New Development Bank

Policy on

Sovereign Loans

&

Loans with Sovereign Guarantee

Owner: Operations Divisions

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Change Log

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Abbreviations

BOD	Board of Directors
CIC	Credit and Investment Committee
DFFS	Development Finance Facility—Sovereign
FAM	Facility Administration Manual
FFA	Facility Framework Agreement
MFF	Multi-tranche Financing Facility
NDB	New Development Bank
PDB	Project Document for the BOD
PFF	Project Finance Facility
PL	Project Loan
SDL	Sustainable Development Loan
TA	Technical Assistance
VP&COO	Vice-President and Chief Operations Officer

Policy on Sovereign Loans & Loans with Sovereign Guarantee

A. Introduction

1. This policy covers NDB's sovereign loans and loans with sovereign guarantee to member countries as allowed under Articles 18 and 19 of the Agreement of the New Development Bank.[1]

B. Eligible Clients

2. NDB lends directly to a member government or against its sovereign guarantee to the project executing agency such as its appointed agency, banks, instrumentality, or political subdivision. Further, as provided under Article 19 (e) of the Agreement and the Policy on Sovereign Guaranteed Projects in Non-Member Countries[2], the BOD may approve a specific project in a non- member emerging economy or developing country involving the operations described in Articles 19 (a) to 19 (c).

3. Direct lending to the executing agency of a project against sovereign guarantee is provided if: (i) the executing agency has a juridical personality and the legal power to borrow and repay; (ii) the legal and other regulations in the member country permit borrowing and repayment abroad; and (iii) the agency has the financial, management, and administrative capability. If providing loans directly to the executing agency is deemed inappropriate, NDB provides the loan through the member country government. In case the executing agency is a government department, the loan is provided to the member country government.

C. Expenditures Financed

4. NDB finances all reasonable costs of a project including interest during construction on its loans. The loans can be financed in convertible foreign currencies or in national currencies of the member countries.

[1] Sovereign guarantee is a guarantee by the national government of a member country. Lending without a sovereign guarantee to sub-national governments, government agencies, majority public sector enterprises, and private sector enterprises is covered by the *Policy on Transactions without Sovereign Guarantee (except Loans to National Financial Intermediaries)*. Loans without a sovereign guarantee to designated national financial intermediaries are covered by the *Policy on Loans without Sovereign Guarantee to National Financial Intermediaries*.
[2] Approved by Board of Governors on January 4, 2019.

D. Lending Currency and other Terms

a. Currency of loans and interest rates

5. NDB provides United States Dollar and Euro denominated loans and endeavors to provide loans denominated in the currencies of its member countries.

6. Interest rates of NDB loans consist of NDB's cost of funds plus the lending spread applicable at the time of the loan approval.

7. For a fixed rate loan, the interest rate (sum of cost of funds and lending spread) is fixed for the whole loan tenor.

8. For a floating rate loan with a fixed spread, the interest rate is determined in terms of a fixed spread, positive or negative, over a floating benchmark rate (e.g. LIBOR, EURIBOR or similar), taking into account the cost of funds and the lending spread at the time of loan approval. This fixed spread will remain unchanged for the whole loan tenor.

9. For a floating rate loan with a variable spread, the interest rate is determined in terms of a spread, positive or negative, over a floating benchmark rate, (e.g. LIBOR, EURIBOR or similar) taking into account the actual cost of funds and the lending spread at the time of loan approval. This spread would vary throughout the life of the loan depending on the actual funding cost of the Bank.

10. The lending spreads are determined by BOD on a regular basis. The detailed components of lending spread for floating rate loans with fixed spread as well as floating rate loans with variable spreads, the current lending rates and other aspects of computation of lending rates are covered under the sovereign loan pricing framework approved by the BOD.

b. Loan conversion (currency and interest rate) options[3]

11. Subject to the availability of viable swap market opportunities, NDB may accede to borrower's request to (i) convert all or any portion of disbursed or undisbursed portion of the loan to a currency of choice; (ii) convert the interest rate from floating to fixed or vice versa during the life of the loan; or (iii) establish an interest rate cap or collar on a floating rate.[4] The conversion options will be subject to the relevant provisions of the applicable loan regulations and the conversion guidelines which may

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[3]This facility will not be available till NDB makes adequate arrangements to hedge currency/interest rate conversion risk.

[4]The term "cap" (or "interest rate cap") means a ceiling that sets an upper limit for the floating interest rate. The term "collar" (or "interest rate collar") means a combination of a ceiling and a floor that sets an upper and lower limit for the floating interest rate.

be changed unilaterally any time.

c. Front-end fee and commitment charges

12. NDB levies a front-end fee to recover the processing and administration cost of loans. The front-end fee will be the same for both foreign-currency denominated and national currency denominated loans.

13. NDB levies a commitment charge to defray the cost of keeping adequate liquidity to meet the disbursements of its borrowers. The commitment charge payable by the borrower shall be at the annual rate of 0.25% ("Commitment Charge") and shall accrue from and including the date on which is sixty (60) days after the date of the signing of the Loan Agreement to and including the date on which all amounts are withdrawn from the Loan Account or cancelled. The Commitment Charge shall be calculated on the following basis:

   i. during the first 12 months' period from the date of signing of the Loan Agreement – on the difference between 15% of the Loan Amount and the Disbursed Loan Amount as on the last day of this 12 months' period (provided that if such difference is equal to zero or less, the Commitment Charge for this 12 months' period shall be nil);

   ii. during the second successive 12 months' period from the date of signing of the Loan Agreement – on the difference between 45% of the Loan Amount and the Disbursed Loan Amount as on the last day of this 12 months' period (provided that if such difference is equal to zero or less, the Commitment Charge for this 12 months' period shall be nil);

   iii. during the third successive 12 months' period from the date of signing of the Loan Agreement – on the difference between 85% of the Loan Amount and the Disbursed Loan Amount as on the last day of this 12 months' period (provided that if such difference is equal to zero or less, the Commitment Charge for this 12 months' period shall be nil); and

   iv. thereafter - on 100% of the Undisbursed Loan Balance.

   The Commitment Charge shall be payable in arrears yearly not later than 45 (forty-five) days after the end of each successive 12 months' period.

14. The borrower shall have a one-time option at the time of loan negotiations to request for commitment charge based on a loan drawdown schedule, which could be different from the one mentioned in paragraph 13. If the borrower decides to exercise this option, then the borrower shall provide a loan drawdown schedule (hereafter referred to as the borrower's loan drawdown schedule) to be included in the Loan Agreement

that specifies:

i. the number of years over which the loan will be drawn down, with the first full year starting from the date of signing of the Loan Agreement and the last year being the year when the loan is completely drawn down;

ii. the loan amount to be drawn down each year; and

iii. the resultant cumulative drawn down loan amount as at the end of each year.

To the extent that the cumulative actual drawdown loan amount at the end of each year is in shortfall of the year-end cumulative draw down loan figure specified in the borrower's loan drawdown schedule, the annual commitment charge of 0.25% will apply on such shortfall, computed at each year-end for each of the years specified in the borrower's loan drawdown schedule.

The commitment charge shall be payable in arrears yearly not later than 45 (forty-five) days after the end of each successive 12 months' period.

15. The level of front-end fee and of commitment charge is determined by the BOD.

d. Equal treatment of Member countries

16. The interest rates as well as the level of fees and charges, in respect of each specific currency and each average repayment maturity, shall be equally applicable to all Member countries.

e. Loan term and repayment schedule

17. The economic life of a project, the financial condition and debt servicing capacity of the borrower, revenue flows of the project, and member country's debt servicing situation are the main factors kept in mind for determining the tenor of the loan subject to the maximum average repayment maturity not exceeding 19 years. The grace period of the loan is determined based on the reasonable time needed to implement the project but may be flexibly applied to reflect country considerations and the time needed to buildup initial operations.

18. NDB offers flexible repayment options ranging from straight-line repayment schedule, annuity method, tailor-made option to align repayment with project's cash-flow pattern, equated debt service instalments, and bullet repayments. In the case of financial intermediation loans, repayments may be linked to actual disbursements.

f. Prepayment and cancellation of Loan

19. NDB allows borrowers to prepay, in part or in full, the outstanding loan balance at any time during the life of a loan by providing a 60 day notice.[5] Partial prepayment is

[5] Prepayment means repayment in advance of the repayment schedule specified in the loan agreement.

applied to the amortization schedule starting with the latest maturity due being repaid, first, and progressively to the subsequent maturity dues in an inverse order. There will be no prepayment charge for a loan with floating-interest rate, if prepayment of any outstanding amount is made on the interest payment date of the loan. If prepayment is done on any other date, NDB will charge actual loss incurred due to the difference between the rate at which the prepaid amount could be reinvested and NDB's funding costs till the next interest date.

20. In the case of prepayment of loans with fixed-interest rates and those that had gone through a currency conversion, NDB will charge costs associated with the prepayment involved.

21. NDB charges no cancellation fee for cancellation of any amount of undisbursed loan during the life of the loan if a 60-day notice is given provided, however, that before such cancellation the borrower shall pay to NDB any commitment fee which has been accrued till the date of receipt of cancellation request by NDB.

E. Terms for Relending

22. If NDB's sovereign guaranteed loan proceeds are passed by the borrower on to any other entity, NDB may impose the following terms on such re-lending:

   i. If the beneficiary is a government agency or instrumentality entrusted with the responsibility to implement socio-economic policies of the member government, the relending terms may be the same, or on terms concessional than terms of the loan;

   ii. If the beneficiary is a public sector commercial undertaking, the relending terms need to generally be costlier than those of the loan;

   iii. If the beneficiary is a private entity, relending terms need to be similar to relevant market terms, and in line with the interest rates prevailing in the member country;

   iv. If the beneficiary is a financial intermediary, relending terms need to take into account the institution's cost of capital; and

   v. Except in the case of sub-clause (i) of this paragraph, the borrower may charge a reasonable fee from the beneficiaries if it is bearing the foreign exchange risk.

F. Counterpart Funds

23. NDB does not exercise control over the use of counterpart funds generated and retained by the borrower due to the differential in lending and relending terms. In the

case of a development financial institution, NDB may require that the counterpart funds remain available for financing development activities relevant to the institution's mandate.

G. Retroactive Financing

24. Retroactive financing happens if NDB finances the project expenses incurred and paid for by the borrower prior to the date of loan signing. Retroactive financing is possible only (i) with prior agreement between the borrower and NDB; and (ii) when goods, works, and consulting services involved in retroactive financing have been procured in accordance with procurement policy and guidelines of NDB, and the expenditure is incurred during the eligible period. The eligible period is normally 12 months prior to the signing of the loan agreement; but in exceptional cases, such as in the case of land acquisition, a reasonable longer period may be allowed. When the procurement is from NDB member countries, retro-active financing may be approved by the VP&COO. The retroactive financing limits will be normally 20% of the loan amount; on exceptional basis, a larger amount may be allowed by the BOD.

H. Supplementary Financing

25. Supplementary financing will be provided only in response to a request from the member government or its agency. It could arise due to changes in the original cost estimates, financing plan, and scope of work/design. NDB may also provide supplementary financing (i) for project restructuring due to unexpected circumstances, and (ii) to meet any needs that may arise during project implementation. Resources may be provided by reallocating unutilized/surplus funds available in previous loans provided to a borrower and/or in the form of a new supplementary financial assistance. There may be more than one request for supplementary financing but the cumulative requests for such financing cannot exceed the size of the original loan. Sustainable development loans and loans to financial intermediaries are not eligible for supplementary financing. The terms and conditions for a supplementary loan will be those applicable for sovereign lending at the time of its approval. Repayment period of the supplementary loan will be aligned with that of the original loan to make their maturity coterminous. There will be no additional grace period for supplementary financing arising out of cost-overrun or changes in the financial plan. In other cases, a reasonable grace period not exceeding 3 years may be provided.

26. NDB gives priority for supplementary financing to projects impacted by natural

calamities, and projects in advanced stage of completion facing cost-overrun. In the case of co-financing, supplementary financing will be provided only when the NDB is satisfied that such financing is (i) advantageous to client, and (ii) coordination between co-financiers and implementation progress of the project are both satisfactory. An additional retroactive financing of 20% of the supplementary loan amount will be available if so required by the borrower under an ongoing NDB financed contract.

27. NDB will use the following procedures to conduct appropriate due diligence on the requests for supplementary financing:

i. Reconfirm continued economic and financial viability of the project if the supplementary financing need arose due to cost-overrun caused by exchange rate changes, inflation, and underestimation of input prices;

ii. Reconfirm financial viability of the project if the need arose due to changes in financing plan caused by delays in arranging resources by co-financiers;

iii. If the need arose due to major changes in the scope of project and/or design, or mid-course restructuring of the project, NDB will use the appraisal procedure used for a new project.

28. The CIC, after due deliberation, takes decision regarding the circulation of the proposal for supplementary financing to the BOD for consideration.

I. Lending Modalities

29. To support NDB's purpose and function of assisting infrastructure and sustainable development projects as stated in Article 1 of the Agreement on NDB, five main modalities will be adopted: (i) project loan (PL), (ii) project finance facility (PFF), (iii) multi tranche finance facility (MFF), (iv) development finance facility—sovereign (DFFS), and (v) sustainable development loan (SDL).

a. Project loan

30. Project loan (PL) is broadly understood to be a loan for a project.

b. Project finance facility

Project finance facility (PFF) takes a holistic approach to the development of a cluster of vertically or horizontally inter-linked projects hereafter referred to as sub-projects. The BOD approves the PFF to finance a number of sub-projects based on project document to the Board (PDB) that includes an investment plan, the criteria for sub-project selection, and the implementation framework for the facility. The PDB also provides a complete appraisal of an indicative sub-project. The financing of subsequent sub-projects under a PFF is approved by CIC; however, projects classified as category A for environment and social impacts will require BOD approval.

31. The client is responsible for identifying, appraising and implementing the sub-projects in accordance with the selection criteria, the investment plan, and the implementation framework agreed with NDB. NDB reviews the client's selection and appraisal of sub-projects including their compliance with NDB's environment and social framework and procurement policy. The facility provides flexibility to the client to replace sub-projects with NDB concurrence, and reallocate funds among the components of sub-projects under implementation.

c. Multi-tranche financing facility

32. The multi-tranche financing facility (MFF) provides substantial flexibility to both client and NDB to finance a large infrastructure project that needs to be implemented in phases over a long period. Under this modality, the BOD approves the maximum investment for each facility; its first tranche; and the facility framework agreement (FFA) which describes (i) the basic understanding between the borrower and the key features of the investment program or the project, and (ii) the terms and conditions for financing.[6] The FFA will not impose a legal obligation on NDB to support the project/program. Likewise, the borrower will not be legally obliged to seek or accept any NDB support under the facility. The legal rights and obligations of the parties arise only when NDB and the client sign legal agreements under individual tranches of the MFF. In response to client's request, NDB Management translates the approved investment ceiling of a MFF into tranches, as may be necessary, to finance individual activities planned under the facility and approves the tranches.[7]

33. To be eligible for NDB financing under a MFF, a project needs to have the strategic context to facilitate long-term partnership with the member government in a sector, sub-sector or a thematic area. The facility, particularly when focusing on a sector, needs to clearly articulate the sector policy framework focusing on legal, regulatory, institutional, financial, and investment promotion issues. The client also needs to have a clear road map for the proposed investments under the facility, resource needs and financing plans, and proposed institutional reforms and capacity development efforts, if any, intended under the facility. The financing plan should cover the entire facility and specify the activities to be financed under individual tranches. Finally, the MFF

[6]An indicative content of FFA is as follows—(i) the facility constituents (sector road map, strategic context, policy environment, investment program or investment plan, and financing plan); (ii) DMF for the entire facility; (iii) implementation framework; (vi) criteria to select individual tranches; (v) environment and social framework, as appropriate; and (vi) facility level undertakings, representations and warranties.

[7]Tranches classified as category A for environment and social impacts will require BOD approval.

will have facility level undertakings/commitments by the client to adhere to the road map of investments, institutional development and reforms. The individual activities programmed under a MFF are tied together by the FFA and the facility administration manual (FAM) which will be agreed during the negotiations for the approval of the facility and its first tranche. The FAM details the implementation arrangements for the entire facility. The FFA also stipulates the maximum implementation period for a MFF which shall not exceed 10 years. Individual tranches in the facility are approved in response to client's tranche release requests (TRRs).

34. A framework to address environment and social impacts needs to be prepared for the entire facility under the FFA. However, actual assessment of environment and social impacts and their categorization is done for individual tranches. The activities financed by individual tranches are subject to NDB's environment and social framework.

35. Supplementary financing of individual components of a MFF is possible in accordance with the policy on supplementary finance within the overall facility financing limit approved by the BOD. The CIC approves the requests for supplementary financing following the policy for approval of MFF tranches.

d. Sustainable development loan

36. Sustainable development loan (SDL) supports the government to promote sustainable development investment schemes. SDL proceeds will be used by the government to meet the costs of schemes such as payout of incentives (for renewable energy, waste-to-energy, energy efficiency improvement, emission reduction, metering of urban water supply, etc.), viability gap funding (such as to encourage private public partnerships/private participation in infrastructure) and capital expenditure programs with well-defined sustainable development objectives. A request for SDL will be supported by details of the proposed scheme(s) such as promotional measures envisaged, estimated payments for promotional measures, projected sustainable development outcomes/outputs in a given time frame, and the guidelines for implementation of the scheme including the criteria for selection of prospective recipients/beneficiaries and activities covered under the scheme. NDB and the member government agree on the steps and arrangements to ensure (i) resources are used with due consideration of economy and efficiency to achieve the intended development results, and (ii) any potential environment and social impact of the scheme is adequately addressed. The projects under SDL may follow country systems for procurement and for addressing environment and social impacts. SDL disbursement will take place on a six monthly basis. It will be based on the projected payout under the scheme in the following six months set out in a semi-annual report, which also will report on the progress made in actual utilization of SDL funds in the

previous six months. In making the disbursement, NDB requires that payments follow the principles and procedures stipulated under the scheme or the capital expenditure program.

e. Development finance facility—sovereign

37. Development finance facility—sovereign (DFFS) is a lending modality through which NDB provides sovereign guaranteed loans to financial intermediaries in its member countries for on-lending for infrastructure and sustainable development projects. Financial intermediaries on-lend NDB loans as sub-loans to finance projects of sub-borrowers termed as subprojects. For providing support under the facility, NDB assesses the financial intermediary and the environment in which it operates. The assessment criteria include: (i) relevant macroeconomic environment, and regulatory framework and the soundness of financial system in the borrowing country; (ii) financial soundness of the intermediary reflected in capital adequacy, asset quality, liquidity, and profitability; (iii) management policies and standards of corporate and financial governance, including, among other things, compliance with prudential regulations for exposure limits, and transparent financial disclosure policies and practices; (iv) internal procedures for credit assessment, risk management and project appraisal and approval; (v) capabilities to assess the social and environmental impact of subprojects and monitor the compliance in managing the impacts in accordance with national standards; (vi) soundness of business strategy, plans, and track record in the sectors targeted by NDB; (vii) autonomy in pricing decisions; and (viii) anti-money laundering mechanisms.

38. DFFS is provided to achieve clearly defined strategic priorities of the member government and NDB. The size of DFFS is determined keeping in mind the member's needs, NDB's exposure limits, and financial assessment of the borrowing financial institution. The facility could be made available for a drawdown period of up to 5 years. Repayment period will depend on the nature and objectives of projects financed, and financial institution's cash flows and ability to manage long-term interest rate and foreign exchange risks. The maximum and minimum size of sub-loan under a DFFS is established during appraisal of the facility.

39. NDB and the financial institution agrees, during the appraisal of the DFFS, on the criteria for selection of subprojects and also on a "free limit" below which the financial institution approves sub-loans meeting the selection criteria without taking prior approval from NDB and submits only the necessary information. The free limit is determined taking into account appraisal capacity and processes in the financial institution, prior experience in administering similar loans, sub-loan size, and environment and social risks. Sub-loans above the free limit need prior NDB approval

to receive NDB funding.

40. In case of large or complex sub-loans, NDB and the financial institution may agree on an "appraisal floor" above which NDB will appraise the sub-project either independently or jointly before NDB's approval of the sub-project.

41. NDB and the financial institution establish a system to (i) make sure NDB resources are used in accordance with the criteria indicated in the loan agreement; and (ii) monitor the quality of portfolio of projects financed by DFFS. NDB may suspend disbursements under the facility if the financial intermediary is in breach of performance standards with respect to financial covenants, quality of sub-project portfolio, and corporate governance for a prolonged period of time. During DFFS's implementation NDB also (i) monitors the financial soundness, solvency, profitability, and regulatory compliance of the borrowing financial intermediary; and (ii) requires submission of audited financial statements that are prepared in accordance with acceptable standards and audited annually by independent auditors acceptable to NDB.

f. Guidelines

42. NDB Management issues, from time to time, detailed staff guidelines to help staff prepare NDB assistance under different modalities.

J. Review of the Policy

43. NDB will review and modify the policy based on the experience gained in further implementing the policy.