



Technical Assistance Report

Project Number: 54087-001
Knowledge and Support Technical Assistance (KSTA)
December 2020

Strengthening Resilience and Stability of Banking and Nonbank Financial Systems in Asia

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 December 2020)

Currency unit	–	Bangladeshi taka (BDT)
BDT1.00	=	\$0.012
\$1.00	=	BDT84.80

Currency unit	–	Kazakhstani tenge (KZT)
KZT1.00	=	\$0.002
\$1.00	=	KZT425.35

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
DMC	–	developing member country
NBFI	–	nonbank financial institution
NPL	–	nonperforming loan
ROK	–	Republic of Korea
SDCC	–	Sustainable Development and Climate Change Department
TA	–	technical assistance

NOTE

In this report, “\$” refers to United States dollars.

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CONTENTS

	Page
KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE AT A GLANCE	
I. INTRODUCTION	1
II. ISSUES	1
III. THE TECHNICAL ASSISTANCE	3
A. Impact and Outcome	3
B. Outputs, Methods, and Activities	3
C. Cost and Financing	4
D. Implementation Arrangements	5
IV. THE PRESIDENT'S DECISION	5
APPENDIXES	
1. Design and Monitoring Framework	6
2. Cost Estimates and Financing Plan	8
3. List of Linked Documents	9

KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 54087-001	
Project Name	Strengthening Resilience and Stability of Banking and Nonbank Financial Systems in Asia	Department/Division	SDCC/SDSC-FIN
Nature of Activity	Research and Development	Executing Agency	Asian Development Bank
Modality	Regular		
Country	REG (BAN, KAZ)		
2. Sector		Subsector(s)	
		ADB Financing (\$ million)	
		Total	0.00
3. Operational Priorities		Climate Change Information	
✓ Addressing remaining poverty and reducing inequalities		GHG Reductions (tons per annum)	0
✓ Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ Strengthening governance and institutional capacity			
✓ Fostering regional cooperation and integration			
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.4		Effective gender mainstreaming (EGM)	✓
SDG 5.a			
SDG 8.10			
SDG 10.3			
		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization Low			
5. Safeguard Categorization Safeguard Policy Statement does not apply			
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.00	
None		0.00	
Cofinancing		0.75	
Republic of Korea e-Asia and Knowledge Partnership Fund (Full ADB Administration)		0.75	
Counterpart		0.00	
None		0.00	
Total		0.75	
Currency of Financing: US Dollar			

I. INTRODUCTION

1. The knowledge and support technical assistance (TA) will strengthen the resilience and stability of banking systems and nonbank financial institutions (NBFIs) in selected developing member countries (DMCs) of the Asian Development Bank (ADB) by examining the causes of weak enabling policy environments and of financial market stakeholders' limited knowledge and expertise.¹ Focusing on Bangladesh and Kazakhstan, the TA team will analyze factors such as: (i) banking policies and practices; (ii) legal and regulatory frameworks for risk-based banking, and supervision and enforcement of legal and regulatory frameworks; (iii) asset quality deterioration, and insolvency and resolution frameworks; (iv) deposit insurance schemes, credit information systems, collateral valuation systems, and asset management systems; and (v) nonbank financial policies and institutions.

2. The TA project is aligned with operational priorities 1, 2, 6, and 7 of ADB's Strategy 2030 as it will support banks and nonbank financial institutions in providing financial services to micro, small, and medium-sized enterprises (MSMEs) and unbanked and underserved individuals, including women. The project will also help build market frameworks and financial infrastructure to create level playing fields, broaden market access, deepen and diversify markets, and enhance financial safety nets in line with international regulatory standards.² The TA is included in the 2020 Management approved results-based work plan of the Sustainable Development and Climate Change Department (SDCC).³

II. ISSUES

3. Finance sector development—e.g., mobilizing and pooling savings, facilitating payments, boosting trade financing, and streamlining financial resource allocation—is closely linked to economic growth and poverty alleviation. Stable and broad-based financial systems ensure that financial resources are mobilized to support economic activities.⁴ Failure of the financial system to perform its functions will impose negative consequences on the economy, which could lead to a sharp contraction in economic activity, a large increase in unemployment, a rise in poverty, and a general loss of trust in the system.⁵

4. **Adverse economic and social impacts.** During the last two decades going through the 1997/98 Asian financial crisis and the 2007/2008 Global financial crisis, there have been sudden large shocks and a fall in economic activity in the region. There also have been the 2013 Taper Tantrum,⁶ the lingering impacts of the US monetary policy normalization, and financial spillovers from the PRC. Since 2010, nonperforming loans (NPLs) in many economies in the region have also been increasing. Such developments have raised concerns over banking stability in the region.⁷ In 2020, economic shocks from the coronavirus disease (COVID-19) pandemic have

¹ The TA project's coverage of nonbank financial institutions will be limited to nonbank lending institutions.

² ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila. Operational Priority 1: Addressing remaining poverty and reducing inequalities; Operational Priority 2: Accelerating progress in gender equality; Operational Priority 6: Strengthening governance and institutional capacity; Operational Priority 7: Fostering cooperation and integration. Operational priorities and plans: <https://www.adb.org/about/strategy-2030-operational-priorities>.

³ The TA first appeared in the business opportunities section of ADB's website on 22 October 2020.

⁴ ADB. 2020. *Asia's Journey to Prosperity: Policy, Market, and Technology over 50 Years*. Manila.

⁵ World Bank. [Financial Stability](#).

⁶ Taper tantrum refers to the 2013 collective reactionary panic that triggered a spike in US treasury yields, after investors learned that the Federal Reserve was slowly putting the breaks on its quantitative easing program.

⁷ J. Lee and P. Rosenkranz. 2019. Nonperforming Loans in Asia: Determinants and Macrofinancial Linkages. *ADB Economics Working Paper Series*. No. 574. Manila: Asian Development Bank.

resulted in high levels of borrowing from households and firms facing liquidity challenges. A lengthened and more severe economic slowdown may lead to debt distress and default, exposing banks and nonbank financial institutions to credit risk and putting pressure on their profitability. With an expected rise in Asia-Pacific banking's nonperforming assets by \$1.4 trillion and credit costs by \$440 billion, adequate policy response from governments is required to meet the needs of the real economy.⁸

5. **Weak enabling policy environment and limited knowledge and expertise.** The ability of DMCs to manage the risks is limited by the weak capacity of financial authorities and financial institutions, which is caused by weak enabling policy environments and limited knowledge and expertise of financial market stakeholders. Frameworks and mechanisms to support macroprudential supervision and regulation require strengthening. Legal, regulatory and supervisory frameworks must ensure that financial authorities are properly empowered to enforce asset quality and capital adequacy standards and effective bank resolution strategies.⁹ In addition, institutions such as credit bureaus, asset management companies, and deposit insurance companies should be established or strengthened to facilitate sound risk-management practices. The application of international standards and best practices in many DMCs has been lagging. In the case of Basel III, delays in implementation are related to difficulties in adopting these standards into local DMC contexts.¹⁰ The poor quality of regulatory reporting impedes the ability of financial authorities to identify and measure nonperforming assets in a timely manner. Weak corporate governance and risk management, insufficient resources, and poor product development practices are additional factors that prevent financial institutions from making sound business decisions.

6. All of the above factors contribute to high NPL levels in Bangladesh and Kazakhstan.¹¹ As of December 2019, the NPL ratio of the Bangladesh banking sector reached 9.3%, driven primarily by state-owned commercial banks, which had an NPL ratio of 23.9% (compared with an NPL ratio of 5.8% for private commercial banks and 5.7% for foreign commercial banks).¹² The market share of state-owned commercial banks and state-owned development financial institutions has been in decline, as they continue to face major issues such as high NPLs, low profitability because of higher provision requirements, weak operational inefficiency, weak governance, widening capital shortfalls, operational inefficiencies, scant automation, inadequate credit monitoring and internal risk management, and an ineffective legal framework.¹³ To address banking sector issues, the authorities have begun to take measures such as enforcing stronger regulations, introducing bankruptcy laws, and establishing money loan courts and credit information bureaus.¹⁴ NBFIs, while significantly fewer in number than banks, also face asset-

⁸ S&P Global. 2020. [S&P Global Ratings](#).

⁹ World Bank defined bank resolution as the set of procedures and measures taken by the authorities to solve the situation of an unviable bank.

¹⁰ Financial Stability Board. 2019. [Basel III Implementation](#).

¹¹ NPLs in Bangladesh are classified as substandard, doubtful, or bad or a loss, which are calculated based on uniform criteria. A loan is substandard if it is overdue for 3 months or more but less than 9 months, doubtful if overdue for 9 months or more but less than 12 months, and bad or a loss if it is overdue for 12 months or more. In Kazakhstan, an NPLs are defined as the sum of loans classified as doubtful of 5th category and loss loans (excluding homogenous loans classified as doubtful of 5th category and loss loans) and provisions for homogenous loans.

¹² CEIC. [Bangladesh Non-Performing Loan: by Ratio](#). (accessed 29 July 2020)

¹³ ADB. 2019. *Asian Development Outlook 2019: Strengthening Disaster Resilience*. Manila.

¹⁴ The Money Loan Court Act 1990 introduced a court of exclusive jurisdiction for the recovery of nonperforming loans (NPLs) to expedite adjudication of creditors' claims. Significant improvements in the execution of the Money Loan Courts were made as part of the Money Loan Court Act 2003. The money loan court process, which is accepted by the banks, has been instrumental in improving the speed and efficiency of collateral acquisition and disposal, and in gaining judgments against uncooperative debtors

quality issues. The NPL ratio for NBFIs in Bangladesh reached 9.5% in 2019, and the amount of loan loss provisions maintained by NBFIs was BDT9.4 billion short of the required amount in 2019.¹⁵

7. In Kazakhstan, the banking sector has experienced significant credit losses resulting in bank mergers and closures. The government had to allocate more than KZT3 trillion (\$10 billion, or 6% of gross domestic product) to support troubled banks in 2017.¹⁶ As of end-2019, the NPL ratio for the banking sector was 8.13%.¹⁷ An issue faced by the banking sector is the widespread practice of related-party lending, which has compromised strategic planning and credit risk management, resulting in unmanageable levels of NPLs. Exacerbating this problem, banks lack the proper internal controls to manage related-party lending. At the same time, financial authorities must be able to identify these related parties using supervisory judgement, given that it is difficult to find hard evidence to prove an affiliation between two parties.¹⁸ Although the authorities aim to streamline the bankruptcy law and encourage the central bank to adopt a risk-based approach to bank regulation, inadequate transparency, accountability, and integrity remain fundamental problems among banks. Resolving them will require a comprehensive overhaul of the regulatory framework—not least to limit the influence of insiders and connected interests—and a rethinking of loan subsidies (footnote 14).

8. **Lessons.** The TA will draw on lessons from previous ADB projects and studies, one of which is that project design should follow a sequenced approach to reforms, building on the partnerships and outputs of previous projects.¹⁹ Because underreporting of NPLs undermines the credibility of official statistics and confidence in banking regulations, central banks need to strengthen macroprudential policies to ensure that commercial banks comply with rules and standards. In addition, central banks need to level the playing field for micro, small and medium-sized enterprises (MSMEs) to access credit (footnote 20).

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

9. The TA is aligned with the following impact: resilience and stability of financial markets improved (footnote 2). The TA will have the following outcome: capacity in selected DMCs for developing finance reform improved.²⁰

B. Outputs, Methods, and Activities

10. **Output 1: Policy reform recommendations on banking systems and nonbank financial institutions developed.** This output will support an analysis of banking and nonbanking work in Bangladesh and Kazakhstan²¹ to develop tools including (i) country diagnostic study of the landscape and enabling environment of the two countries, both of which exhibit high NPL

¹⁵ In the Financial Stability Report of the Bangladesh Bank, NPL ratio refers to ratio of nonperforming loans and leases to total loans and leases.

¹⁶ M. Ghilardi, et. al. 2018. Republic of Kazakhstan: Selected Issues. Washington, D.C.

¹⁷ CEIC database (accessed February 2020).

¹⁸ National Bank of Kazakhstan. 2018. *Financial Stability Report of Kazakhstan, 2015–2017*. Almaty.

¹⁹ ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Technical Assistance Grant to Mongolia for the Banking Sector Rehabilitation and Financial Stability Strengthening Program*. Manila

²⁰ The design and monitoring framework is in Appendix 1.

²¹ Country selection was done in consultation with ADB operations departments. Government clearances will be sought subsequent to TA approval.

ratios; (ii) a comparative analysis of the banking sector in the region, including policy best practices; and (iii) policy recommendations with a focus on (a) introducing legal, regulatory, and supervisory frameworks to enhance institutional capacity for risk-based supervision and credit intermediation; (b) strengthening corporate governance, strengthening financial auditing and accounting, ensuring asset quality, developing effective bank resolution, and modernizing insolvency regimes; (c) developing diverse savings and loans products such as housing- and SME-financing products; (d) strengthening bank capacity to manage liquidity risks, shocks, and other crises; and (e) facilitating financial inclusion for the unbanked and underserved, including women and MSMEs.

11. **Output 2: Knowledge of reforms for financial institutions improved.** Building upon the support provided to Bangladesh and Kazakhstan under output 1, stakeholder capacity development will be carried out through a technical advisory program that will include policy dialogue, roundtables, and capacity building activities for policymakers, financial authorities, and financial market stakeholders in Bangladesh and Kazakhstan. This output will tap into the expertise of international financial institutions and standard-setting bodies in strengthening financial stability.²²

12. This TA will leverage ADB's partnership with the Government of the Republic of Korea (ROK) to draw on lessons from the ROK's experience in dealing with excessive NPLs following the 1997 financial crisis. The measures taken by the Government of the ROK to deal with excessive NPLs, such as setting up an asset management company, online asset disposal, and issuance of asset-backed securities, will be assessed and their applicability to Bangladesh and Kazakhstan explored. SDCC will produce knowledge products for wider dissemination of innovative ideas and lessons through ADB knowledge events. Where possible, the TA will complement and/or supplement existing and proposed initiatives.

C. Cost and Financing

13. The TA is estimated to cost \$750,000 which will be financed on a grant basis by the Republic of Korea e-Asia and Knowledge Partnership Fund and administered by ADB. The key expenditure items are listed in Appendix 2.

14. **Eligible and Non-Eligible Expenditures.** The Republic of Korea e-Asia and Knowledge Partnership Fund will finance operational expenses related to eligible proposals agreed upon by the Government and ADB. It will not be used for (i) civil works, (ii) procurement of large-scale equipment, (iii) permanent staffing costs, or (iv) the hiring of staff consultants. The activities under the TA will not cover any of these ineligible expenditures.

D. Implementation Arrangements

15. ADB will administer the TA. The Finance Sector Group under the Sector Advisory Service Cluster of SDCC will implement the TA and carry out TA administration and supervision, implementation oversight, and communication with consultants and stakeholders in coordination with relevant sector and thematic groups and operations departments. Activities organized under the TA will include the organization and participation of ADB DMCs in virtual and face-to-face knowledge events, such as workshops and conferences. ADB staff involved with the TA may participate as resource persons in knowledge-sharing events, which will include eliciting feedback

²² For example, the Korea Asset Management Corporation played an important role in facilitating restructuring and development of financial markets during the Asian financial crisis of 1997.

and suggestions on improving the activities being implemented under the TA. Budget will also be allocated for (i) representation expenses during knowledge events, and (ii) ADB staff to provide support services (travel and related costs for secretarial and administrative services) for TA implementation and administration.

16. The implementation arrangements are summarized in the table.

Implementation Arrangements			
Aspects	Arrangements		
Indicative implementation period	January 2021–December 2023		
Executing agency	ADB through SDSC-FIN		
Implementing agency	ADB through SDSC-FIN		
Consultants	To be selected and engaged by ADB		
	Individual: individual selection	International expertise (22 person-months)	\$343,200
	Individual: individual selection	National expertise (60 person-months)	\$128,300
Disbursement	Disbursement of TA resources will follow ADB's <i>Technical Assistance Disbursement Handbook</i> (2020, as amended from time to time).		

ADB = Asian Development Bank; SDSC-FIN = Finance Sector Group, Sector Advisory Service Cluster; TA = technical assistance.

Source: Asian Development Bank.

17. **Consulting services.** ADB will engage the consultants following the ADB Procurement Policy (2017, as amended from time to time) and its associated staff instructions.²³ Individual consultants will be recruited through individual selection to provide 22 person-months of international and 60 person-months of national consulting services. Individual consultants are expected to bring in-depth knowledge of the subject and extensive hands-on experience in dealing with businesses and governments in multiple geographies. Resource persons will also be engaged to contribute to the delivery of regional knowledge events under the TA.

18. **Cofinancier requirements.** The team will submit progress reports on a regular basis to the Republic of Korea e-Asia and Knowledge Partnership Fund fund manager, and additional updates (as necessary) on project implementation. For major change in scope, duration, or funding arrangement, the TA team will circulate draft memos to the relevant fund manager for initial assessment prior to the conduct of interdepartmental review by ADB's Procurement, Portfolio, and Financial Management Department; Controllers Department; and Office of the General Counsel.

IV. THE PRESIDENT'S DECISION

19. The President, acting under the authority delegated by the Board, has approved the Asian Development Bank administering technical assistance not exceeding the equivalent of \$750,000 to be financed on a grant basis by the Republic of Korea e-Asia and Knowledge Partnership Fund for Strengthening Resilience and Stability of Banking and Nonbank Financial Systems in Asia, and hereby reports this action to the Board.

²³ Terms of Reference for Consultants (accessible from the list of linked documents in Appendix 3).

DESIGN AND MONITORING FRAMEWORK

Impact the TA is Aligned with			
Resilience and stability of financial markets improved (ADB Strategy 2030). ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Capacity in selected DMCs for developing finance reform improved	a. By 2023, at least one ADB program or project designed to include recommended finance policy reform (2019 baseline: 0)	a. ADB project concept paper/report and recommendation of the President	Change in DMC governments' priorities may delay the application of policy reforms. Extreme unfavorable changes in global and regional financial market conditions, including high capital volatility, may strain the learning capacity of selected DMCs.
Outputs 1. Policy reform recommendations on banking systems and NBFIs developed 2. Knowledge of reforms for financial institutions improved	1a. By 2023, at least two country diagnostic reports on issues related to banking and NBFIs published (2019 baseline: 0) 1b. By 2023, a compendium of international best practices completed and policy recommendations made (2019 baseline: not applicable) 2a. By 2023, at least two technical advisory program activities organized, such as policy dialogues, roundtables, trainings, and seminars (2019 baseline: 0) 2b. By 2023, at least 50 participants (30% of whom are women) joined the technical advisory activities and reported increased knowledge of strengthening financial stability (2019 baseline: 0)	1a. Published country diagnostic reports 1b. Published compendium of best practices and recommendations 2a. TA quarterly monitoring reports 2b. Post-training/seminar assessment reports	Uncertainty related to COVID-19 outbreak restricts DMCs' ability to support TA activities.

Key Activities with Milestones

1. Policy reform recommendations on banking systems and nonbank financial institutions developed.

- 1.1 Review ADB projects on banking and nonbank systems approved since 2015, as well as finance sector assessments carried out by ADB and other development partners for Bangladesh and Kazakhstan. (Q1 2021–Q2 2021)
- 1.2 Develop the outline and scope of the country diagnostics on (i) implementing legal, regulatory, and supervisory framework and enhancing institutional capacity for risk-based supervision and effective credit intermediation; (ii) strengthening corporate governance, ensuring asset quality, developing effective banking resolution, and modernizing insolvency regimes; (iii) developing diverse savings and loans products such as housing- and SME-finance products; (iv) strengthening bank capacity to manage liquidity risks and shocks; and (v) facilitating financial inclusion for the unbanked and underserved, including women and MSMEs (Q2 2021–Q4 2021)
- 1.3 Produce the country diagnostic reports in close coordination with operations departments and knowledge departments to ensure their operational relevance (Q1 2022–Q4 2022)
- 1.4 Prepare the compendium of international best practices and tailor-made suggestions (Q2 2022–Q2 2023)
- 1.5 Publish the country diagnostic reports and compendium of international best practices and tailor-made suggestions (Q1 2023–Q4 2023)

2. Knowledge of reforms for financial institutions improved.

- 2.1 Design technical advisory program for target DMCs based on the results of the technical studies (Q1 2022–Q2 2022)
- 2.2 Organize at least two technical advisory program activities such as policy dialogues, roundtables, and workshops linked to the themes of the technical studies to develop resilient and stable banking systems and NBFIs (Q2 2022–Q2 2023)
- 2.3 Assess the technical advisory program and provide recommendation based on participants' feedback to ensure the program's usability and relevance to DMC participants (Q2 2023–Q4 2023)

TA Management Activities

Seek no-objection from participating DMCs; engage topic experts and consultants to (i) prepare the studies and design the project concept reports; and (ii) organize knowledge events, and compose knowledge products on selected topics (Q4 2020–Q3 2023)

Inputs

Republic of Korea e-Asia and Knowledge Partnership Fund: \$750,000

Assumptions for Partner Financing

Not applicable

ADB = Asian Development Bank, COVID-19 = coronavirus disease, DMC = developing member country, MSMEs = micro, small and medium-size enterprises, NBFIs = nonbank financial institution, Q = quarter, SMEs = small and medium-sized enterprises, TA = technical assistance.

^a ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila. Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN (\$'000)

Item	Amount
Republic of Korea e-Asia and Knowledge Partnership Fund ^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	343.2
ii. National consultants	128.3
b. Out-of-pocket expenditures	
i. International and local travel	36.0
2. Printed external publications ^b	10.0
3. Goods (rental or purchase) ^c	5.0
4. Training, seminars, workshops, forum, and conferences	
a. Resource speakers and travel cost of ADB staff acting as a resource person and/or providing secretarial and administrative support ^d	60.0
b. Venue rental and related facilities	60.0
c. Participants	60.0
d. Representation ^d	10.0
5. Contingencies	37.5
Total	750.0

Note: The technical assistance (TA) is estimated to cost \$750,000, of which contributions from the Republic of Korea e-Asia and Knowledge Partnership Fund is presented in the table.

^a Administered by the Asian Development Bank.

^b About 100 copies of each publication will be printed to be disseminated to relevant country stakeholders.

^c Refer to Administrative Order No. 4.02 for the definition of goods.

^d ADB. 2017. [Staff Instruction on Business Processes for Cost Sharing and Eligibility of Expenditures for ADB Financing](#). Manila.

Source: Asian Development Bank estimates.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=54087-001-TARreport>

1. Terms of Reference for Consultants