

Public Disclosure Authorized

**CONFORMED COPY**

---

---

**CREDIT NUMBER 3727 NEP**

# **Development Credit Agreement**

**(Financial Sector Technical Assistance Project)**

**between**

**KINGDOM OF NEPAL**

**and**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**Dated April 30, 2003**

Public Disclosure Authorized



**CREDIT NUMBER 3727 NEP**

**DEVELOPMENT CREDIT AGREEMENT**

AGREEMENT, dated April 30, 2003, between the KINGDOM OF NEPAL (the Borrower) and the 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;

(B) the Borrower intends to obtain funds (the DFID Grant) from Department for International Development (DFID), a government department of the United Kingdom, to assist in financing the Project on the terms and conditions set forth in various agreements (the DFID Agreements) to be entered into between the Borrower and DFID; and

(C) Nepal Rastra Bank, with the Borrower's assistance, shall carry out the Project, and, for this purpose, the Borrower shall make the proceeds of the credit provided for in Article II of this Agreement (the Credit) available to Nepal Rastra Bank as set forth in this Agreement; and

WHEREAS, on the basis of the foregoing, the Association has agreed to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement, and in the project agreement of even date herewith between the Association and the Nepal Rastra Bank (the Project 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) "Association Registration Act" means the Borrower's Association Registration Act, 1974, as amended from time-to-time;

(b) “Banijya Bank Act” means the Borrower’s Commercial Bank Act, 1974, as amended from time to time;

(c) “Bankers Training Centre” means the training center for bankers established and operating within the Nepal Rastra Bank;

(d) “Coordination Support Team” means the team of staff and officials to be maintained within Nepal Rastra Bank’s Operations Department, which shall be responsible for implementing the Project on behalf of Nepal Rastra Bank;

(e) “Credit Information Bureau” means the Credit Information Bureau operated by the Nepal Bankers’ Association with Nepal Rastra Bank’s support;

(f) “DFID Grant Agreement” means the Grant Agreement between the Association and the Recipient governing the use of DFID Grant proceeds;

(g) “Eligible Categories” means categories (1), (2), (3) and (4) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(h) “Eligible Expenditures” means expenditures for (i) goods and services referred to in Section 2.02(a) of this Agreement and to be financed out of the proceeds of the Credit allocated from time to time to the Special Account’s Eligible Categories, and (ii) for goods and services referred to in paragraph 4.1 of the DFID Grant Agreement and to be financed out of the proceeds of the Pooled Funds allocated from time to time to the Special Account’s Eligible Categories;

(i) “Financial Management System” means the financial management system that the Borrower shall establish and operate or cause to be established and operated pursuant to Section 3.01 of the Project Agreement;

(j) “Fiscal Year” and “FY” mean the twelve month period corresponding to any of the Borrower’s fiscal years, which period commences and ends in mid July of each calendar year;

(k) “Inspection Department” means the Bank Inspection Department of Nepal Rastra Bank;

(l) “National Planning Commission” means the National Planning Commission, an advisory body established by an executive order issued by His Majesty’s Government of Nepal;

(m) “Nepal Bank Limited” means the Nepal Bank Limited operating in accordance with the Banijya Bank Act;

(n) “Nepal Bankers’ Association” means the Nepal Bankers’ Association, an association operating under the Association Registration Act;

(o) “Nepal Rastra Bank” means the Borrower’s central bank established and operating under the Nepal Rastra Bank Act;

(p) “Nepal Rastra Bank Act” means the Borrower’s Nepal Rastra Bank Act, 2001 as amended from time-to-time, under which the Nepal Rastra Bank has been established and operates as the Borrower’s central bank;

(q) “Nepalese Rupee” and the sign “Rs.” mean the lawful currency of the Borrower;

(r) “NRB Subsidiary Grant Agreement” means the agreement to be entered into between the Borrower and Nepal Rastra Bank pursuant to the provisions of Section 3.01 (c) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the NRB Subsidiary Grant Agreement;

(s) “Operations Department” means the Bank Operations Department of Nepal Rastra Bank;

(t) “Pooled Funds” means the DFID Grant;

(u) “Pooled Funds Account” means the account established for the purposes of the Pooled Funds;

(v) “Project Agreement” means the agreement between the Association and the Nepal Rastra Bank of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;

(w) “Project Implementation Plan” means Nepal Rastra Bank’s Project Implementation Plan dated June 18, 2002, approved by the Association, containing, among other things, financial projections or forecasts for the Project, details regarding procurement, format and content of project financial reports, monitoring and performance indicators and procedures to be used for implementation of the Project, and shall include any accompanying schedules or exhibits and any amendments or updates made from time to time by the Nepal Rastra Bank with the agreement of the Association;

(x) “Project Management Report” means each report prepared in accordance with Section 3.02 of the Project Agreement;

(y) “Project Preparation Advances” mean the advances granted by the Association to the Borrower pursuant to a letter agreement between the Association and the Borrower, countersigned on behalf of the Borrower on October 28, 1999, including any amendments thereto countersigned on behalf of the Borrower;

(z) “Rastriya Banijya Bank” means the Rastriya Banijya Bank operating in accordance with the Banijya Bank Act;

(aa) "Research Department" means the Research Department of Nepal Rastra Bank; and

(bb) "Special Account" means the account referred to in Part B of Schedule 1 to this Agreement.

## **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 twelve million four hundred thousand Special Drawing Rights (SDR12,400,000).

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) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be June 30, 2007 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 March 1 and September 1 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 March 1 and September 1 commencing March 1, 2013 and ending September 1, 2042. Each installment to and including the installment payable on September 1, 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 (6) 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, without any limitation or restriction upon any of its other obligations under the Development Credit Agreement, shall cause Nepal Rastra Bank to perform in accordance with the provisions of the Project Agreement all the obligations of Nepal Rastra Bank therein set forth, shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable Nepal Rastra Bank to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance.

(b) The Borrower shall make available on a grant basis to Nepal Rastra Bank the proceeds of the Credit and the Pooled Funds, allocated from time to time, in accordance with the NRB Subsidiary Grant Agreement to be entered into between the Borrower and Nepal Rastra Bank under terms and conditions which shall have been approved by the Association.

(c) In accordance with the provisions of the NRB Subsidiary Grant Agreement, the Borrower shall make available, in a timely manner, to Nepal Rastra Bank sufficient funds, in necessary and appropriate amounts, to ensure effective implementation of the Project. Such funds shall include proceeds of the Credit, the Pooled Funds, and any additional funds from Borrower's own resources required for carrying out the Project.

(d) The Borrower shall exercise its rights under the NRB Subsidiary Grant 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, the Borrower shall not assign, amend, abrogate or waive the NRB Subsidiary Grant Agreement or any provision thereof.

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 and the Pooled Funds, shall be governed by the provisions of Schedule 1 to the Project 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 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 3.04. The Borrower and the Association hereby agree that 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, respectively) shall be, or caused to be, carried out, by Nepal Rastra Bank pursuant to the provisions of Section 2.03 of the Project Agreement.

## **ARTICLE IV**

### **Financial Covenants**

Section 4.01. (a) For all expenditures with respect to which withdrawals from the Credit Account and the Pooled Funds Account were made on the basis of Project Management Reports or statements of expenditure, the Borrower shall:

- (i) maintain or cause to be maintained, in accordance with sound accounting practices, records and separate accounts reflecting such expenditures;
- (ii) retain, until at least one (1) year after the Association has received the audit report for the Fiscal Year in which the last withdrawal from the Credit Account and the Pooled Funds 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 Project Management Reports or 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.

- (b) The Borrower shall:
- (i) have the records and accounts referred to in paragraph (a) (i) of this Section and those for the Special Account 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 (6) months after the end of each such Fiscal Year, the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested, including a separate opinion by said auditors as to whether the Project Management Reports or 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; and
  - (iii) furnish to the Association such other information concerning said records and accounts 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 events are specified:

- (a) Nepal Rastra Bank shall have failed to perform any of its obligations under the Project Agreement;
- (b) as a result of events which have occurred after the date of the Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that Nepal Rastra Bank will be able to perform its obligations under the Project Agreement;
- (c) the Baniya Bank Act or the Nepal Rastra Bank Act shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of Nepal Rastra Bank, to perform any of its obligations under the Project Agreement or the NRB Subsidiary Grant Agreement; and
- (d) any of the DFID Agreements shall have been terminated or the right of the Borrower to withdraw proceeds of the DFID Grant shall have been suspended; provided, however, that the provisions of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Association that adequate funds for the Project are

available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

Section 5.02. Pursuant to Section 7.01 (h) of the General Conditions, the following additional events are specified:

(a) the event specified in paragraph (a) of Section 5.01 of this Agreement shall occur and shall continue for a period of sixty (60) days after notice thereof shall have been given by the Association to the Borrower; and

(b) the events specified in paragraphs (b) and (c) of Section 5.01 of this Agreement shall occur.

## **ARTICLE VI**

### **Effective Date; Termination**

Section 6.01. 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 DFID Agreements have been executed and delivered and all conditions precedent to their effectiveness or to the right of the Borrower to make withdrawals thereunder, except only the effectiveness of these agreements, have been fulfilled; and

(b) the NRB Subsidiary Grant Agreement has been executed on behalf of the Borrower and Nepal Rastra Bank;

Section 6.02. The following is specified as an additional matter, 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 Project Agreement and the NRB Subsidiary Grant Agreement have been duly authorized and executed by each of the respective parties thereto, including the Borrower and Nepal Rastra Bank, and are legally binding upon each of such parties, in accordance with their terms.

Section 6.03. 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 VII

### Representative of the Borrower; Addresses

Section 7.01. The Secretary, Ministry of Finance of the Borrower, is designated as the 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:

Ministry of Finance  
Baghdurbar  
Kathmandu  
Nepal

Cable address:	Telex:	Facsimile:
ARTHA Kathmandu, Nepal	2249-NEP	(977-1)259-891

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)	(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 Kathmandu, Nepal, as of the day and year first above written.

KINGDOM OF NEPAL

By /s/ Bhanu Prasad Acharya  
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Kenichi Ohashi  
Country Director for Nepal

### SCHEDULE 1

#### Withdrawal of the Proceeds of the Credit and the Pooled Funds

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit and the Pooled Funds, the allocation of the amounts of the Credit and the Pooled Funds 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)</u>	<u>Amount of the Pooled Funds Allocated (Expressed in Pounds Sterling)</u>	<u>% of Expenditures to be Financed</u>
(1)	Goods	1,200,000	704,560	90%
(2)	Consultants' services	9,490,000	5,699,250	85%
(3)	Training, workshops and study tours	770,000	445,900	100%
(4)	Incremental Operating Costs	16,000	10,290	90% through July 1, 2003, 80% through July 1, 2004, 70% through July 1, 2005 and 60% thereafter until completion of the Project
(5)	Refunding of Project Preparation Advance	900,000	Not applicable	Amount due pursuant to Section 2.02 (b) of this Agreement
(6)	Unallocated	24,000	0	
	<b>TOTAL</b>	<u>SDR 12,400,000</u>	<u>1,686,000</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 the incremental operating costs incurred by the Coordination Support Team on account of Project implementation, management, monitoring and supervision costs, including communications, supplies, materials, incremental staff costs, but excluding salaries of officials of the Borrower or Nepal Rastra Bank.

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

4. Without prejudice to the provisions of Section 5.04 of the General Conditions, Notwithstanding the allocation of an amount of the Pooled Funds or the percentages for withdrawal set forth or referred to in paragraph 1, above, if the Association has reasonably estimated that the amount of the Pooled Funds then allocated to any withdrawal category set forth in paragraph 1, above, or added thereto by amendment will be insufficient to finance the agreed percentage of all expenditures in that category, the Association may, by notice to the Borrower:

(a) reallocate to such category, to the extent required to meet the estimated shortfall, proceeds of the Pooled Funds which are then allocated to another category and which in the opinion of the Association are not needed to meet other expenditures; and

(b) if such reallocation cannot fully meet the estimated shortfall, reduce the percentage for withdrawal of Pooled Funds then applicable to such expenditures in order that further withdrawals under such category may continue until all expenditures thereunder shall have been made.

5. The Association may require withdrawals from the Credit Account and the Pooled Funds Account to be made on the basis of statements of expenditure for expenditures for: (i) goods estimated to cost less than \$200,000 equivalent per contract, (ii) services of consulting firms under contracts costing less than \$30,000 equivalent per contract; (iii) services of individual consultants under contracts costing less than \$10,000 equivalent per contract; and (iv) all training costs and incremental operating costs; all under such terms and conditions as the Association shall specify by notice to the Borrower.

**B. Special Account**

1. The Borrower shall open and maintain in Dollars a separate special deposit account in Nepal Rastra Bank, on terms and conditions satisfactory to the Association.

2. After the Association has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Credit Account and the Pooled Funds Account of amounts to be deposited into the Special Account shall be made as follows:

(a) until the Association shall have received (i) the first Project Management Report referred to in Section 3.02 (b) of the Project Agreement, and (ii) a request from the Borrower for withdrawal on the basis of Project Management Reports, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) upon receipt by the Association of a Project Management Report pursuant to Section 3.02 (b) of the Project Agreement, accompanied by a request from the Borrower for withdrawal on the basis of Project Management Reports, all further withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the 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.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if the Association determines at any time that any Project Management Report does not adequately provide the information required pursuant to Section 3.02 of the Project Agreement;

(b) if the Association determines at any time that all further withdrawals should be made by the Borrower directly from the Credit Account or Pooled Funds Account; or

(c) if the Borrower shall have failed to furnish to the Association within the period of time specified in Section 3.01 (b)(ii) of the Project Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of (A) the records and accounts for the Special Account, or (B) the records and accounts reflecting expenditures with respect to which withdrawals were made on the basis of Project Management Reports.

5. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule 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 Section 6.02 of the General Conditions. Upon such notification, the Association shall determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.



6. (a) If the Association determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the 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 determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, 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 Account.

(d) Refunds to the Association made pursuant to sub-paragraphs (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account and the Pooled Funds Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Development Credit Agreement.

**Annex A  
to  
SCHEDULE 1**

**Operation of Special Account  
When Withdrawals Are Not Made  
On the Basis of Project Management Reports**

1. For the purposes of this Annex:

the term "Authorized Allocation" means an amount equivalent to \$2,000,000 to be withdrawn from the Credit Account and the Pooled Funds Account and deposited into the Special Account pursuant to paragraph 2 of this Annex; provided, however, that, unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$1,000,000 until the aggregate amount of withdrawals from the Credit Account and the Pooled Funds Account, plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall equal or exceed the equivalent of SDR3,500,000.

2. Withdrawals of the Special Account's Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

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

- (b) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. 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 B.3 of Schedule 1 to this Agreement 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 the Pooled Funds Account and deposit into the 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 Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account and the Pooled Funds Account under one or more of the Special Account's Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit and the Pooled Funds minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions, shall equal the equivalent of twice the

amount of the Special Account's Authorized Allocation. Thereafter, withdrawal from the Credit Account and the Pooled Funds Account of the remaining unwithdrawn amount of the Credit and the Pooled Funds 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 Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

**Annex B  
to  
SCHEDULE 1**

**Operation of Special Account  
When Withdrawals Are Made  
On the Basis of Project Management Reports**

1. Except as the Association may otherwise specify by notice to the Borrower, all withdrawals from the Credit Account and the Pooled Funds Account shall be deposited by the Association into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Borrower from the Credit Account and the Pooled Funds Account under one or more of the Special Account's Eligible Categories.

2. Each application for withdrawal from the Credit Account and the Pooled Funds Account for deposit into the Special Account shall be supported by a Project Management Report.

3. Upon receipt of each application for withdrawal of an amount of the Credit and the Pooled Funds, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and the Pooled Funds Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Association has determined, based on the Project Management Report accompanying said application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such report; provided, however, that the amount so deposited, when added to the amount indicated by said Project Management Report to be remaining in the Special Account, shall not exceed the equivalent of \$3,200,000.

## SCHEDULE 2

### Description of the Project

The objectives of the Project are to assist the Borrower in: (i) restructuring and re-engineering the Nepal Rastra Bank for it to effectively perform key central banking functions; (ii) implementing reforms in the commercial banking sector that will focus initially on restructuring Rastriya Banijya Bank and Nepal Bank Limited; and (iii) improving the environment for financial sector reforms in areas such as credit information and financial news reporting through specialized training and capacity building.

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: Reengineering of the Nepal Rastra Bank

1. Strengthening Nepal Rastra Bank's human resource management capabilities through the following measures:

(a) formulating a right-sizing strategy and designing a suitable voluntary retirement scheme;

(b) revising existing human resource policies or systems to ensure appropriate incentives and financial rewards for higher-level and well-performing staff;

(c) developing and implementing a decompressed salary system; and

(d) introducing appropriate computer systems to manage human resource functions.

2. Strengthening Nepal Rastra Bank's supervisory and regulatory capacity with respect to banks and non-banking financial institutions through the following measures:

(a) enhancing a supervisory and regulatory system for these institutions;

(b) supporting Nepal Rastra Bank's bank examiners in supervising and inspecting these institutions; and

(c) upgrading computer systems to ensure bank supervisors conduct off-site and on-site supervisory operations effectively and efficiently.

3. Supporting Nepal Rastra Bank's comprehensive legislative and regulatory reform efforts in the financial sector.

4. Supporting Nepal Rastra Bank's research activities, including, among other things, computerizing and developing Nepal Rastra Bank's library services.

5. Strengthening Nepal Rastra Bank's accounting and auditing capabilities to produce better quality and more timely financial and accounting information.
6. Supporting internal audit functions.
7. Strengthening information technology solutions for Nepal Rastra Bank.
8. Conducting a training program for professional development of Nepal Rastra Bank staff including in-house training and attendance at external seminars and conferences.

Part B: Restructuring Rastriya Banijya Bank and Nepal Bank Limited

1. Implementing a restructuring program for each of Rastriya Banijya Bank and Nepal Bank Limited with a view to:
  - (a) controlling bank day-to-day operations;
  - (b) stabilizing their operational and financial position;
  - (c) strengthening the accounts of these institutions and improving their accounting systems;
  - (d) designing a human resources program that will include, among other things, a training program, a retrenchment program, and a revised remuneration package for bank staff; and
  - (e) preparing these institutions for divestiture from the public sector.
2. Supporting the establishment and operation of information technology and computer systems to facilitate the restructuring program referred to in Part B.1, above, of the Project.

Part C: Other Financial Sector Assistance

1. Strengthening the Banker's Training Center by (i) developing a strategic plan for the center; (ii) designing appropriate course work; (iii) supporting enhanced training capabilities; and (iv) establishing and operating a modern information technology and computer system at the center.
2. Strengthening the Credit Information Bureau and the means through which credit information is disseminated.
3. Supporting training and capacity building among local journalists to assist them in conveying financial and business news and issues to the public.

4. Supporting the Coordination Support Team in implementing and supervising the Project, especially in relation to financial management, procurement and coordination capabilities.

\*

\*

\*

The Project is expected to be completed by December 31, 2006.

Seble Berhanu

M:\legsa\Nepal\Financial Sector Technical Assistance\Development Credit Agreement  
(Board).doc

December

20,

2002

11:26

AM