
LOAN NUMBER 3338-MON

PROJECT AGREEMENT

(Supporting the Credit Guarantee System for Economic Diversification and Employment
Project)

between

ASIAN DEVELOPMENT BANK

and

CREDIT GUARANTEE FUND OF MONGOLIA

DATED 8 JANUARY 2016

48015 MON

PROJECT AGREEMENT

PROJECT AGREEMENT dated 8 January 2016 between ASIAN DEVELOPMENT BANK ("ADB") and CREDIT GUARANTEE FUND OF MONGOLIA ("CGFM").

WHEREAS

(A) by a Loan Agreement of even date herewith between Mongolia ("Borrower") and ADB, ADB has agreed to make to the Borrower a loan of sixty million Dollars (\$60,000,000) on the terms and conditions set forth in the Loan Agreement, but only on the condition that the proceeds of the loan be made available to CGFM and that CGFM agrees to undertake certain obligations towards ADB as set forth herein; and

(B) CGFM, in consideration of ADB entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations set forth herein;

NOW THEREFORE the parties hereto agree as follows:

ARTICLE I

Definitions

Section 1.01. Wherever used in this Project Agreement, unless the context otherwise requires, the several terms defined in the Loan Agreement and in the Loan Regulations (as so defined) have the respective meanings therein set forth.

ARTICLE II

Time Deposits

Section 2.01. (a) Except as ADB may otherwise agree, the proceeds of the Loan converted to MNT made available to CGFM under the Subsidiary Loan Agreement shall be used only for Time Deposits pursuant to Time Deposit Agreements for the purposes of providing funds to the PFIs for making SME Loans to Qualified SME Borrowers for Qualified SME Subprojects and shall be applied exclusively to the cost of Goods and Works and other items of expenditure required to carry out such Qualified SME Subprojects.

(b) Upon receipt of the funds in MNT under the Subsidiary Loan Agreement, CGFM shall immediately deposit the funds into the Subaccount for placing Time Deposits and any interest earned on the Subaccount shall be retained by CGFM.

(c) CGFM shall ensure that each Time Deposit Agreement shall be in a form and on terms and conditions acceptable to ADB, and shall be without prejudice to, and

without limitation on, the obligations of the Borrower under the Loan Agreement. Subject to the foregoing, and except as ADB may otherwise agree, each Time Deposit shall (i) be denominated in MNT; (ii) have a maturity linked to the tenor of the SME Loans eligible for funding under the Loan and will be rolled-over to the remaining maturity of the SME Loans as provided in subsection (f) below; (iii) pay a market-based rate in line with the Borrower and other development agencies' loan financing programs as determined by ADB from time to time and detailed in the PAM; (iv) include as a termination event the failure of the relevant PFI to comply with any obligation set forth in paragraphs 3 and 4 of Schedule 5 of the Loan Agreement and paragraphs 3 and 4 of the Schedule to this Project Agreement; and (v) provide that the Time Deposit cannot be pledged, retained or claimed by the PFI should the PFI have a claim under a credit guarantee issued by CGFM.

(d) CGFM shall ensure that a PFI's request for Time Deposit funding shall be based upon projected monthly principal amortization schedule for the portfolio of SME Loans made during a set reporting time period as described in the PAM.

(e) If the principal amortization schedule for the portfolio of SME Loans reflects tenors longer than five years, then all remaining amortizations beyond five years shall be cumulated into a five-year time deposit and then at the five-year maturity, the time deposits shall be rolled over into new time deposits, using the same method described herein and detailed in the PAM, to cover the remaining portfolio amortization schedule through the final maturity of the portfolio of SME Loans.

(f) CGFM shall ensure that, at any time, the overall deposit level of Time Deposits placed with a PFI shall not be greater than the cumulative level of guarantees issued by CGFM to that PFI eligible for SME Loans that have been issued newly created guarantee products approved by ADB.

(g) CGFM shall ensure that the total Time Deposits shall be funded at an agreed ratio of 90% funded by the Loan and 10% funded by CGFM funds and the co-funding from CGFM for the Time Deposits shall be placed in PFIs at the same terms, rates and conditions as the time deposits funded by the Loan.

(h) CGFM shall ensure that after the maturity of each Time Deposit, the funds shall be immediately deposited in the Escrow Account. Any interest earned on the Time Deposits and Escrow Account shall be retained by CGFM.

Section 2.02. (a) CGFM shall promptly and effectively exercise its rights under each Time Deposit Agreement and, whenever legally permissible, under each SME Loan Agreement in accordance with the prudent standards and in such manner as to protect the interests of CGFM and ADB and to accomplish the purposes of the Loan.

(b) No rights or obligations under a Time Deposit Agreement shall be assigned, amended, abrogated or waived nor any modifications or changes to a Time Deposit Agreement shall be made or otherwise agreed to by CGFM without prior consent of ADB and MOF.

ARTICLE III

SME Loans

Section 3.01. (a) CGFM shall ensure that the proceeds of the Loan provided for the Time Deposits shall be used only for making SME Loans to Qualified SME Borrowers for Qualified SME Subprojects and shall be applied exclusively to the cost of Goods and Works and other items of expenditure required to carry out such Qualified SME Subprojects.

(b) Except as ADB may otherwise agree, all Goods and Works shall be procured in accordance with the provisions of Schedule 4 to the Loan Agreement.

Section 3.02. CGFM shall cause each PFI to ensure that:

- (a) each SME Loan (i) is used by a Qualified SME Borrower for a Qualified Subproject, (ii) is denominated in MNT, (iii) has a market-based interest rate, and (iv) at least partially guaranteed by a new guarantee product issued by CGFM;
- (b) each PFI bears the unguaranteed credit risk associated with each SME Loan made by it to a Qualified SME Borrower; and
- (c) each PFI shall independently determine the creditworthiness of each Qualified SME Borrower and the terms and conditions of the related SME Loan, subject to subparagraph 3.02(a) above.

Section 3.03. The Borrower shall cause CGFM to ensure that only up to 15% of the total gross amount provided to CGFM under the Subsidiary Loan Agreement shall be used for SME Loans with repayment period less than five years at any time.

Section 3.04. Without limiting the generality of the foregoing provisions of Section 3.02 of this Project Agreement and in addition to any other provisions which a prudent lender would request, each SME Loan Agreement shall include provisions to the effect that:

- (a) the Qualified SME Borrower shall carry out and operate the Qualified SME Subproject with due diligence and efficiency and in accordance with sound applicable technical, financial, business and development practices, including maintenance of adequate accounts and records;
- (b) the Goods and Works shall be used exclusively in the carrying out of the Qualified SME Subproject;
- (c) ADB, CGFM and each PFI shall each have the right to inspect such Goods and Works, the Qualified SME Borrower, the Qualified SME Subproject and any relevant records and documents;
- (d) the Qualified SME Borrower shall take out and maintain with responsible insurers insurance against such risks and in such amounts

as shall be consistent with sound business practice, and without any limitation upon the foregoing, such insurance shall cover hazards incident to the acquisition, transportation and delivery of Goods to the place of use or installation, and for such insurance any indemnity shall be payable in a currency freely usable to replace or repair such Goods;

- (e) ADB, CGFM and each PFI shall each be entitled to obtain all such information as each shall reasonably request relating to the SME Loan, the Goods and Works, the Qualified SME Subproject, the Qualified SME Borrower and other related matters; and
- (f) CGFM and each PFI shall be entitled to suspend or terminate further access by the Qualified SME Borrower to the use of the proceeds of the Loan upon failure by the Qualified SME Borrower to perform its obligations under its agreement with the relevant PFI.

Section 3.05. CGFM shall, and shall cause each PFI to promptly and effectively exercise its rights in relation to each Qualified SME Subproject in accordance with the standards of a prudent lender and in such manner as to protect the interests of the Borrower, CGFM, each PFI and ADB.

ARTICLE IV

Particular Covenants

Section 4.01. (a) CGFM shall and shall cause each PFI to carry out the Project with due diligence and efficiency and in conformity with sound applicable technical, financial, business and development practices.

(b) In the carrying out of the Project and in the conduct of its business, CGFM shall perform all the obligations set forth in the Loan Agreement and all obligations set forth in the Schedule to this Project Agreement.

Section 4.02. CGFM shall ensure that each PFI shall not make a SME Loan to any Qualified SME Borrower unless such Qualified SME Borrower has at its disposal, or has made appropriate arrangements to obtain as and when required, all local currency funds, including adequate working capital, and other resources which are required by such Qualified SME Borrower for the carrying out of its Qualified SME Subproject in respect of which the SME Loan is to be made.

Section 4.03. CGFM shall and shall cause each PFI to maintain records and accounts adequate to record the progress of the Project and of each Qualified SME Subproject (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, the operations and financial condition of CGFM and each PFI.

Section 4.04. (a) ADB and CGFM shall cooperate fully to ensure that the purposes of the Loan will be accomplished.

(b) CGFM shall promptly inform ADB of any condition which interferes with, or threatens to interfere with, the progress of the Project, the performance of its obligations under this Project Agreement, or the accomplishment of the purposes of the Loan.

(c) ADB and CGFM shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters relating to the Project, CGFM, PFIs and the Loan.

Section 4.05. (a) CGFM shall and shall cause each PFI to furnish to ADB all such reports and information as ADB shall reasonably request concerning (i) the Loan and the expenditure of the proceeds thereof; (ii) the Project; (iii) the Qualified SME Borrower, the Qualified SME Subprojects and the SME Loans; (iv) the administration, operations and financial condition of CGFM and PFIs and (v) any other matters relating to the purposes of the Loan.

(b) Without limiting the generality of the foregoing, CGFM shall and shall cause each PFI to furnish to ADB periodic reports on the execution of the Project and on the operation and management of CGFM and PFIs. Such reports shall be submitted in such form and in such detail and within such a period as ADB shall reasonably request, and shall indicate, among other things, progress made and problems encountered during the period under review, steps taken or proposed to be taken to remedy these problems, and proposed program of activities and expected progress during the following period.

(c) Promptly after the Loan Closing Date, but in any event not later than 3 months after the said closing date or such later date as ADB may agree for this purpose, CGFM shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the utilization of the Loan, the execution of the Qualified SME Subprojects, their costs, the performance by CGFM of its obligations under this Project Agreement and the accomplishment of the purposes of the Loan.

Section 4.06. (a) CGFM shall (i) maintain separate accounts and records for the Project; (ii) prepare an annual consolidated Statement of Utilization of Funds for the Project in accordance with accounting principles acceptable to ADB; (iii) have such consolidated Statement of Utilization of Funds audited annually 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; (iv) as part of each such audit, have the auditors prepare a report (which includes the auditors' opinion on the Statement of Utilization of Funds, use of the Loan proceeds and compliance with the financial covenants of the Loan Agreement and this Project Agreement as well as on the use of the procedures for the imprest fund, the Subaccount and statement of expenditures) and a management letter (which sets out the deficiencies in the internal control of the Project that were identified in the course of the audit, if any); and (v) furnish to the Borrower to be provided to ADB, no later than 6 months after the end of each fiscal year to which they relate, copies of such audited Statement of Utilization of Funds, audit report and management letter, all in the English language, and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.

(b) ADB shall disclose the annual audited consolidated Statement of Utilization of Funds and the opinion of the auditors thereto within 30 days of the date of their receipt by posting them on ADB's website.

(c) In addition to the annual audited Statement of Utilization of Funds referred to in subsection (a) hereinabove, CGFM shall (i) provide its annual consolidated financial statements prepared in accordance with International Financial Reporting Standard which shall be supported by a statement of Time Deposits to be reconciled and confirmed by auditors against the audited Statement Utilization of Funds of the PFIs, as further described in the PAM; (ii) have its consolidated financial statements audited annually 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; and (iii) furnish to ADB, through the Borrower, no later than 1 month after approval by the relevant authority, copies of such audited financial statements in English language and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.

Section 4.07. CGFM shall enable ADB's representatives to discuss the Statement of Utilization of Fund and the consolidated and unconsolidated financial statements of CGFM and its financial affairs where they relate to the Project with the auditors appointed by CGFM pursuant to Section 4.06(a)(iii) hereinabove, and shall authorize and require any representatives of such auditors to participate in any such discussion requested by ADB. This is provided that such discussions shall be conducted in the presence of an authorized officer of CGFM, unless CGFM shall otherwise agree.

Section 4.08. CGFM shall enable ADB's representatives to inspect any Qualified SME Borrower, any Qualified SME Subproject, the Goods and Works, and any relevant records and documents.

Section 4.09. (a) CGMF shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations, and to acquire, maintain and renew all rights, properties, powers, privileges and franchises which are necessary in the carrying out of the Project or in the conduct of its business.

(b) CGFM shall at all times conduct its business in accordance with sound applicable technical, financial, and business practices, and under the supervision of competent and experienced management and personnel.

(c) Except as ADB may otherwise agree, CGFM shall not sell, lease or otherwise dispose of any of its assets which shall be required for the efficient carrying on of its operations or the disposal of which may prejudice its ability to perform satisfactorily any of its obligations under this Project Agreement.

Section 4.10. Except as ADB may otherwise agree, CGFM shall duly perform all its obligation under the Subsidiary Loan Agreement and shall not take, or concur in, any action which would have the effect of assigning, amending, abrogating or waiving any rights or obligations of the parties under the Subsidiary Loan Agreement.

Section 4.11. CGFM shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of its constitutional documents, which, if implemented, could adversely affect the carrying out of the Project. CGFM shall afford ADB

an adequate opportunity to comment on such proposal prior to taking any affirmative action thereon.

ARTICLE V

Effective Date; Termination

Section 5.01. This Project Agreement shall come into force and effect on the date on which the Loan Agreement comes into force and effect. ADB shall promptly notify CGFM of such date.

Section 5.02. This Project Agreement and all obligations of the parties hereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms.

Section 5.03. All the provisions of this Project Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the Loan Agreement.

ARTICLE VI

Miscellaneous

Section 6.01. Any notice or request required or permitted to be given or made under this Project Agreement and any agreement between the parties contemplated by this Project Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand, mail or facsimile to the party to which it is required or permitted to be given or made at its address hereinafter specified, or at such other address as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For ADB

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

Facsimile Numbers:

(632) 636-2444
(632) 636-2494.

For CGFM

Room 301, Orange Plaza
5-th Khoroo
Chingeltei District
Ulaanbaatar
Mongolia

Facsimile Number:

976-70110058.

Section 6.02. (a) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Project Agreement by or on behalf of CGFM may be taken or executed by its Executive Director or by such other person or persons as he shall so designate in writing notified to ADB.

(b) CGFM shall furnish to ADB sufficient evidence of the authority of each person who will act under subsection (a) hereinabove, together with the authenticated specimen signature of each such person.


Section 6.03. No delay in exercising, or omission to exercise, any right, power or remedy accruing to either party under this Project Agreement upon any default shall impair any such right, power or remedy or be construed to be a waiver thereof or an acquiescence in such default; nor shall the action of such party in respect of any default, or any acquiescence in any default, affect or impair any right, power or remedy of such party in respect of any other or subsequent default.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Project 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.

ASIAN DEVELOPMENT BANK

By 
ROBERT SCHOELLHAMMER
Country Director
Mongolia Resident Mission

CREDIT GUARANTEE FUND OF
MONGOLIA

By 
P. CHANDMANI
Authorized Representative

7. March. 2016.

SCHEDULE

Execution of Project; Financial Matters

Implementation Arrangements

1. CGFM shall ensure that the Project is implemented in accordance with the detailed arrangements set forth in the PAM. Any subsequent change to the PAM shall become effective only after approval of such change by the Borrower and ADB. In the event of any discrepancy between the PAM and this Project Agreement, the provisions of this Project Agreement shall prevail.

Eligibility Criteria for CGFM

2. CGFM shall ensure that the following conditions are met at all times during the Project:

- (a) satisfactory annual results from an independent external audit of the financial condition of CGFM, as determined by ADB;
- (b) the ratio of the outstanding balance of subloans to which any guarantees have been issued by CGFM that are 90 days or more past due in proportion to the total outstanding balance of the subloans to which any guarantees have been issued shall not exceed 8%;
- (c) CGFM maintains appropriate financial soundness at all times as evidenced by adequate capital, asset quality, liquidity and profitability, and maintenance of financial ratios at levels acceptable to ADB including a current assets to current liabilities ratio of 1.2 times;
- (d) CGFM maintains adequate credit guarantee and risk management policies, operating systems and procedures;
- (e) CGFM maintains compliance with prudential regulations, including exposure limits, maximum leverage of credit guarantees issuance of no more than 20 times and an adequate credit risk loss covering 100% of expected claims;
- (f) CGFM maintains acceptable corporate and financial governance and management practices including, among other things, transparent financial and operational disclosure policies and practices;
- (g) CGFM maintains sound business objectives and strategy and/or plans;
- (h) CGFM maintains autonomy in guarantee issuance and pricing decisions and assesses guarantee requested by PFIs individually;
- (i) CGFM maintains composition of the board and credit guarantee committee consistent with best practice international standards;

- (j) CGFM shall only accept new capital if its use is unrestricted and shall only acquire external credit guarantee portfolios if the new net composite risk shall not materially impact the financial soundness of CGFM or impair its capacity to meet its financial covenants and conditions of the Subsidiary Loan Agreement; and
- (k) CGFM maintains adequate policies, systems and procedures to assess and monitor the economic, social, and environmental impact of subprojects in accordance with parameters established by ADB for the purposes of the Project.

Eligibility Criteria for PFIs

3. CGFM shall ensure that each PFI shall comply with the following eligibility criteria at selection.

- (a) be in satisfactory operation for at least the last 5 years as determined by ADB;
- (b) have at least 5 years of experience in SME or microcredit lending as determined by documentation submitted by the PFI;
- (c) demonstrate a track record of running a successful SME program, as determined by ADB;
- (d) have corporate, financial and governance practices acceptable to ADB;
- (e) have adequate credit and risk management policies and operating systems acceptable to ADB;
- (f) have a satisfactory and transparent accounting, management information system and internal audit system as determined by ADB;
- (g) have satisfied ADB's integrity, anti-money laundering and counter-financing of terrorism due diligence requirements and put in place anti-money laundering and counter-financing of terrorism controls and measures to implement such controls, in each case acceptable to ADB;
- (h) have established ESMS acceptable to ADB and appointed a qualified staff to implement the ESMS for screening prospective Qualified SME Subprojects in accordance with the SPS and the requirements set forth in the PAM to the satisfaction of ADB; and
- (i) have obtained relevant approvals for newly created guarantee products from CGFM for SME Loans to be provided to Qualified SME Borrowers for Qualified SME Subprojects and signed the relevant master guarantee agreement, approved by ADB.

4. CGFM shall ensure that each PFI shall comply with the following eligibility criteria at all times (including at selection):

- (a) comply fully with capital adequacy ratios and all other prudential requirements mandated by the agency responsible for banking and financial supervision in Mongolia (currently the Bank of Mongolia), as evidenced by the most recent annual audited financial statements, interim financial statements, public reports or reports issued by the banking and financial supervision in Mongolia, provided that if the requirements set forth in this paragraph 4 imposes more stringent requirements, such more stringent requirements shall apply;
- (b) have a ratio of non-performing loans (NPLs) less than 8% of the total loan portfolio (for the purposes of the foregoing, NPLs means loans overdue by 90 days or more), as evidenced by its most recent annual audited financial statement and interim financial statements (in case of quarterly reporting evidenced by interim financial statements, a certification must also be provided by a PFI to CGFM certifying compliance with this eligibility criteria);
- (c) be profitable for its most recently completed fiscal year (for the purposes of the foregoing, profitability refers to operating profit after tax), as evidenced by the most recent annual audited financial statements; and
- (d) have its financial accounts audited by an external auditor annually and the results are satisfactory as determined by ADB, as evidenced by the most recent annual audited financial statements.

Nevertheless, a PFI that does not meet the eligibility criteria provided in paragraph 3 (a), (b), (c), (d), (e), and/or (f) and paragraph 4 (a), (b), (c) and/or (d), may still participate if it agrees to implement measures to achieve full compliance with all of the eligibility criteria within 12 months of signing the relevant master guarantee agreement with CGFM. For the avoidance of doubt, if a PFI does not come into full compliance with all of the PFI eligibility criteria provided in paragraphs 3 and 4 above within 12 months of signing the relevant master guarantee agreement with CGFM, it shall not be permitted to participate under the Project and CGFM shall promptly notify ADB and exercise its rights under the relevant agreements in consultation with ADB.

Monitoring of Eligibility Criteria of PFIs

5. CGFM shall monitor each PFI's compliance with the eligibility criteria set out in paragraph 4 above and (i) for eligibility criteria provided in paragraph 4 (a) and (b), submit quarterly reports to ADB on the status of compliance and (ii) for eligibility criteria provided in paragraph 4 (c) and (d), submit annual reports to ADB on the status of compliance. Upon becoming aware of any non-compliance by any PFI of any of the eligibility criteria set out in paragraph 4 above, the CGFM shall promptly notify ADB and exercise its rights under the relevant agreements in consultation with ADB.

Reporting Requirements

6. CGFM shall provide to ADB, on a quarterly basis, Statement of Utilization of Funds provided by relevant PFIs to show that the Loan is used for the purposes of the Project, including a detailed list of SME Loans issued by each PFI with breakdown by Loan funds used and CGFM funds used and amount of guarantees received by each PFI for eligible subloans.

7. Throughout implementation of the Project, CGFM shall ensure that each PFI provides clear, timely and sufficient information on the performance of the SME Loans as requested by CGFM or ADB.

Change of Control of PFIs

5. CGFM shall ensure that it shall be a termination event under each Time Deposit Agreement if any change in control (as such term shall be defined in the applicable Time Deposit Agreement) of the relevant PFI will, in CGFM's sole discretion, either (a) have a material adverse effect on such PFI's operations or financial performance, or (b) entail a change in such PFI's business strategy not conducive to achieving the objectives of this Project. CGFM shall promptly notify ADB of the occurrence of any change in control of such PFI and, if requested by ADB, CGFM shall promptly exercise its rights under the applicable Time Deposit Agreement in respect of such change in control.

Calculation of Time Deposits for Placement with PFIs

7. CGFM shall ensure that the CGFM PIU has established a process and documentation to calculate the appropriate level of time deposits to be placed in PFIs and the tenor of those time deposits that is acceptable to ADB, which shall conform to the methodology set out in the PAM.

Eligibility Criteria for Qualified SME Borrower

8. CGFM shall and shall cause each PFI to ensure that each Qualified SME Borrower:

- (a) is a small and/or medium-sized enterprise according to the definition stipulated in the Law on SMEs of Mongolia;
- (b) is not engaged in any prohibited investment activities listed in the attachment to this Schedule 5 and Schedule and the list of prohibited investment activities in Appendix 5 of the SPS, to the extent not duplicative or included in the list of prohibited investment activities list attached hereto;
- (b) is in compliance with the applicable laws and regulations of Mongolia; and
- (c) meets appropriate credit and other risk related criteria as determined and applied by the PFI and CGFM.

Eligibility Criteria for Qualified SME Subproject

9. CGFM shall cause each PFI to ensure that no Qualified SME Subproject, for which the PFI provides a SME Loan to a Qualified SME Borrower, shall:

- (a) involve any involuntary resettlement or indigenous peoples impacts, all within the meaning of SPS (no Qualified SME Subproject treated as category A or B for involuntary resettlement or indigenous peoples permitted);
- (b) involve any significant environmental impacts, all within the meaning of SPS (no Qualified SME Subproject treated as category A for environment permitted);
- (c) involve any activity included in the list of prohibited investment activities attached to this Schedule and the list of prohibited investment activities in Appendix 5 of the SPS, to the extent not duplicative or included in the list of prohibited investment activities list attached hereto; and
- (d) involve activities that are not in compliance with the applicable laws and regulation of Mongolia.

10. Without limiting subparagraph 10(a) of this Schedule:

- (a) in the event that any subproject that has been assessed as a Qualified SME Subproject does have an impact of the type described in subparagraph 10(a) of this Schedule, CGFM shall cause the applicable PFI to promptly notify ADB and ensure that all steps are taken to ensure that the Qualified SME Subproject complies with the applicable laws and regulations of the Borrower and with the SPS; and
- (b) CGFM shall cause each PFI to ensure that in respect of any proposed Qualified SME Subproject that involves the acquisition or transfer of any interest in land, such acquisition or transfer is between willing parties and not under eminent domain.

Grievance Redress Mechanism for Qualified SME Subprojects

11. Prior to the first SME Loan guarantee, CGFM shall establish a grievance redress mechanism to deal with complaints about each Qualified SME Subproject's environmental and social concerns in accordance with the provisions ESMS (the "GRM"), as further described in the PAM.

12. CGFM shall ensure that each PFI includes in the relevant SME Loan Agreement a requirement that each Qualified SME Borrower shall refer affected people's concerns, complaints and grievances about each Qualified SME Subproject's environmental and social concerns to the PFI or the public complaints unit under the GRM and implement any redress solution, as further described in the PAM.

Qualified SME Subprojects (Screening, Categorization, and Environmental and Social Assessment and Planning)

13. CGFM shall cause each PFI to ensure that before any proposed subproject is approved to be a Qualified SME Subproject for financing:
- (a) each PFI has appointed adequate number of qualified staff for the Project implementation particularly for financial management, reporting and evaluation;
 - (b) each PFI has established an ESMS acceptable to ADB and appointed qualified staff to implement the ESMS for screening prospective Qualified SME Subprojects in accordance with the SPS and the requirements set forth in the PAM to the satisfaction of ADB;
 - (c) the ESMS is used to screen and categorize the significance of potential environmental, indigenous peoples or involuntary settlement impacts associated with such subproject; and
 - (d) an EMP is prepared for the proposed subprojects as required pursuant to the ESMS.

Anti-Money Laundering and Counter-Terrorism

14. Before any proposed subproject is approved to be a Qualified SME Subproject for financing, CGFM shall cause each PFI to establish anti-money laundering and counter-financing of terrorism controls and measures to implement such controls, in each case acceptable to ADB.

Environment

15. CGFM shall cause each PFI to ensure that the preparation, design, construction, implementation, operation and decommissioning of each Qualified SME Subproject comply with (a) all applicable laws and regulations of the Borrower relating to environment, health and safety; (b) the ESMS; and (c) all measures and requirements set forth in the respective EMP, and any corrective or preventative actions set forth in a Safeguards Monitoring Report.

Safeguards Monitoring Report

16. CGFM shall cause each PFI to do the following:
- (a) submit semi-annual Safeguards Monitoring Reports to CGFM for compilation and timely submission by CGFM to the Borrower and annually to ADB;
 - (b) if any unanticipated environmental and/or social risks and impacts arise during any Qualified SME Subproject implementation, promptly inform the Borrower, CGFM and ADB of the occurrence of such risks or impacts, with detailed description of the event and proposed corrective plan; and

- (c) report to the Borrower, CGFM and ADB any actual or potential breach of compliance with the measures and requirements set forth in the EMP, promptly after becoming aware of the breach.

Labor Standards

17. CGFM shall cause each PFI to ensure that the core labor standards (as set out in the relevant conventions of the International Labor Organization) and the Borrower's applicable laws and regulations, including workplace occupational safety requirements, are complied with during implementation of the Qualified SME Subprojects.

Gender and Development

18. CGFM shall cause each PFI to ensure that the principles of gender equity aimed at increasing benefits and impacts on women in the Qualified SME Subproject areas consistent with ADB's Policy on Gender and Development (1998) are followed during implementation of the Qualified SME Subprojects, including (a) equal pay to men and women for work of equal value; (b) enabling working conditions for women workers; and (c) taking necessary actions to encourage women living in the Qualified SME Subproject areas to participate in the design and implementation of Qualified SME Subproject activities.

Governance and Anticorruption

19. CGFM shall and shall cause each PFI 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 Project, including any Qualified SME Subprojects; and (b) cooperate with any such investigation and extend all necessary assistance for satisfactory completion of such investigation.

20. CGFM shall and shall cause each PFI to ensure that anticorruption provisions acceptable to ADB are included in all bidding documents and contracts, including provisions specifying the right of ADB to audit and examine the records and accounts of the contractors, suppliers, consultants, and other service providers as they relate to the Project, including any Qualified SME Subprojects.

Combating Money Laundering and Financing of Terrorism

21. CGFM shall and shall cause each PFI to:
- (a) comply with applicable laws and regulations of the Borrower on combating money laundering and financing of terrorism and that Loan proceeds are not used, directly or indirectly, in money laundering or financing of terrorism;
 - (b) formulate and implement internal control procedures, including customer due diligence procedures, to prevent violation of subparagraph (a) hereinabove; and

- (c) promptly inform the Borrower and ADB if there is any violation or potential violation of subparagraph (a) hereinabove. In the event that ADB informs CGFM and/or a PFI of its concern that there has been such an alleged violation, CGFM and/or a PFI shall: (i) cooperate in good faith with ADB and its representatives so that ADB can determine whether such a violation has occurred; (ii) respond promptly and in reasonable detail to any query from ADB; and (iii) furnish documentary support for such response upon ADB's request.

Prohibited List of Investments

22. CGFM shall cause each PFI to ensure that no proceeds of the Loan are used to finance any activity included in the list of prohibited investment activities attached hereto and the list of prohibited investment activities in Appendix 5 of the SPS, to the extent not duplicative or included in the list of prohibited investment activities list attached hereto.

Restrictions on Distribution of Excess Funds by CGFM

23. CGFM shall ensure that no distribution of excess operating revenues net of expenses or equity shall be made to any founder or member of CGFM shall be made unless:

- (a) the co-funding ratio between ADB and CGFM can be met for the remaining life of the Loan (which requires that the total Time Deposits shall be funded at an agreed ratio of 90% funded by the Loan and 10% funded by CGFM funds);
- (b) the level of non-performing loans ("NPLs") remains below 3% of the total loan guarantee portfolio (for the purposes of the foregoing, NPLs means loans overdue by 90 days or more);
- (c) the maximum leverage of credit guarantee issued by CGFM does not exceed 10x;
- (d) expected claims on credit guarantee issuance remains covered at 100%;
- (e) CGFM has surplus during the prior fiscal year and is anticipated to have surplus in the next fiscal year (surplus refers to operating revenue minus expenses and any tax); and
- (f) CGFM will remain in sound financial condition capable to meet the terms and conditions of the Subsidiary Loan Agreement.

Counterpart Support

24. CGFM shall ensure that the necessary capital or funds are available to meet regulatory requirements and the Subsidiary Loan Agreement.

PROHIBITED INVESTMENT ACTIVITIES LIST

- (a) production or activities involving harmful or exploitative forms of forced labor¹ or child labor;²
- (b) production of or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements or subject to international phase-outs or bans, such as (a) pharmaceuticals,³ pesticides, and herbicides,⁴ (b) ozone-depleting substances,⁵ (c) polychlorinated biphenyls⁶ and other hazardous chemicals,⁷ (d) wildlife or wildlife products regulated under the Convention on International Trade in Endangered Species of Wild Fauna and Flora,⁸ and (e) transboundary trade in waste or waste products;⁹
- (c) production of or trade in weapons and munitions, including paramilitary materials;
- (d) production of or trade in alcoholic beverages, excluding beer and wine;¹⁰
- (e) production of or trade in tobacco;¹⁰
- (f) gambling, casinos, and equivalent enterprises;¹⁰
- (g) production of or trade in radioactive materials,¹¹ including nuclear reactors and components thereof;
- (h) production of, trade in, or use of unbonded asbestos fibers;¹²
- (i) commercial logging operations or the purchase of logging equipment for use in primary tropical moist forests or old-growth forests;
- (j) marine and coastal fishing practices, such as large-scale pelagic drift net fishing and fine mesh net fishing, harmful to vulnerable and protected species in large numbers and damaging to marine biodiversity and habitats;
- (k) real estate investment, if non-owner occupied, or property acquisition;

¹ Forced labor means all work or services not voluntarily performed, that is, extracted from individuals under threat of force or penalty.

² Child labor means the employment of children whose age is below the host country's statutory minimum age of employment or employment of children in contravention of International Labor Organization Convention No. 138 "Minimum Age Convention" (www.ilo.org).

³ A list of pharmaceutical products subject to phase-outs or bans is available at <http://www.who.int>.

⁴ A list of pesticides and herbicides subject to phase-outs or bans is available at <http://www.pic.int>.

⁵ A list of the chemical compounds that react with and deplete stratospheric ozone resulting in the widely publicized ozone holes is listed in the Montreal Protocol, together with target reduction and phase-out dates. Information is available at <http://www.unep.org/ozone/montreal.shtml>.

⁶ A group of highly toxic chemicals, polychlorinated biphenyls are likely to be found in oil-filled electrical transformers, capacitors, and switchgear dating from 1950 to 1985.

⁷ A list of hazardous chemicals is available at <http://www.pic.int>.

⁸ A list is available at <http://www.cites.org>.

⁹ As defined by the Basel Convention; see <http://www.basel.int>.

¹⁰ This does not apply to project sponsors who are not substantially involved in these activities. Not substantially involved means that the activity concerned is ancillary to a project sponsor's primary operations.

¹¹ This does not apply to the purchase of medical equipment, quality control (measurement) equipment, and any equipment for which ADB considers the radioactive source to be trivial and adequately shielded.

¹² This does not apply to the purchase and use of bonded asbestos cement sheeting where the asbestos content is less than 20%.

- (l) commercial real estate construction unless SME owner-occupied
- (m) heavy construction material-related sectors;
- (n) multi-family housing construction;
- (o) all mining, mineral processing and extraction activities;
- (p) businesses involved with oil or energy import;
- (q) businesses involved primarily with the import of luxury items;
- (r) SMEs that are subsidiaries of or controlled by large enterprises;
- (s) wastewater treatment activities; and
- (t) water supply activities.