

CONFORMED COPY

CREDIT NUMBER 3571 PAK

Development Credit Agreement

(Banking Sector Restructuring and Privatization Project)

between

ISLAMIC REPUBLIC OF PAKISTAN

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated October 24, 2001

CREDIT NUMBER 3571 PAK

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated October 24, 2001, between ISLAMIC REPUBLIC OF PAKISTAN, acting by its President (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project;

WHEREAS (B) the Association has received, from the Borrower, a Staff Rationalization Plan describing the terms and conditions and criteria for voluntary separation of the employees of the nationalized commercial banks and the National Development Finance Corporation (the Staff Rationalization Plan), and declaring the Borrower's commitment to the execution of the Staff Rationalization Plan; and

WHEREAS (C) the Association has agreed, on the basis, inter alia, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985 (as amended through October 6, 1999), with the modifications set forth below (the General Conditions), constitute an integral part of this Agreement:

(a) A new paragraph (12) is added to Section 2.01 to read as set forth below, and the existing paragraphs (12) through (14) of said Section are accordingly renumbered as paragraphs (13) through (15):

"12. 'Participating Country' means any country that the Association determines meets the requirements set forth in Section 11 of Resolution No. 194 of the Board of Governors of the Association, adopted on April 8, 1999; and 'Participating Countries' means, collectively, all such countries."; and

(b) The second sentence of Section 5.01 is modified to read:

"Except as the Borrower and the Association shall otherwise agree, no withdrawals shall be made: (a) on account of expenditures in the territories of any country which is not a Participating Country or for goods produced in, or services supplied from, such territories; or (b) for the purpose of any payment to persons or entities, or for any import of goods, if such payment or import, to the knowledge of the Association, is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations."

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "BSAL" means the Banking Sector Adjustment Loan (Number 4357-PAK) provided by the Bank to the Borrower under the Loan Agreement dated December 12, 1997, between the Borrower and the Bank;

(b) "Fiscal Year" means the Borrower's fiscal year starting July 1 and ending June 30 of each year;

(c) "MOF" means the Borrower's Ministry of Finance;

(d) "NDFC" means the National Development Finance Corporation, established and operating pursuant to the Borrower's NDFC Act of 1974, as the same may be amended from time to time;

(e) "NCBs" means collectively the Nationalized Commercial Banks comprising Habib Bank, Limited, United Bank, Limited, and National Bank of Pakistan;

(f) "PC" means the Borrower's Privatization Commission established through the Borrower's Presidential Ordinance No. L-II of 2000, as the same may be amended from time to time, or any successor thereto;

(g) "Project Management Report" means each report prepared in accordance with Section 4.02 of this Agreement;

(h) "Staff Rationalization Plan" means collectively the plans adopted by the NCBs and NDFC describing the terms and conditions and criteria for voluntary separation of the employees of the NCBs and NDFC, including severance payments thereunder; and

(i) "SBP" means the State Bank of Pakistan, being the Borrower's central bank established and existing under the Borrower's State Bank Act of 1956, as the same may be amended from time to time, or any successor thereto.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to two hundred thirty-nine million five hundred thousand Special Drawing Rights (SDR 239,500,000).

Section 2.02. The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made in respect of the reasonable payments required for the Project and to be financed out of the proceeds of the Credit.

Section 2.03. The Closing Date shall be December 31, 2004 or such later date as

the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on January 15 and July 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each January 15 and July 15 commencing January 15, 2012 and ending July 15, 2036. Each installment to and including the installment payable on July 15, 2021 shall be one and one-fourth percent (1-1/4%) of such principal amount, and each installment thereafter shall be two and one-half percent (2-1/2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by: (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project through SBP, NCBs and NDFC with due diligence and efficiency and in conformity with appropriate administrative, financial, and banking practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) above, and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 3 to this Agreement.

Section 3.02. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) 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 Borrower and the Association, a plan designed to ensure the continued achievement of the Project's objectives; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

Section 3.03. The Borrower shall take all necessary measures to ensure that the NCBs will not hire any new staff over their normal attrition, so as to guarantee a zero staff growth, net of those separated under the Project in accordance with the Staff Rationalization Plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall maintain a financial management system, including records and accounts, and prepare financial statements in a format acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

(i) have the records, accounts and financial statements referred to in paragraph (a) of this Section, for each fiscal year audited, in accordance with auditing standards acceptable to the Association, 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 the financial statements referred to in paragraph (a) of this Section for such year as so audited, and (B) an opinion on such statements, records and accounts and 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 such other information concerning such records and accounts, and the audit thereof, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

(i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;

(ii) retain, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such

expenditures;

- (iii) enable the Association's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

Section 4.02. The Borrower shall cause SBP to prepare, in accordance with guidelines acceptable to the Association, and furnish to the Association not later than 45 days after the end of each calendar quarter, a Project management report for such period, which: (i) sets forth actual sources and applications of funds for 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.

Section 4.03. The Borrower shall cause the NCBs to:

- (i) have the records, accounts, and financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent, internationally recognized auditors;
- (ii) furnish to the Association as soon as available, but in any case not later than six (6) months after the end of each such year:
(A) certified copies of its financial statements for such year 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, such other information concerning such records, accounts and financial statements and the audit thereof as the Association shall from time to time reasonably request.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (1) of the General Conditions, the following additional event is specified, namely that the Staff Rationalization Plan shall have been amended, abrogated, or waived so as to materially and adversely affect the implementation of the Project.

ARTICLE VI

Termination

Section 6.01. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Secretary to the Government of Pakistan, Economic Affairs Division, or any Additional Secretary, Joint Secretary, Deputy Secretary or Section Officer in that Division of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

The Secretary to the Government of Pakistan
Economic Affairs Division

Islamabad
Pakistan

Cable address:

ECONOMIC
Islamabad

Telex:

ECDIV-05-634

For the Association:

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

Cable address:

477-6391

INDEVAS
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

Facsimile:

(202)

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.

ISLAMIC REPUBLIC OF PAKISTAN

By /s/ Tanwir Ali Agha

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ John Wall

Country Director, Pakistan

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Category of items to be financed out of the proceeds of the Credit, the allocation of the amount of the Credit to the Category set forth below and the percentage of expenditures to be financed there under:

Category	Amount of the Credit Allocated (Expressed in SDR Equivalent)	% of Expenditures to be Financed
(1) Severance payments	79,800,000	100%
(2) Severance payments	79,800,000	100%
(3) Severance payments	40,000,000	100%
(4) Severance payments	39,900,000	100%
TOTAL	239,500,000	

2. For the purposes of this Schedule, the term "Severance payments" means payments made by the NCBs and NDFC to their employees separated pursuant to the Staff

Rationalization Plan.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR79,800,000, may be made on account of payments made for expenditures before that date but after January 1, 2001.

4. Notwithstanding the provisions of paragraph 1 above:

(i) no withdrawal shall be made on account of Severance payments under Category 2, unless the Borrower has furnished to the Association, evidence (A) that the payments have been made in accordance with the terms and conditions and criteria stipulated in the Staff Rationalization Plan, and (B) that the Borrower has made satisfactory progress in the closure of 1/3 of the branches, as agreed between the Borrower and the Association;

(ii) no withdrawal shall be made on account of Severance payments under Category 3, unless the Borrower has furnished to the Association, evidence (A) that the payments have been made in accordance with the terms and conditions and criteria stipulated in the Staff Rationalization Plan, and (B) that the Borrower has made satisfactory progress in the closure of 2/3 of the branches, as agreed between the Borrower and the Association; and

(iii) no withdrawal shall be made on account of Severance payments under evidence Category 4, unless the Borrower has furnished to the Association, (A) that the payments have been made in accordance with the terms and conditions and criteria stipulated in the Staff Rationalization Plan, and (B) that the Borrower has made satisfactory progress in the closure of all of the branches, as agreed between the Borrower and the Association.

5. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures, under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objectives of the Project are to: (a) restructure the NCBs to improve their prospects for privatization to qualified strategic investors, and complete privatization of partially privatized banks; (b) improve market structure by reducing the market share of the state-owned segment of the Borrower's banking system, including the amalgamation of NDFC into the NBP, and encouraging the expansion of sound and efficient private banks; and (c) sustain and deepen the banking reforms initiated by the Borrower in 1997 under the BSAL.

The Project consists of the following components, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: NCB Staff Rationalization

Implementation of the Staff Rationalization Plan including the payments of severance for approximately 50% staff of NCBs seeking voluntary separation, as a result of restructuring of the NCBs.

Part B: Branch Rationalization

Carrying out of NCBs branch rationalization through the reduction of bank branches, including provision for real-estate costs resulting from the branch closure.

Part C: NDFC Amalgamation

Amalgamation of NDFC into NBP including the payments of severance for approximately 800 staff laid off as a result of said amalgamation.

* * *

The Project is expected to be completed by June 30, 2004.

SCHEDULE 3

Implementation Program

1. In the overall carrying out of the Project, the Borrower shall assign the responsibilities for Project implementation as follows:

- (i) the SBP and the MOF to be responsible for the coordination of the restructuring measures under the Project;
- (ii) the NCBs to be responsible for the design and implementation of their respective restructuring plans;
- (iii) the PC to be responsible for: (A) coordinating all necessary actions for bringing the NCBs to the point of sale and for identifying bona fide strategic investors in parallel with the restructuring exercise; and (B) coordinating the selection process with the SBP, the bank regulator and supervisor, to ensure that the process would result in the selection of qualified buyers who have the required integrity, capital, banking expertise, technology, and management; and
- (iv) the SBP to be responsible for amalgamating NDFC into NBP in an orderly manner.

2. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about June 30, 2002, 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 the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) review with the Association, by September 30, 2002, or such later date as the Association shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

