

CONFORMED COPY

CREDIT NUMBER 3434-ER

Project Agreement

(Emergency Reconstruction Project)

between

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

BANK OF ERITREA

Dated December 6, 2000

CREDIT NUMBER 3434-ER

PROJECT AGREEMENT

AGREEMENT, dated December 6, 2000, between INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and BANK OF ERITREA (BE).

WHEREAS (A) by the Development Credit Agreement of even date herewith between The State of Eritrea (the Borrower) and the Association, the Association has agreed to lend to the Borrower for Part C of the Project an amount in various currencies equivalent to twenty-three million one hundred thousand Special Drawing Rights (SDR 23,100,000) for Part C of the Project, on the terms and conditions set forth in the Development Credit Agreement, but only on conditions that BE agree to undertake such obligations toward the Association as are set forth in this Agreement;

(B) by a subsidiary agreement to be entered into between the Borrower and BE, part of the proceeds of the Credit provided for under the Development Credit Agreement will be made available to BE on the terms and conditions set forth in said Subsidiary Agreement; and

WHEREAS BE, in consideration of the Association's entering into the Development Credit Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

## ARTICLE I

### Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Development Credit Agreement, the Preamble to this Agreement and in the General Conditions (as so defined) have the respective meanings therein set forth.

## ARTICLE II

### Execution of Part C of the Project; Management and Operations of BE

Section 2.01. (a) BE declares its commitment to the objectives of Part C of the Project as set forth in Schedule 2 to the Development Credit Agreement and to this end, shall carry out Part C of the Project and conduct its operations and affairs, in accordance with sound financial standards and practices, with qualified and experienced management team, and consistently with the provisions of the PIP.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Association and BE shall otherwise agree, BE shall carry out Part C of the Project in accordance with the Implementation Program set forth in Schedule 1 to this Agreement.

(c) BE shall: (i) maintain, until the completion of Part C of the Project, the PSR Unit, in a form and with functions and staffing satisfactory to the Association; and (ii) be responsible for the carrying out of Part C of the Project including the supervision of the PFIs in the carrying out of their obligations under the Participation Agreements.

(d) BE shall:

(i) make available to the PFIs the proceeds of the Credit allocated to Categories (4) and (5) in the table set forth in paragraph 1 of Schedule 1 to the Development Credit Agreement under Participation Agreements to be entered into between BE and each PFI, under terms and conditions which shall have been approved by the Association, including the terms and conditions set forth in the Schedule 1 to this Agreement; and

(ii) without limitation or restriction upon any of its other obligations under this Agreement, take all action, including the provision of funds, facilities, services or other resources, necessary or appropriate to enable the PFIs to perform in accordance with the provisions of their respective Participation Agreements all the obligations of the PFIs therein set forth, and not to take any action which would prevent or interfere with such performance.

Section 2.02. (a) BE undertakes that, unless the Association shall otherwise agree, Sub-loans will be made in accordance with the procedures and on the terms and conditions set forth or referred to in PIP and Schedule 1 to this Agreement.

(b) BE shall exercise its rights in relation to each Subproject in such manner as to: (i) protect the interests of the Association, of the Borrower, and of BE; (ii) comply with its obligations under this Agreement, the Subsidiary Agreement and the Participation Agreement; and (iii) achieve the purposes of Part C of the Project.

Section 2.03. Except as the Association shall otherwise agree, procurement of the goods and services required for Part C of the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to the Development Credit Agreement.

Section 2.04. (a) BE shall carry out the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use

of goods and services, plans and schedules, records and reports, maintenance and land acquisition) in respect of Part C of the Project Agreement.

(b) For the purposes of Section 9.07 of the General Conditions and without limitation thereto, BE shall:

- (i) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Association and BE, a plan for the future operation of Part C the Project; and
- (ii) afford the Association reasonable opportunity to exchange views with BE on said plan.

Section 2.05. BE shall duly perform all its obligations under the Subsidiary Agreement. Except as the Association shall otherwise agree, BE shall not take or concur in any action which would have the effect of assigning, amending, abrogating or waiving the Subsidiary Agreement, or any provision thereof.

Section 2.06. (a) BE shall, at the request of the Association, exchange views with the Association with regard to the progress of Part C of the Project, the performance of its obligations under this Agreement, under the Subsidiary Agreement, and other matters relating to the purposes of the Credit and to that end, together with the Borrower, review with the Association, periodically as necessary progress in carrying out Part C of the Project, with a view to determining and effecting such changes as may be required to ensure the successful carrying out of Part C of the Project.

(b) BE shall promptly inform the Association of any condition which interferes or threatens to interfere with the progress of Part C of the Project, the accomplishment of the purposes of the Credit, or the performance by BE of its obligations under this Agreement, or under the Subsidiary Agreement.

### ARTICLE III

#### Financial Covenants

Section 3.01. (a) BE shall, maintain records, accounts and financial statements adequate to reflect in accordance with consistently maintained sound accounting practices its operations and financial condition and to register separately the operations, resources and expenditures related to Part C of the Project and each Subproject.

(b) BE shall:

- (i) have its records, accounts and financial statements (balance sheets, statements of income and expenses and related statements) with respect to Part C of the Project for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;
- (ii) furnish to the Association, as soon as available but in any case not later than six months after the end of each such year: (A) certified copies of its financial statements for such year as so audited; and (B) the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and
- (iii) furnish to the Association a management letter and such other information concerning said records, accounts and financial statements as well as the audit thereof as the Association shall from time to time reasonably request.

Section 3.02. Without limitation upon the provisions of Section 3.01 of this

Agreement, BE shall carry out a time-bound action plan acceptable to the Association for the strengthening of its financial management system for Part C of the Project in order to enable BE, not later than three months after the Effective Date, or such later date as the Association shall agree, to prepare quarterly Project Management Reports, acceptable to the Association, each of which:

(a) (i) sets forth actual sources and applications of funds for Part C of the Project, both cumulatively and for the period covered by said report, and (ii) shows separately expenditures financed out of the proceeds of the Credit during the period covered by said report and expenditures proposed to be financed out of the proceeds of the Credit; and

(b) (i) describes progress in Project implementation, both cumulatively and for the period covered by said report, and (ii) explains variances between the actual and previously forecast implementation targets.

#### ARTICLE IV

##### Effective Date; Termination Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Development Credit Agreement becomes effective.

Section 4.02. (a) This Agreement and all obligations of the Association and of BE thereunder shall terminate on the earlier of the following two dates:

(i) the date on which the Development Credit Agreement shall terminate; or

(ii) the date 10 years after the date of this Agreement.

(b) If the Development Credit Agreement terminates before the date specified in paragraph (a) (ii) of this Section, the Association shall promptly notify BE of this event.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

#### ARTICLE V

##### Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex or radiogram to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other addresses as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For the Association:

International Development Association  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:

INTBAFRAD  
Washington, D.C.

Telex:

248423 (MCI) or  
64145 (MCI)

For BANK OF ERITREA:

21 Victory Street  
Asmara  
Eritrea

Section 5.02. Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Agreement on behalf of BE or by BE on behalf of the Borrower under the Development Credit Agreement, may be taken or executed by its Governor, or by such other person or persons as the Governor shall designate in writing, and BE shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Callisto Madavo

Regional Vice President  
Africa

BANK OF ERITREA

By /s/ Semere Russom

Authorized Representative

SCHEDULE 1

Implementation Program

1. BE shall carry out, or cause to be carried out, Part C of the Project in accordance with the procedures set out in the Project Implementation Plan, and, except as the Association shall otherwise agree, BE shall not amend, abrogate or waive any provision thereof which, in the opinion of the Association, may materially and adversely affect the carrying out of Part C of the Project.

2. The day-to-day management and implementation of Part C of the Project shall be carried out through the PSR Unit at the BE. The Governor of BE shall establish implementation requirements as follows:

(a) setting up institutional responsibilities and related procedures for the implementation and operation of each part of Part C of the Project;

(b) approving detailed implementation and operational strategies for each part of Part C of the Project;

(c) defining monitorable implementation targets and performance indicators for each part of Part C of the Project, as well as for Part C of the Project as a

whole;

(d) monitoring implementation and operational progress of Part C of the Project with reference to agreed targets and Performance Indicators, including guidance to implementing agencies on Project-related problems and issues; and

(e) interacting with the Association on all Project-related matters including reporting on and periodic reviews of Part C of the Project progress, refinements and amendments in Part C of the Project design, as necessary.

3. The PSR Unit shall be responsible for:

(a) managing the flow of the Project funds for Part C of the Project for all its sub-components, for the purpose of making disbursements out of the Special Account to PFIs, enterprises and agencies for eligible Project expenses, collecting repayments from PFIs, and agencies, according to agreed amortization schedules, and making repayments to the Borrower, as agreed;

(b) maintaining Project accounts with a control account and sub-accounts for each activity under Part C of the Project;

(c) obtaining, before the initial disbursement to each PFI, a clearance from BE management that the PFI has signed the required Participating Agreement and that such an agreement is effective;

(d) in disbursing to PFIs, ensuring that the Subprojects financed out of the Project funds meet the general eligibility criteria as well as the environmental requirements of Part C of the Project; and

(e) preparing, in conjunction with the respective PFIs, and all other implementing agencies, the progress reports on a timely basis to be submitted to the Borrower's Project Management Unit and the Association.

4. BE shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the Performance Indicators set forth in Schedule 6 to the Development Credit Agreement, the carrying out of Part C of the Project and the achievement of the objectives thereof; and

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association through the PMU, 6 months after the Effective Date, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of Part C of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of Part C of the Project and the achievement of the objectives thereof during the period following such date; and review with the Association, not later than one month thereafter, or such later date as the Association shall request, the report referred to above, and, thereafter, take all measures required to ensure the efficient completion of Part C of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association views on the matter.

Terms and Conditions of Sub-loans and Subprojects

A. Eligibility Criteria for PFIs under Part C of the Project

5. (a) PFIs shall be evaluated in accordance with the information and criteria set out in paragraphs 6, 7 and 8 below.

(b) The BE shall have the right to revoke the certification to participate in Part C of the Project of any PFI found not to be in full compliance with the eligibility criteria of PFIs or the provisions of the Banking Laws of the Borrower and any enactment and prudential regulations relating thereto.

6. Each PFI under Part C of the Project shall:

(a) be licensed under the Borrower's 1997 Financial Institutions Proclamation Number 94 of 1997;

(b) be subjected to full bank supervisory examinations (on-site as well as off-site) by the BE; and

(c) produce in a timely manner (within six months or less after the end of the financial year) externally audited annual financial statements and a Management Letter in conformity with BE regulations and in accordance to standards acceptable to the Association.

7. In addition to the criteria referred to in sub-paragraphs (a) through (c) of paragraph 6 and after being declared an eligible PFI, the PFI shall provide the PSR Unit with monthly statistical reports on the Ssub-loans financed out of the Investments (including loan collection performance) and semi-annual progress reports on the lending portfolio under Part C of the Project and progress with the technical assistance under Part C of the Project.

8. The eligibility criteria for PFIs set out in paragraphs 6 and 7 (a) and (b) shall be subject to such changes as the BE in consultation with the Association may determine.

B. Participation Agreement

9. Each Participation Agreement shall, inter alia, contain provisions pursuant to which each PFI that has been declared an eligible participating financial institution shall:

(a) continue to operate under the laws of the Borrower;

(b) appraise the financial, technical, environmental and economic feasibility of Subprojects;

(c) make Sub-loans to Final Beneficiaries under Part C. 2 of the Project on the basis of the criteria, procedures and terms and conditions set forth in the PIP and this Schedule;

(d) maintain the organization, management staff and other resources required for the efficient carrying out of its activities and for the management of Sub-loans granted to Final Beneficiaries;

(e) provide BE and the Association with a medium-term business plan which outlines its goals for the next three years relating to operations, staff recruitment and development, profitability, quality of portfolio and financial condition, and such information as they may reasonably request; and

(f) continue to comply with all eligibility criteria set forth in the Project Implementation Plan.

C. Terms and Conditions Applicable to all Subloans

10. No expenditures for goods or services required for a Subproject shall be eligible for financing out of the proceeds of the Credit unless:

(a) the Sub-loan for such Subproject shall have been verified by the PSR Unit to meet eligibility criteria for the Investment Fund set forth in the PIP; and

(b) Each request by a PFI for funding in respect of a Sub-loan shall contain: (i) a summary description of the Final Beneficiary, including a description of the expenditures proposed to be financed out of the proceeds of the Credit, and (ii) the terms and conditions of the Sub-loan, including the schedule of amortization

therefor; and (iii) such other information as the Association shall reasonably request.

11. Sub-loans shall be made on terms whereby each PFI shall obtain, by written contract with the Final Beneficiary or by other appropriate legal means, rights adequate to protect the interests of the Borrower, of the Association and the BE including, the right to:

(a) require the Final Beneficiary to carry out and operate the Subproject with due diligence and efficiency and in accordance with sound technical, financial and managerial standards and to maintain adequate records;

(b) require that the goods and services to be financed out of the proceeds of the Credit shall be purchased in accordance with private sector commercial practices;

(c) inspect, by itself or jointly with representatives of the Association, if the Association shall so request, such goods, works, plants and construction included in the Subproject, the operation thereof, and any relevant records and documents;

(d) require that: (i) the Final Beneficiary shall take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice; and (ii) without any limitation upon the foregoing, such insurance shall cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Credit to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable by the Investment Enterprise to replace or repair such goods;

(e) obtain all such information as the Association or PFI shall reasonably request relating to the foregoing and to the administration, operations and financial condition of the Investment Enterprise or Exporter and to the benefits to be derived from the Subproject; and

(f) suspend or terminate the right of the Final Beneficiary to the use of the proceeds of the Credit upon failure by such Final Beneficiary to perform its obligations under its contract with PFI .

12. Any Subloan not processed in conformity with the criteria of eligible sectors and other eligible criteria set forth in the PIP shall be reimbursed to the Credit.

D. Terms and Conditions Relating to the Investments under Part C.2 of the Project

13. The terms and conditions relating to the Investments shall be governed by the guidelines for policies and operating procedures in the PIP and shall inter alia include the following:

14. (a) A portion of proceeds of Credit shall be provided to the PFIs from BE at the marginal cost of funding within the banking system (currently the savings rate-6 percent);.

(b) PFIs shall be free to charge an interest rate, fixed or variable, on Ssub-loans commensurate with the costs and risks involved;. and

(c) the interest rate mechanisms described above shall be reviewed by BE periodically and adjusted as appropriate in consultation with the Association.

15. Commitments, disbursements and repayments shall be in Nakfa. Withdrawal applications from the Special Account shall be made in the dollar equivalent of the Nakfa amount.

16. (a) Loan terms and grace periods shall be determined by PFIs in conformity with the projected cash flow of the Subprojects. The grace period (on principal only) to the PFIs from the BE shall be a standard two year on all loans made.



(b) Maximum Subloan amounts to a single Final Beneficiary or related group of Final Beneficiaries shall be based upon BE exposure limits, but may not exceed 15 million Nakfa, unless otherwise agreed to by the Association.

(c) The minimum cContributions by the Final Beneficiary shall be determined by the PFI.

(d) The viability of the Subprojects shall be determined by the PFI making the Subloan, and shall be subject to review by the PSR Unit.

(e) A Final Beneficiary with current non-performing loans in any financial institution shall not be granted Subloans under Part C of the Project.

E. Terms and Conditions Relating to the Support to Affected Enterprises under Part C. 1 of the Project

17. The terms and conditions relating to the Support to Affected Enterprises shall be governed by the Guidelines for Policies and Operating Procedures in the PIP and shall inter alia include the following:

(a) Debt relief shall be provided in categories as defined in the PIP for borrowers affected by the border conflict.

(b) Funds shall be lent to the PFIs as subordinate loans at a rate equivalent to 180 days Treasury Bill rate prevailing at January 01 and July 01 of the previous six months period.

(c) Loans shall be denominated in Nakfa.

(d) Repayments from the PFIs to the BE shall be over a period of 20 years under terms and conditions acceptable to the Association.

