with borrowers than do most insurers, particularly private-sector insurers, which some "B" loan participants value highly. A multilateral lender is invariably concerned with the commercial

value highly. A multilateral lender is invariably concerned with the commercial viability of the borrowers under its "B" loan program. Not only is the multilateral always a lender, and typically the largest single lender; but it also structures the transaction, negotiates the credit agreement with the borrower, and conducts the due diligence. As "B" loans become increasingly important to the multilaterals—and IFC's "B" loans, for instance, were larger than its own loan portfolio at end-June 1997 and 1998, although lower than that during the past two years—it is increasingly important for them to build and maintain strong relationships with participants, which are damaged when there are problems with timely repayment of "B" loans for commercial reasons.

More broadly, a multilateral has a long-term commitment to facilitate private-sector investment in the countries in which it operates. Should new government policies, a weakening regulatory environment, or a breach of government commitments imperil projects in which the multilateral is lending, a multilateral will use its influence with the government to overcome such problems. This can be an important factor in facilitating successful project implementation.

While multilateral providers of T&C insurance have similar broad concerns, other providers of T&C insurance have little at stake in the commercial viability of an issuer, since they lose nothing except premium income when an issuer defaults for commercial reasons. Their real concern is that the borrower's country of domicile not take action resulting in a claim under its T&C policy. Indeed, in a time of severe financial distress, when the probability of sovereign interference with payment of foreign currency obligations increases, the position of the insurer will actually be improved by the bankruptcy and liquidation of the borrower. This is because the insurer is not obligated to pay under its T&C policy if the borrower does not have local currency sufficient to purchase the foreign currency required to make its debt service payments.

4. If the issuer has the required local currency, the relevant willingness and ability to supply foreign exchange under a "B" loan is that of the borrower's government; with T&C insurance, it is that of the insurer. The issues of willingness and ability to pay are qualitatively different for multilaterals and T&C insurance providers. In the case of "B" loans, multilaterals act only as intermediaries and not as providers of formal insurance to the "B" loan participants. The issues of willingness and ability to make foreign exchange available in a timely fashion to borrowers with sufficient local currency relate entirely to the sovereign, whose decisions are made in light of the preferred creditor status of the multilateral.

By contrast, the willingness and ability of providers of T&C insurance to pay in a timely manner are key. Ability to pay is extremely strong in the case of OPIC—its obligations are backed by the full faith and credit of the U.S. government—and very strong for other bilateral official insurers from most highly rated countries or highly rated multilaterals. However, Standard & Poor's looks closely at not only the stand-alone financial strength of an official insurer, but also at the degree and manner of expected support from its government owners. The ability of a private insurer to pay claims is determined by its financial strength rating, and no transaction enhanced by T&C insurance from a private insurer will be rated without a rating of the insurer.

The ability to pay must be accompanied by the willingness to pay, and in a timely manner. The best evidence of willingness to pay is a long history of satisfactory claims paying behavior, such as that of OPIC. Moreover, OPIC has tailored its claims processing procedures explicitly to address the issue of timeliness, and Standard & Poor's is comfortable that a valid claim will be processed and paid in a manner consistent with the rating of the insured transaction. The claims-paying behavior of other long-active insurers—mostly official—would be subject to a similar review, as would the tailoring of their claims processing procedures. The absence of a long claims-paying history would require in-depth discussions with the senior management of the insurer and, if appropriate, its parent.

Two aspects of willingness that must be considered are those of policy

Two aspects of willingness that must be considered are those of policy exclusions and the insurer's approach to handling claims. T&C insurance is not a guarantee of timely payment, and claims are payable only if the requirements of the policy and other documentation have been satisfied. For instance, in the case of the OPIC insurance policy, grounds for denying payment of a claim could be the lack of a satisfactory effort by the insured to use all reasonable efforts to convert local currency and transfer it, or a finding that an unreasonable act by the insured was the primary cause of the sovereign interference. Similarly, the "company support agreement" between OPIC and the borrower includes covenants relating to corrupt practices, environmental matters, and worker rights, violation of which are grounds for the denial of a claim or the cancellation of the policy. In general, covenants of this nature seem more likely to appear in policies of official rather than private insurers, since they reflect the policy concerns of the government sponsor.

The second aspect of willingness to pay concerns the way certain issues relating to claims payments are handled and has been highlighted by recent experience with some providers of financial guarantees. The policies of so-called "monoline insurers"—companies whose only business is providing financial guarantees—are standardized to meet the requirements of the rating agencies with respect to timeliness of payment and the approach to disputed claims. In short, they are expected to pay on time and to challenge the claim later. However, recently more "multiline" insurers have begun issuing financial guarantees. In some of these institutions, the culture is one of paying a claim only after a challenge to that claim has been adjudicated—for instance, in the case of suspicion of fraud, monoline insurers are expected to make the scheduled payment and then pursue remedies, whereas some multiline policies allow the insurer the right to review a claim prior to paying and refuse payment if it feels that the claim is invalid. As a consequence, Standard & Poor's has determined that in some cases the willingness of a multiline insurance company to pay on a timely basis may be considerably weaker than its ability to pay. In light of this, Standard & Poor's has developed "financial enhancement ratings," which explicitly address both ability and willingness to pay (see "Criteria for Insurer Financial Enhancement Ratings Introduced," RatingsDirect, July 20, 2000). In all cases, a very close reading of all related documents and a clear understanding of exactly what is being insured are essential to the rating.

Summary

While "B" loan structures and T&C insurance can both elevate the foreign currency credit ratings of obligations of private-sector borrowers from emerging market countries as high as the borrowers' local currency credit ratings, they do so in very different ways. "B" loan structures ultimately rely upon the willingness and ability of the borrower's government to afford preferred creditor treatment to the multilateral providing the "B" loans; T&C insurance relies upon the willingness and ability of the insurer to pay in accord with the terms of its policy in a timely manner once sovereign interference has actually occurred. Insurance may cover only a portion of debt service payments, while "B" loans, by their nature, cover all payments. Insurance also generally introduces more documentary complexity, which must be assessed to determine whether difficulties could arise that would affect the ability to successfully claim under the insurance policy.

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