

CONFORMED

CREDIT NUMBER 3659 MOG

Development Credit Agreement

(Financial Capacity Development Project)

between

MONGOLIA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated September 05, 2002

CREDIT NUMBER 3659 MOG

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated September 05, 2002, between MONGOLIA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS 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; and

WHEREAS 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) (the General Conditions), constitute an integral part of this Agreement.

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) "Bank of Mongolia" and the acronym "BOM" mean the Borrower's central bank, and any successor thereto.

(b) "BOM Special Account" means the account referred to in Section 2.02 (b)(ii) of this Agreement.

(c) "Category" means a category of items set forth in the table in paragraph 1 of Schedule 1 to this Agreement.

(d) "Financial Monitoring Report" and the acronym "FMR" mean each report prepared in accordance with the provisions of Section 4.02 of this Agreement.

(e) “MOFE” means the Borrower’s Ministry of Finance and Economy, and any successor thereto.

(f) “MOFE Special Account” means the account referred to in Section 2.02 (b)(i) of this Agreement.

(g) “Participating Banks” means the commercial banks selected under criteria satisfactory to the Association to participate in Part A of the Project in accordance with the provisions of paragraph 4 of Schedule 4 to this Agreement; and “Participating Bank” means any of the Participating Banks.

(h) “Project Implementation Unit” and “PIU” mean the Project Implementation Unit to be established by each of the Participating Banks and by BOM in respect of their Respective Parts of the Project, in accordance with the provisions of paragraph 2 of Schedule 4 to this Agreement.

(i) “Project Coordination Office” means the office established and maintained by the Borrower in accordance with the provisions of paragraph 1(b) of Schedule 4 to this Agreement.

(j) “Project Steering Committee” means the entity established and maintained by the Borrower in accordance with the provisions of paragraph 1(a) of Schedule 4 to this Agreement.

(k) “Respective Part of the Project” means: (i) in respect of BOM, Part B of the Project; and (ii) in respect of each Participating Bank, Project activities under Part A of the Project.

(l) “Savings Bank” means the specialized state-owned deposit institution established and operating pursuant to the Government of Mongolia’s Decree of May 1996.

(m) “Special Accounts” means, collectively, the BOM Special Account and the MOFE Special Account; and “Special Account” means either of said Special Accounts.

(n) “Subsidiary Loan Agreement” means an agreement entered into between the Borrower and a Participating Bank in accordance with the provisions of paragraph 4(b) of Schedule 4 to this Agreement.

(o) “Switch/Clearing House System” means the operational system, including equipment for data processing and communications, and operational rules and procedures, to be established under Part B of the Project to facilitate the electronic transfer of funds and settlement of payments among the participants 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 four million Special Drawing Rights (SDR 4,000,000).

Section 2.02. (a) 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 (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit.

(b) The Borrower may open and maintain in Dollars in a commercial bank acceptable to the Association, on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure or attachment:

- (i) a special account for the purposes of Parts A, C and D of the Project (the MOFE Special Account); and
- (ii) a special account for the purposes of Part B of the Project (the BOM Special Account).

Deposits into, and payments out of each respective Special Account shall be made in accordance with the provisions of Schedule 5 to this Agreement.

Section 2.03. The Closing Date shall be March 31, 2006, 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 May 15 and November 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 May 15 and November 15 commencing November 15, 2012 and ending May 15, 2042. Each installment to and including the installment payable on May 15, 2022 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (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: (i) carry out, and cause to be carried out, Part A of the Project through the Participating Banks; (ii) carry out, and cause to be carried out, Part B of the Project through Bank of Mongolia; and (iii) carry out Parts C and D of the Project through its Ministry of Finance and Economy; all with due diligence and efficiency and in conformity with appropriate administrative, management, financial and banking standards and practices, and shall provide, and cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) For purposes of paragraph (a)(i) of this Section and Part A of the Project, the Borrower shall make available to each Participating Bank part of the proceeds of the Credit allocated from time to time to Categories (1)(b), (2)(b) and (3)(b) set forth in the table in Schedule 1 to this Agreement, under a subsidiary loan agreement acceptable to the Association which will include the following principal terms:

- (i) The principal amount to be made available shall be the equivalent in Dollars (determined on the date, or respective dates, of withdrawal from the Credit Account or payment out of the MOFE Special Account, as the case may be) of the value of the currency or currencies so withdrawn or paid out on account of the cost of goods and services required for said Participating Bank's Respective Part of the Project and to be financed out of the proceeds of the Credit.

- (ii) The principal amount so made available shall be recovered in Dollars, over a period of twenty (20) years, inclusive of a grace period of five (5) years.
- (iii) Interest shall be charged on such principal amount withdrawn and outstanding from time to time at a rate of three percent (3%) per annum.

(c) Without limitation upon the provisions of paragraphs (a) and (b) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out, and cause to be carried out, the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement.

Section 3.03. 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 for the continued achievement of the objectives of the Project; and
- (b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall maintain, or cause to be maintained, 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 and the records and accounts for the Special Accounts 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 (6) 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 a 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. (a) Without limitation upon the Borrower's progress reporting obligations set out in paragraph 5 of Schedule 4 to this Agreement, the Borrower shall prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) the Borrower has engaged a Project Coordinator under terms of reference acceptable to the Association, in accordance with the provisions of paragraph 1 (b) of Schedule 4 to this Agreement;

(b) the Borrower has adopted a financial management manual satisfactory to the Association in accordance with the provisions of paragraph 3 of Schedule 4 to this Agreement;

(c) the Borrower has entered into subsidiary loan agreements satisfactory to the Association, with at least two Participating Banks, in accordance with the provisions of paragraph 4 of Schedule 4 to this Agreement;

(d) BOM and the two Participating Banks referred to in paragraph (c) of this Section 5.01 have established their respective Project Implementation Units, in accordance with the provisions of paragraph 2 of Schedule 4 to this Agreement;

(e) the Project Coordinator and the manager and staff of each PIU established under paragraph (d) of this Section 5.01 have completed a course of training satisfactory to the Association on project management, including without limitation, on financial management and procurement; and

(f) the Borrower has appointed an independent auditor acceptable to the Association, under terms of reference satisfactory to the Association, to carry out the audit of Project accounts in accordance with the provisions of Section 4.01 of this Agreement.

Section 5.02. The following is specified as additional matters, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association, namely that the Subsidiary Loan Agreements have been duly executed by the Borrower and the Participating Banks, and are legally binding upon the Borrower and the Participating Banks in accordance with their respective terms.

Section 5.03. 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 VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance and Economy of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance and Economy
United Nations Street – 5 a
Ulaanbaatar - 210646
Mongolia

Facsimile:

976- 11- 320247

For the Association:

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

Cable address:	Telex:	Facsimile
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(1-202) 477-6391

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

MONGOLIA

By

/s/ Chultemiin Ulaan
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Saha Dhevan Meyanathan
Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Goods:		100% of foreign expenditures, 100% of local expenditures (ex-factory cost) and 90% of local expenditures for other items procured locally
(a) Under Part A of the Project	240,000	
(b) Under Part B of the Project	2,660,000	
(c) Under Other Parts of the Project	3,000	
(2) Consultants' services:		94%
(a) Under Part A of the Project	621,000	
(b) Under Part B of the Project	40,000	
(c) Under other Parts of the Project	129,000	
(d) for the audit of Project accounts	15,000	

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(3) Training and study tours:		100%
(a) Under Part A of the Project	160,000	
(b) Under Part B of the Project	20,000	
(c) Under other Parts of the Project	35,000	
(4) Incremental Operating Costs	17,000	90%
(5) Unallocated	60,000	
 TOTAL	<u>4,000,000</u> =====	

2. For the purposes of this Schedule:

(a) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) the term “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower; and

(c) the term “Incremental Operating Costs” means reasonable expenditures incurred by the Project Coordination Office in managing and coordinating the implementation of the Project, including expenditures for office consumables and communication, and for the dissemination of Project documents, which expenditures would not have been incurred absent the Project, but excluding salaries.

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 under Category (3), in an aggregate amount not exceeding the equivalent of SDR 20,000 may be made on account of payments made for expenditures before that date but after February 1, 2002.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (a) goods under contracts costing less than \$100,000 equivalent each; (b) consultant's services under contracts with firms costing less than \$50,000 equivalent each; (c) training and study tours; and (d) incremental operating costs; all under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Borrower to strengthen its banking sector by reducing systemic risks and enhancing financial intermediation through: (i) the improvement of commercial bank risk management; (ii) the modernization of payment systems and instruments; and (iii) the resolution of Savings Bank.

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

PART A: **Improvement of Commercial Bank Risk Management**

Carrying out of a program to assist selected commercial banks to strengthen their policies, procedures and institutional structures, and to develop appropriate strategy to assess and manage their credit risk and monitor the quality of their portfolio, through the provision of consultants' services and training, and the upgrading of systems related to risk management.

PART B: **Modernization of Payment Systems and Instruments**

Establishment of a Switch/Clearing House system to serve Bank of Mongolia, financial institutions, merchants and users of non-cash payments; development of new non-cash payment instruments; and establishment of a shared financial network with multiple functions for the banking sector, through the provision and installation of electronic systems and related software, and the provision of consultants' services and training.

PART C: **Savings Bank Resolution**

Development of a plan for the redemption or replacement of Bank Restructuring Bonds, and formulation and implementation of a controlled divestiture program for Savings Bank, through the provision of consultants' services and training.

PART D: Implementation Support

Strengthening of the Borrower's Project implementation capacity, including financial management and audit, through the provision of consultants' services, training and equipment.

* * *

The Project is expected to be completed by September 30, 2005.

SCHEDULE 3

Procurement

Section I. Procurement of Goods

Part A: General

Goods shall be procured in accordance with: (a) the provisions of Section I of the “Guidelines for Procurement under IBRD Loans and IDA Credits” published by the Bank in January 1995 and revised in January and August 1996, September 1997 and January 1999 (the Guidelines); and (b) the provisions of the following Parts of this Section I.

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The following provisions shall apply to goods to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

Preference for domestically manufactured goods

The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower.

Part C: Other Procurement Procedures

International and National Shopping

(a) Goods under contract costing less than \$100,000 equivalent each, up to an aggregate amount not to exceed \$594,000 equivalent, may be procured under contracts awarded on the basis of international shopping procedures; and (b) goods under contract costing less than \$50,000 equivalent each, up to an aggregate amount not to exceed \$193,000 equivalent, may be procured on the basis of national shopping procedures; all in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Association of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

2. Prior Review

With respect to each contract for goods estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part D, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with: (a) the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Association in January 1997 and revised in September 1997 and January 1999 (the Consultant Guidelines); and (b) the provisions of the following Parts of this Section II.

Part B: Quality- and Cost-based Selection

Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

Services for the audit of Project accounts may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines

2. Individual Consultants

Services for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines, up to an aggregate amount not to exceed \$1,145,000 equivalent, may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Association of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$50,000 or more, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to all contracts for the employment of individual consultants, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Association for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 4

Implementation Program

Project Management

1. The Borrower shall, throughout the period of Project implementation, maintain:
 - (a) the Project Steering Committee, with representation from the Ministry of Finance and Economy and from Bank of Mongolia, to provide policy direction and guidance, evaluate the Project outcome, and ensure inter-agency coordination in the implementation of the Project; and
 - (b) the Project Coordination Office, under the direction of a qualified and experienced manager, staffed with competent personnel in sufficient numbers, including a Project Coordinator appointed under terms of reference acceptable to the Association, and provided with adequate resources, said Office to serve as a secretariat to the Project Steering Committee and be responsible for the day-to-day administration of the Project.
2. The Borrower shall ensure that:
 - (a) in respect of Part B of the Project, Bank of Mongolia establish and, throughout the period of Project implementation, maintain a Project Implementation Unit, under the direction of qualified and experienced managers, staffed with competent personnel in sufficient numbers, including a network specialist, a switch specialist, a specialist on payment instruments, and a Project administrator, all under terms of reference acceptable to the Association, and provided with adequate resources, to manage the implementation of its Respective Part of the Project; and
 - (b) in respect of Part A of the Project, each Participating Bank establish and, thereafter throughout the period of Project implementation, maintain a Project Implementation Unit, under the direction of qualified and experienced managers, staffed with competent personnel in sufficient numbers, and provided with adequate resources, to manage its Respective Part of the Project.
3. The Borrower: (a) shall, through the Project Coordination Office, prepare and adopt a financial management manual satisfactory to the Association, setting forth policies and detailed procedures for internal control, flow of funds, accounting and auditing, and maintenance of records; and (b) shall not amend, waive or abrogate any provisions thereof without the prior concurrence of the Association.

Project Implementation

4. In respect of Part A of the Project, the Borrower:

(a) shall select Participating Banks in accordance with criteria satisfactory to the Association, which shall include, without limitation, criteria related to their total assets size, limits on non-performing loans, capital adequacy ratio, degree of compliance with Bank of Mongolia prudential requirements, and ownership diversification;

(b) shall enter into a subsidiary loan agreement acceptable to the Association with each Participating Bank so selected, whereby said Participating Bank undertakes to:

- (i) carry out its Respective Part of the Project with diligence and efficiency and in accordance with appropriate administrative, management and financial standards, and commercial banking practices;
- (ii) take, and cause to be taken, all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable it to perform such obligations;
- (iii) not take, or permit to be taken, any action which would prevent or interfere with the performance of such obligations;
- (iv) procure goods and services necessary for its Respective Part of the Project and to be financed out of the proceeds of the Credit, in accordance with the provisions of Schedule 3 to this Agreement;
- (v) by January 31 of each year, commencing in 2003, furnish to the Association an annual training plan for its staff in credit risk management, including secondment of selected staff to commercial banks outside of Mongolia, and thereafter implement such training plan as shall have been agreed to by the Association;
- (vi) maintain records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices, its operations and financial condition;
- (vii) have its 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 auditors acceptable to the Association;
- (viii) furnish to the Borrower and the Association, as soon as available, but in any case not later than six months after the end of each fiscal year: (A) certified copies of said financial

statements and accounts for such year as so audited; and (B) the report of such audit by said auditors in such scope and detail as the Borrower or the Association shall have reasonably requested;

- (ix) prepare and furnish to the Borrower and the Association all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Borrower or the Association shall reasonably request;
- (x) take, and cause to be taken, all action necessary or appropriate to maintain its eligibility in accordance with the criteria for participation in the Project referred to in sub-paragraph (a) of this paragraph 4;
- (xi) promptly inform the Borrower and the Association of any condition which interferes or threatens to interfere with the progress of its Respective Part of the Project, the performance of its obligations under the Subsidiary Loan Agreement, or its continuing compliance with the eligibility criteria set forth in sub-paragraph (a) of this paragraph 4, including any failure to comply with the prudential regulations issued by Bank of Mongolia; and
- (xii) at the request of the Borrower or the Association, review with the Borrower and the Association, the quarterly reports prepared by Bank of Mongolia in respect of said Participating Bank's compliance with Bank of Mongolia's prudential regulations and any required corrective actions thereunder; and

(c) shall exercise its rights under each Subsidiary Loan Agreement in such manner as to protect the interests of the Borrower and the Association, and to accomplish the purposes of the Credit, and except as the Association shall otherwise agree, not assign, amend, abrogate or waive any Subsidiary Loan Agreement or any provision thereof.

5. 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, by January 31, April 30, July 31 and October 31 of each year, commencing in 2003 a quarterly progress report, each such report integrating the results

of the monitoring and evaluation activities performed pursuant to sub-paragraph (a) of this paragraph 5, on the progress achieved in the carrying out of the Project during the preceding calendar quarter 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) promptly review with the Association each of the reports referred to in sub-paragraph (b) of this paragraph 5 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.

SCHEDULE 5

Special Accounts

1. For the purposes of this Schedule:

(a) the term “eligible Categories” means: (i) Categories (1)(a), (1)(c), (2)(a), (2)(c), 2(d), (3)(a), (3)(c) and (4) set forth in the table in paragraph 1 of Schedule 1 to this Agreement, in respect of Parts A, C and D of the Project; and (ii) Categories (1)(b), (2)(b) and (3)(b) in respect of Part B of the Project.

(b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

(c) the term “Authorized Allocation” means an amount equivalent to: (i) \$100,000 in respect of the MOFE Special Account for Parts A, C and D of the Project; and (ii) an amount equivalent to \$100,000 in respect of the BOM Special Account for Part B of the Project, to be withdrawn from the Credit Account and deposited into the respective Special Account pursuant to paragraph 3(a) of this Schedule.

2. Payments out of the respective Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Association has received evidence satisfactory to it that the respective Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the respective Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the respective Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the respective Special Account such amount or amounts as the Borrower shall have requested.

(b) (i) For replenishment of the respective Special Account, the Borrower shall furnish to the Association requests for deposits into the respective Special Account at such intervals as the Association shall specify.

- (ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the respective Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the respective Special Account for eligible expenditures. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the respective Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into any Special Account:

- (a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

- (b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Accounts;

- (c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

- (d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories for the respective Special Account, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the

General Conditions with respect to the respective Parts of the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories for the respective Parts of the Project shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the respective Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of any Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the respective Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into any Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in any Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Accounts.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.