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LOAN NUMBER 3258-BHU(SF)

GRANT NUMBER 0431-BHU

FINANCING AGREEMENT  
(Special Operations)  
(Strengthening Economic Management Program II)

between

KINGDOM OF BHUTAN

and

ASIAN DEVELOPMENT BANK

DATED 15 JUNE 2015

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BHU 46371

**FINANCING AGREEMENT  
(Special Operations)**

FINANCING AGREEMENT dated 15 June 2015 between KINGDOM OF BHUTAN (“Beneficiary”) and ASIAN DEVELOPMENT BANK (“ADB”).

WHEREAS

(A) ADB has received from the Beneficiary a development policy letter dated 25 March 2015 (“Policy Letter”), setting forth certain objectives, policies and actions, described in Schedule 1 to this Financing Agreement, designed to improve macroeconomic stability in the territory of the Beneficiary (“Program”);

(B) the Beneficiary has applied to ADB for a loan and a grant for the purposes of the Program; and

(C) ADB has agreed to provide financing by making a loan and a grant to the Beneficiary from ADB's Special Funds resources upon the terms and conditions set forth herein;

NOW THEREFORE the parties agree as follows:

**ARTICLE I**

**Loan Regulations and Grant Regulations; Definitions**

Section 1.01. All the provisions of the Special Operations Loan Regulations of ADB, dated 1 January 2006 (“Loan Regulations”), are hereby made applicable to the Loan made pursuant to this Financing Agreement with the same force and effect as if they were fully set forth herein, subject, however, to the following modifications:

(a) The term “Loan Agreement”, wherever it appears in the Loan Regulations, shall be substituted by the term “Financing Agreement”.

(b) The term “Borrower”, wherever it appears in the Loan Regulations, shall be substituted by the term “Beneficiary” as defined in the opening paragraph of this Financing Agreement.

(c) Section 2.01(24) is deleted and the following is substituted therefor:

24. The term “Program” means the program for which ADB has agreed to make the Loan, as described in the Financing Agreement and as the description thereof may be amended from time to time by agreement between ADB and the Beneficiary.

(d) The term "Project" wherever it appears in the Loan Regulations shall be substituted by the term "Program".

(e) Section 2.01(26) is deleted and the following is substituted therefor:

26. The term "Program Executing Agency" means the entity or entities responsible for the carrying out of the Program as specified in the Financing Agreement.

(f) The term "Project Executing Agency" wherever it appears in the Loan Regulations shall be substituted by the term "Program Executing Agency".

Section 1.02. All provisions of the Special Operations Grant Regulations of ADB, dated 7 February 2005 ("Grant Regulations"), are hereby made applicable to the Grant made pursuant to this Financing Agreement with the same force and effect as if they were fully set forth herein subject, however, to the following modifications:

(a) The term "Grant Agreement", wherever it appears in the Grant Regulations, shall be substituted by the term "Financing Agreement".

(b) The term "Recipient", wherever it appears in the Grant Regulations, shall be substituted by the term "Beneficiary" as defined in the opening paragraph of this Financing Agreement.

(c) Section 2.01(15) is deleted and the following is substituted therefor:

15. The term "Program" means the program for which ADB has agreed to make the Grant, as described in the Financing Agreement and as the description thereof may be amended from time to time by agreement between ADB and the Beneficiary.

(d) The term "Project" wherever it appears in the Grant Regulations shall be substituted by the term "Program".

(e) Section 2.01(17) is deleted and the following is substituted therefor:

17. The term "Program Executing Agency" means the entity or entities responsible for the carrying out of the Program as specified in the Financing Agreement.

(f) The term "Project Executing Agency" wherever it appears in the Grant Regulations shall be substituted by the term "Program Executing Agency".

Section 1.03. Wherever used in this Financing Agreement, the several terms defined in the Loan Regulations and the Grant Regulations have the respective meanings therein set forth unless modified herein or the context otherwise requires. Additional terms used in this Financing Agreement have the following meanings:

- thereto;
- (a) “BDBL” means Bhutan Development Bank Limited or any successor thereto;
- (b) “CIB” means Credit Information Bureau of Bhutan or any successor thereto;
- (c) “Counterpart Funds” means the local currency generated from the proceeds of the Loan and the Grant under the Program and referred to in paragraph 5 of Schedule 4 to this Financing Agreement;
- (d) “DPA” means the Department of Public Accounts of MOF or any successor thereto;
- (e) “DRC” means the Department of Revenue and Customs of MOF or any successor thereto;
- (f) “Eligible Imports” means the total imports of the Beneficiary during the relevant period minus the following imports during the same period:
- (i) imports from countries which are not members of ADB;
  - (ii) imports of ineligible items specified in Attachment 1 to Schedule 3 to this Financing Agreement; and
  - (iii) imports financed by official international or bilateral aid agencies or any other loans or grants made by ADB;
- (g) “Eligible Items” means the Eligible Imports and services in connection with the delivery and installation of such imports;
- (h) “First Tranche” means the proceeds of the Grant to be withdrawn pursuant to and subject to the provisions of paragraph 4 of Schedule 3 to this Financing Agreement;
- (i) “Gewog” means a group of villages;
- (j) “Grant Deposit Account” means the account referred to in paragraph 3 of Schedule 3 to this Financing Agreement;
- (k) “Loan Deposit Account” means the account referred to in paragraph 3 of Schedule 3 to this Financing Agreement;
- (l) “Loan Disbursement Handbook” means ADB’s Loan Disbursement Handbook (2015, as amended from time to time);
- (m) “MoEA” means the Beneficiary’s Ministry of Economic Affairs or any successor thereto;
- (n) “MOF” means the Beneficiary’s Ministry of Finance or any successor thereto;

(o) “NPPF” means the National Pension and Provident Fund or any successor thereto;

(p) “Policy Matrix” means the policy matrix attached to the Policy Letter as agreed between the Beneficiary and ADB;

(q) “Program Executing Agency” for the purposes of, and within the meaning of, the Loan Regulations and the Grant Regulations means DPA or any successor thereto acceptable to ADB, which is responsible for the carrying out of the Program;

(r) “Program Implementing Agencies” means the various concerned departments and agencies of the Beneficiary (including MOF, DPA, DRC and RMA), and BDBL, CIB, NPPF and the Registrar of Companies;

(s) “RAMIS” means the Beneficiary’s revenue administration management information system;

(t) “Registrar of Companies” means the Registrar of Companies in the MoEA or any successor thereto;

(u) “RMA” means the Beneficiary’s Royal Monetary Authority or any successor thereto; and

(v) “Second Tranche” means the proceeds of the Loan to be withdrawn pursuant to and subject to the provisions of paragraph 5 of Schedule 3 to this Financing Agreement.

## **ARTICLE II**

### **The Loan and the Grant**

Section 2.01. ADB agrees to provide to the Beneficiary from ADB's Special Funds resources:

- (a) a loan in various currencies equivalent to fourteen million four hundred forty three thousand Special Drawing Rights (SDR14,443,000) (“Loan”); and
- (b) a grant in the amount of sixteen million one hundred thousand Dollars (\$16,100,000) (“Grant”).

Section 2.02. (a) The Beneficiary shall pay to ADB an interest charge at the rate of 1% per annum during the grace period, and 1.5% per annum thereafter, on the amount of the Loan withdrawn from the Loan Account and outstanding from time to time.

(b) The term “grace period” as used in paragraph (a) of this Section means the period prior to the first Principal Payment Date in accordance with the amortization schedule set forth in Schedule 2 to this Financing Agreement.

Section 2.03. The interest charge and any other charge on the Loan shall be payable semiannually on 1 June and 1 December in each year.

Section 2.04. The Beneficiary shall repay the principal amount of the Loan withdrawn from the Loan Account in accordance with the amortization schedule set forth in Schedule 2 to this Financing Agreement.

Section 2.05. The currency of repayment of the principal amount of the Loan and the currency of payment of the interest charge for the purposes of Section 4.03(a) and 4.04 of the Loan Regulations shall be the Dollar.

### **ARTICLE III**

#### **Use of Proceeds of the Loan and the Grant**

Section 3.01. The Beneficiary shall cause the proceeds of the Loan and the Grant to be applied to the financing of expenditures on the Program in accordance with the provisions of this Financing Agreement.

Section 3.02. The proceeds of the Loan and the Grant shall be withdrawn from the Loan Account and the Grant Account in accordance with the provisions of Schedule 3 to this Financing Agreement, as such Schedule may be amended from time to time by agreement between the Beneficiary and ADB.

Section 3.03. Withdrawals from the Loan Account and the Grant Account shall be made only on account of expenditures relating to Eligible Items which:

- (a) are produced in, and are supplied from, such member countries of ADB as shall have been specified by ADB from time to time as eligible sources for procurement, and
- (b) meet such other eligibility requirements as shall have been specified by ADB from time to time.

Section 3.04. The Loan Closing Date for the purposes of Section 8.02 of the Loan Regulations shall be 31 December 2016, and the Grant Closing Date for the purposes of Section 8.02 of the Grant Regulations shall be 31 December 2016 or, in each case, such other date as may from time to time be agreed between the Beneficiary and ADB.

## **ARTICLE IV**

### **Particular Covenants**

Section 4.01. In the carrying out of the Program, the Beneficiary shall perform, or cause to be performed, all obligations set forth in Schedule 4 to this Financing Agreement.

Section 4.02. (a) The Beneficiary shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and the Grant and to record the progress of the Program.

(b) The Beneficiary shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section.

Section 4.03. (a) As part of the reports and information referred to in Section 6.05 of the Loan Regulations and Section 6.04 of the Grant Regulations, the Beneficiary shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the Counterpart Funds and the use thereof; and (ii) the implementation of the Program, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.

(b) Without limiting the generality of the foregoing or Section 6.05 of the Loan Regulations and Section 6.04 of the Grant Regulations, the Beneficiary shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the Program and on the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.

## **ARTICLE V**

### **Effectiveness**

Section 5.01. The following is specified as an additional condition to the effectiveness of this Financing Agreement for the purposes of Section 9.01(f) of the Loan Regulations and Section 9.01(e) of the Grant Regulations, respectively: ADB shall be satisfied that the Beneficiary has met all conditions for the release of the First Tranche as set out in Attachment 2 to Schedule 3 to this Financing Agreement.

Section 5.02. A date ninety (90) days after the date of this Financing Agreement is specified for the effectiveness of the Financing Agreement for the purposes of Section 9.04 of the Loan Regulations and Section 9.04 of the Grant Regulations.

## ARTICLE VI

### Miscellaneous

Section 6.01. The Minister of Finance of the Beneficiary is designated as representative of the Beneficiary for the purposes of Section 11.02 of the Loan Regulations and Section 11.02 of the Grant Regulations.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the Loan Regulations and Section 11.01 of the Grant Regulations:

#### For the Beneficiary

Ministry of Finance  
Royal Government of Bhutan  
Thimphu, Bhutan

Facsimile Number:

(975) 2 323 154.

#### For ADB

Asian Development Bank  
6, ADB Avenue  
Mandaluyong City  
1550 Metro Manila  
Philippines

Facsimile Numbers:

(632) 636-2444

(632) 636-2337.



IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Financing Agreement to be signed in their respective names as of the day and year first above written and to be delivered at the principal office of ADB.

KINGDOM OF BHUTAN

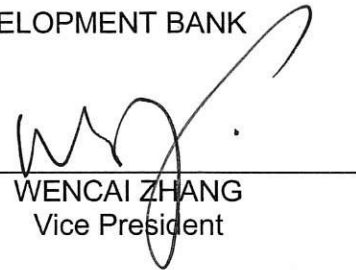
By



NAMGAY DORJI  
Minister  
Ministry of Finance

ASIAN DEVELOPMENT BANK

By



WENCAI ZHANG  
Vice President

**SCHEDULE 1****Description of the Program**

1. The principal objective of the Program is to improve macroeconomic stability of the Beneficiary and the scope includes improved macroeconomic management and strengthened financial sector development. The Program is described in more detail in the Policy Letter.
2. The Program is expected to be completed by 31 December 2016.

**SCHEDULE 2****Amortization Schedule****(Strengthening Economic Management Program II)**

Date Payment Due	Payment of Principal (expressed in Special Drawing Rights)*
1 December 2023	451,344
1 June 2024	451,344
1 December 2024	451,344
1 June 2025	451,344
1 December 2025	451,344
1 June 2026	451,344
1 December 2026	451,344
1 June 2027	451,344
1 December 2027	451,344
1 June 2028	451,344
1 December 2028	451,344
1 June 2029	451,344
1 December 2029	451,344
1 June 2030	451,344
1 December 2030	451,344
1 June 2031	451,344
1 December 2031	451,344
1 June 2032	451,344
1 December 2032	451,344
1 June 2033	451,344
1 December 2033	451,344
1 June 2034	451,344
1 December 2034	451,344
1 June 2035	451,344
1 December 2035	451,344
1 June 2036	451,344
1 December 2036	451,344
1 June 2037	451,344
1 December 2037	451,344
1 June 2038	451,344
1 December 2038	451,344
1 June 2039	<u>451,336</u>
<b>TOTAL</b>	<b>14,443,000</b>

\* The arrangements for payment of each maturity are subject to the provisions of Sections 3.04 and 4.03 of the Loan Regulations.

**SCHEDULE 3****Withdrawal of Loan and Grant Proceeds**

1. Except as ADB may otherwise agree, the following provisions of this Schedule shall apply to the withdrawal of Loan and Grant proceeds from the Loan Account and the Grant Account.

2. (a) An application for withdrawal from the Loan Account and the Grant Account shall be submitted to ADB by the Beneficiary and shall be in a form satisfactory to ADB.

(b) Such withdrawal applications shall be accompanied by a certificate of the Beneficiary confirming that with respect to each year during which the proceeds of the Loan and the Grant are expected to be disbursed, the value of the Eligible Imports is expected to be greater than the aggregate amount of the Loan and the Grant expected to be disbursed during such year.

(c) The Beneficiary shall allow experts appointed by ADB to verify the value of Eligible Imports during any period in respect of which the Beneficiary has certified the value of Eligible Imports in its withdrawal application.

3. (a) Prior to submitting the first application to ADB for withdrawal from the Loan Account and the Grant Account, the Beneficiary shall nominate (i) a Loan Deposit Account and (ii) a Grant Deposit Account, both at RMA, into which all withdrawals from the Loan Account and the Grant Account, respectively, shall be deposited. The Loan Deposit Account and the Grant Deposit Account shall be established, managed and liquidated in accordance with terms and conditions satisfactory to ADB.

(b) Separate accounts and records in respect of the Loan Deposit Account and the Grant Deposit Account shall be maintained in accordance with accounting principles acceptable to ADB. Upon ADB's request, the Beneficiary shall have the financial statements for the Loan Deposit Account and the Grant Deposit Account audited by independent auditors, whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with international standards for auditing or the national equivalent acceptable to ADB. Promptly after their preparation but in any event not later than 6 months after the date of ADB's request, copies of such audited financial statements and the opinion of the auditors on the financial statements, in the English language, shall be furnished to ADB.

(c) Throughout the Program implementation period, the Beneficiary shall submit trade statistics and any other information as ADB may require from time to time to assess the Beneficiary's compliance with the formula for determining Eligible Imports.

4. The Beneficiary may withdraw the First Tranche upon effectiveness of this Financing Agreement.

5. Notwithstanding any other provisions of this Financing Agreement and except as ADB may otherwise agree, no withdrawal shall be made from the Loan Account unless ADB is satisfied that (a) sufficient progress has been achieved by the Beneficiary in the carrying out of the Program; (b) the policy actions that were met for the release of the First

Tranche continue to be complied with by the Beneficiary; and (c) the Beneficiary has met the policy actions for the release of the Second Tranche specified in Attachment 3 to this Schedule.

**Negative List**

No withdrawals will be made for the following:

- (i) expenditures for goods included in the following groups or sub-groups of the United Nations Standard International Trade Classification, Revision 3 (SITC, Rev. 3) or any successor groups or sub-groups under future revisions to the SITC, as designated by ADB by notice to the Beneficiary:

**Table: Ineligible Items**

<b>Chapter</b>	<b>Heading</b>	<b>Description of Items</b>
112		Alcoholic beverages
121		Tobacco, unmanufactured; tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitute)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), nonirradiated for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum-group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, nonmonetary (excluding gold ore and concentrates)

Source: United Nations.

- (ii) expenditures in the currency of the Beneficiary or for goods supplied from the territory of the Beneficiary;
- (iii) expenditures for goods supplied under a contract that any national or international financing institution or agency will have financed or has agreed to finance, including any contract financed under any loan or grant from the ADB;
- (iv) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
- (v) expenditures for narcotics;
- (vi) expenditures for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Beneficiary or international agreements to which the Beneficiary is a party; and
- (vii) expenditures on account of any payment prohibited by the Beneficiary in compliance with a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations.

**Policy Actions for Release of the First Tranche**

1. DRC shall have approved a plan to establish a taxpayer information call center, including taxpayer services to be provided, and staff, budget, and IT infrastructure requirements.
2. RMA shall have notified the public of the disclosure requirements under its macroprudential regulations (including for annual and quarterly disclosures of Tier 1 and Tier 2 capital; capital adequacy ratios for each tier; loans by sector and type of counterparty; assets and liabilities; non-performing loans and provisions; geographical distribution of exposures; and credit risk exposure by collateral).
3. RMA shall have established a committee tasked with monitoring the stability of the financial sector.
4. The NPPF Board shall have approved risk-based investment guidelines.
5. Regulations for the public issue of shares (including issuer eligibility criteria, minimum subscription amounts, over- and under-subscription procedures, restrictions on the promoter's shareholding, subscription procedures, disclosure requirements, and documents required for the issue) shall have become effective.
6. MOF shall have approved and started implementation of the Bhutanese Accounting Standards / International Financial Reporting Standards.
7. RMA shall have approved regulations which will (i) govern the establishment, organization and operation of a credit reporting system; (ii) establish the conditions for credit reporting and (iii) specify the roles of participants, and other relevant information.
8. CIB shall have approved a business plan, including new products and services, projected budget, staffing needs, upgrades of IT infrastructure, and other organizational issues.

**Policy Actions for Release of the Second Tranche**

1. The property tax rates based on the property valuation methodology shall have been submitted to Parliament, and the policies, systems and processes which are necessary to collect property tax using the new rates shall have been completed within the municipality of Thimphu.
2. DRC shall have operationalized the direct and sales tax modules of RAMIS (including those for personal income, business income and corporate income taxes).
3. The taxpayer information call center shall have become operational.
4. MOF shall have (a) published a calendar for issuance of government debt securities for FY2017; and (b) issued government debt securities following the calendar.
5. RMA shall have notified financial institutions of new money market instruments to develop the inter-financial institutions lending market.
6. RMA shall, as part of the annual onsite inspection, have assessed the compliance with the macroprudential regulations for at least three financial institutions.
7. RMA shall have prepared an assessment report on the implementation of its liquidity management and stress testing framework by the Bank of Bhutan Limited and Bhutan National Bank Limited.
8. RMA shall have published a financial stability report (including an analysis of financial system soundness) in 2016 for FY2015.
9. (a) The National Pension Policy shall have been approved by the Cabinet, and the NPPF Board shall have approved the Strategic Plan (together, these documents shall include the membership structure, contributions and benefits and investment guidelines).  
  
(b) NPPF shall have increased its membership by at least 5%.
10. The Prospectus Approval Committee under the Registrar of Companies (comprising, among others, representatives of the MoEA and RMA) shall have prepared a report on the legal, regulatory, and institutional requirements for, and feasibility of, establishing a separate securities exchange commission.
11. Based on its review of international experience, MOF shall have prepared a report on the legal, regulatory, and institutional requirements for, and feasibility of, securitization of Bhutan's hydropower revenues.
12. RMA shall have approved a regulatory and supervisory framework to improve financial inclusion, and adopted regulations such as branchless banking and deposit-taking microfinance.
13. BDBL shall have substantially implemented Gewog banking services in non-urban areas.



14. RMA shall have developed and implemented a financial literacy program (covering both school-age and adult populations) in consultation with stakeholders with a focus on gender equity.
15. An oversight unit for the credit reporting system shall have been established.
16. CIB shall have substantially implemented the business plan.

## **SCHEDULE 4**

### **Program Implementation and Other Matters**

#### Implementation Arrangements

1. The Beneficiary shall be responsible for the coordination and execution of the Program with the Program Implementing Agencies. The Program Executing Agency shall oversee and coordinate the timely implementation of agreed policy, legal, and regulatory actions. The Program Implementing Agencies shall also be responsible for Program administration, disbursements, and maintenance of all Program records. ADB will work through the Beneficiary's Program steering committee mechanism to monitor progress, oversee the implementation of the Program, and guide and direct the activities of the Program Executing Agency.

#### Policy Actions and Dialogue

2. The Beneficiary shall (a) use its best endeavors to ensure that critical Program staff will remain in their position on a full-time basis for a reasonable duration to ensure continuity in the implementation of the Program; and (b) ensure that all Program Implementing Agencies will be adequately staffed and provided with the necessary financial, technical, and other resources to perform their functions under the Program.

3. The Beneficiary shall (a) ensure that all policy actions adopted under the Program, as set out in the Policy Letter and the Policy Matrix, continue to be in effect for the duration of the Program and subsequently; and (b) make submissions to ADB on the completion of actions under the Policy Matrix by reference to the indicators set out therein.

4. The Beneficiary shall keep ADB informed of policy discussions with other multilateral or bilateral aid agencies that have implications for implementation of the Program, and shall provide ADB with an opportunity to comment on any resulting policy proposals. The Beneficiary shall take into account ADB's views before finalizing and implementing any such proposals.

#### Use of Counterpart Funds

5. The Beneficiary shall ensure that the Counterpart Funds are used to finance the implementation of certain programs and activities consistent with the objectives of the Program and provide the necessary budget appropriation to finance the costs relating to the implementation of reforms under the Program.

#### Governance and Anticorruption

6. The Beneficiary shall, and cause BDBL, CIB and NPPF to: (a) comply with ADB's Anticorruption Policy (1998, as amended to date) and acknowledge that ADB reserves the right to investigate directly, or through its agents, any alleged corrupt, fraudulent, collusive or coercive practice relating to the Program; and (b) cooperate with any such investigation and extend all necessary assistance for satisfactory completion of such investigation.

Monitoring and Review

7. The Beneficiary and ADB shall undertake ongoing monitoring and regular formal review of Program performance. The Beneficiary, through the Program Executing Agency, shall establish and maintain a Program performance monitoring system that will include a database on the compliance status of policy actions.

8. The Beneficiary shall monitor the implementation and outcomes of the Program using a set of indicators and targets that has been agreed between the Beneficiary and ADB to assess progress towards meeting the objectives of the Program. For each of the agreed indicators, progress shall be measured against the baselines in the design and monitoring framework.