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DOCUMENTS**

CREDIT NUMBER 5701-NP

Financing Agreement

(Post Disaster Second Financial Sector Stability Development Policy Financing)

between

NEPAL

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated AUGUST 14, 2015

FINANCING AGREEMENT

AGREEMENT dated **AUGUST 14**, 2015, entered into between NEPAL ("Recipient") and INTERNATIONAL DEVELOPMENT ASSOCIATION ("Association") for the purpose of providing financing in support of the Program (as defined in the Appendix to this Agreement). The Association has decided to provide this financing on the basis, *inter alia*: of (a) the actions which the Recipient has already taken under the Program and which are described in Section I.A of Schedule 1 to this Agreement, and (b) the Recipient's maintenance of an adequate macroeconomic policy framework. The Recipient and the Association therefore hereby agree as follows:

ARTICLE I — GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II — FINANCING

- 2.01. The Association agrees to extend to the Recipient, on the terms and conditions set forth or referred to in this Agreement, a credit in an amount equivalent to seventy two million Special Drawing Rights (SDR 72,000,000) (variously, "Credit" and "Financing").
- 2.02. The Recipient may withdraw the proceeds of the Financing in support of the Program in accordance with Section II of Schedule 1 to this Agreement.
- 2.03. The Maximum Commitment Charge Rate payable by the Recipient on the Unwithdrawn Financing Balance shall be one-half of one percent (1/2 of 1%) per annum.
- 2.04. The Service Charge payable by the Recipient on the Withdrawn Credit Balance shall be equal to three-fourths of one percent (3/4 of 1%) per annum.
- 2.05. The Payment Dates are June 15 and December 15 in each year.
- 2.06. The principal amount of the Credit shall be repaid in accordance with the repayment schedule set forth in Schedule 2 to this Agreement.

- 2.07. The Payment Currency is Dollar.

ARTICLE III — PROGRAM

- 3.01. The Recipient declares its commitment to the Program and its implementation. To this end:
- (a) the Recipient and the Association shall from time to time, at the request of either party, exchange views on the Recipient's macroeconomic policy framework and the progress achieved in carrying out the Program;
 - (b) prior to each such exchange of views, the Recipient shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request; and
 - (c) without limitation upon the provisions of paragraphs (a) and (b) of this Section, the Recipient shall promptly inform the Association of any situation that would have the effect of materially reversing the objectives of the Program or any action taken under the Program including any action specified in Section I of Schedule 1 to this Agreement.

ARTICLE IV — REMEDIES OF THE ASSOCIATION

- 4.01. The Additional Event of Suspension consists of the following: that a situation has arisen which shall make it improbable that the Program, or a significant part of it, will be carried out.

ARTICLE V — EFFECTIVENESS; TERMINATION

- 5.01. The Additional Condition of Effectiveness consists of the following: that the Association is satisfied with the progress achieved by the Recipient in carrying out the Program and with the adequacy of the Recipient's macroeconomic policy framework.
- 5.02. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

ARTICLE VI — REPRESENTATIVE; ADDRESSES

6.01. The Recipient's Representative is the Secretary, Ministry of Finance of the Recipient.

6.02. The Recipient's Address is:

Ministry of Finance
Government of Nepal
Singha Durbar
Kathmandu
Nepal

Facsimile:

(977-1) 4211-164

6.03. The Association's Address is:

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)

1-202-477-6391

AGREED at Kathmandu, Nepal, as of the day and year first above written.

NEPAL

By




Authorized Representative

Name: Suman Prasad Sharma

Title: Finance Secretary

INTERNATIONAL DEVELOPMENT ASSOCIATION

By



Authorized Representative

Name: Johannes Zutt

Title: Country Director

SCHEDULE 1

Program Actions; Availability of Financing Proceeds

Section I. Actions Taken Under the Program

The actions taken by the Recipient under the Program include the following:

1. The Ministry of Finance has endorsed the Nepal Financial Sector Development Strategy.
2. The RBB has implemented the following actions in accordance with the second phase of its recapitalization plan: (a) the conversion of preference shares with a nominal value of NPR 787 million into common shares; (b) the conversion into capital of a dividend of preference shares in the amount of NPR 86.57 million; (c) the sale of non-banking assets of RBB for an amount equal to NPR 30.90 million; and (d) retained earnings in Fiscal Years 2012/13, 2013/14, and nine months of 2014/15 in the amount of NPR 7.21 billion.
3. NBL has taken measures to implement the second phase of NBL's recapitalization plan by: (a) converting a loan from the Recipient of NPR 2.49 billion into capital; (b) retaining earnings in Fiscal Years 2013/14 and six months of 2014/15 in the amount of NPR 1.10 billion; and (c) selling non-banking assets of NBL for an amount equal to NPR 708 million.
4. The decision to reduce the number of state-controlled commercial banks to one by divesting control of the NBL to a bank strategic investor has been announced by the Minister of Finance in the Budget Speech.
5. The NRB has completed the implementation of the first phase of a diagnostic of the banking system and has: (a) approved Special Inspection Reports for 27 financial institutions; and (b) approved Prompt Corrective Action Programs for all financial institutions found to be undercapitalized.
6. The NRB has issued a notice to licensed BFIs to conduct an assessment of the impact of the Earthquake on their assets (collateral and loans) and physical infrastructure.
7. The NRB continues its policy of consolidating the banking system by: (a) maintaining its moratorium on new licenses issuance for Classes A, B and C financial institutions as defined in BAFIA; and (b) adopting a new bylaw to facilitate acquisitions of BFIs by other BFIs.

8. The NRB has issued a notice requiring all NRB-authorized financial non-governmental organizations to convert to Class D microfinance institutions, as defined in BAFIA, by mid-July 2015.
9. The NRB Act Amendments Bill has been approved by Cabinet for submission to Parliament.
10. The Bill on the Deposit and Credit Guarantee Fund has been approved by Cabinet for submission to Parliament.
11. The board of NRB has approved the Nepal Payments System Development Strategy.
12. The NRB has issued a guideline governing the transition of BFIs to NFRS.
13. Steps have been taken to strengthen the governance of the banking system, including state-controlled banks, by: (a) the endorsement by the Ministry of Finance of the Bill on Banks and Financial Institutions for submission to Cabinet; and (b) the inclusion by NRB of adequate governance measures in the revised and reissued Directive No. 6/071 on Governance of BFIs.
14. The transparency and safety of the banking system has been strengthened by the enactment of the following key AML/CFT legislation: (i) the Mutual Legal Assistance Act; (ii) the Extradition Act; and (iii) the Prevention of Organized Crime Act.

Section II. Availability of Financing Proceeds

- A. General.** The Recipient may withdraw the proceeds of the Financing in accordance with the provisions of this Section and such additional instructions as the Association may specify by notice to the Recipient.
- B. Allocation of Financing Amounts.** The Financing is allocated in a single withdrawal tranche, from which the Recipient may make withdrawals of the Financing. The allocation of the amounts of the Financing to this end is set out in the table below:

Allocations	Amount of the Financing Allocated (expressed in SDR)
(1) Single Withdrawal Tranche	72,000,000
TOTAL AMOUNT	72,000,000

C. Withdrawal Tranche Release Conditions

1. No withdrawal shall be made of the Single Withdrawal Tranche unless the Association is satisfied (a) with the Program being carried out by the Recipient, and (b) with the adequacy of the Recipient's macroeconomic policy framework.

D. Deposits of Financing Amounts. Except as the Association may otherwise agree:

1. all withdrawals from the Financing Account shall be deposited by the Association into an account designated by the Recipient and acceptable to the Association; and
2. the Recipient shall ensure that upon each deposit of an amount of the Financing into this account, an equivalent amount is accounted for in the Recipient's budget management system, in a manner acceptable to the Association.

E. Excluded Expenditures. The Recipient undertakes that the proceeds of the Financing shall not be used to finance Excluded Expenditures. If the Association determines at any time that an amount of the Financing was used to make a payment for an Excluded Expenditure, the Recipient shall, promptly upon notice from the Association, refund an amount equal to the amount of such payment to the Association. Amounts refunded to the Association upon such request shall be cancelled.

F. Closing Date. The Closing Date is December 31, 2015.

SCHEDULE 2

Repayment Schedule

Date Payment Due	Principal Amount of the Credit repayable (expressed as a percentage)*
On each June 15 and December 15, commencing December 15, 2021 to and including June 15, 2053	1.5625%

* The percentages represent the percentage of the principal amount of the Credit to be repaid, except as the Association may otherwise specify pursuant to Section 3.03 (b) of the General Conditions.

APPENDIX

Section I. Definitions

1. “Accounting Standards Board” means the independent statutory body established in March 2003, with an amendment to the Institute of Chartered Accountants of Nepal Act, 1997, responsible for setting and issuing accounting standards for preparation and presentation of financials statements in the territory of the Recipient.
2. The acronym “AML/CTF” means anti-money laundering and counter-terrorism financing.
3. “BAFIA” means the Recipient’s Banks and Financial Institutions Act, 2063 (2006), as amended from time to time.
4. “BFIs” means banks and financial institutions.
5. “Bill on Banks and Financial Institutions” means the draft bill replacing the BAFIA and providing for strengthened fit and proper requirements for bank directors and executives, including all government-appointed directors and chief executive officers of state-controlled banks.
6. “Bill on the Deposit and Credit Guarantee Fund” means the draft bill providing for the establishment and operation of a deposit and credit guarantee fund for the protection of rights and interests of depositors and creditors.
7. “Budget Speech” means the speech delivered by the Minister of Finance of the Recipient to the Parliament on July 13, 2014, for Fiscal Year 2014/15.
8. “Directive No. 6/071 on Governance of BFIs” means the directive relating to good corporate governance of BFIs, which is part of the Unified Directives.
9. “Earthquake” means the earthquake which occurred on the Recipient’s territory on April 25, 2015, and its aftershocks, resulting in, among other things, devastating loss of life, livelihoods, social services, and infrastructure, impacting financial institutions’ physical and financial assets, and potentially impairing their solvency and liquidity.
10. “Excluded Expenditure” means any expenditure:
 - (a) for goods or services supplied under a contract which any national or international financing institution or agency other than the Association or

the Bank has financed or agreed to finance, or which the Association or the Bank has financed or agreed to finance under another credit, grant or loan;

- (b) for goods included in the following groups or sub-groups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Association by notice to the Recipient:

Group	Sub-group	Description of Item
112		Alcoholic beverages
121		Tobacco, un-manufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
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), non-irradiated, 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, non-monetary (excluding gold ores and concentrates)

- (c) for goods intended for a military or paramilitary purpose or for luxury consumption;
 - (d) for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Recipient or international agreements to which the Recipient is a party;
 - (e) on account of any payment prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
 - (f) with respect to which the Association determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the Recipient or other recipient of the Financing proceeds, without the Recipient (or other such recipient) having taken timely and appropriate action satisfactory to the Association to address such practices when they occur.
- 11. "Extradition Act" means the Recipient's Extradition Act, 2070 (2014).
 - 12. "Fiscal Year" means the fiscal year of the Recipient, RBB, and NBL beginning on Shrawan 1 in one calendar year and ending on Ashadh 31 in the following calendar year.
 - 13. "General Conditions" means the "International Development Association General Conditions for Credits and Grants", dated July 31, 2010 with the modifications set forth in Section II of this Appendix.
 - 14. "Mutual Legal Assistance Act" means the Recipient's Mutual Legal Assistance Act, 2070 (2014).
 - 15. "NBL" means the Recipient's Nepal Bank Limited, or any successor thereto.
 - 16. "Nepal Financial Sector Development Strategy" means the Recipient's comprehensive strategy to support the development of an inclusive, efficient, and stable financial sector.
 - 17. "Nepal Payments System Development Strategy" means the strategy adopted by NRB on July 3, 2014 for the development of the national payment system in the territory of the Recipient.

18. “NFRS” means Nepal Financial Reporting Standards, the reporting standards adopted by the Accounting Standards Board.
19. “NPR” means Nepalese Rupees, the currency of the Recipient.
20. “NRB” means the Recipient’s Nepal Rastra Bank, or any successor thereto.
21. “NRB Act” means the Recipient’s Nepal Rastra Bank Act, 2058 (2002) providing for the establishment of Nepal Rastra Bank to carry out the function of the Central Bank, as amended to the date hereof.
22. “NRB Act Amendments Bill” means the draft bill providing NRB with modernized tools for bank resolution.
23. “Prevention of Organized Crime Act” the Recipient’s Prevention of Organized Crime Act, 2070 (2014).
24. “Program” means the program of actions, objectives and policies designed to reduce the vulnerability of the Recipient’s financial sector and increase its transparency and resilience, set forth in the letter dated May 31, 2015, from the Recipient to the Association declaring the Recipient’s commitment to the execution of the Program, and requesting assistance from the Association in support of the Program during its execution.
25. “Prompt Corrective Action Programs” means the programs setting forth the prompt corrective actions, including resolution programs, set forth in Section 86 of the NRB Act.
26. “RBB” means the Recipient’s Rastriya Banijya Bank, or any successor thereto.
27. “Single Withdrawal Tranche” means the amount of the Financing allocated to the category entitled “Single Withdrawal Tranche” in the table set forth in Part B of Section II of Schedule 1 to this Agreement.
28. “Special Inspection Report” means a report prepared in accordance with Section 84 of the NRB Act and describing the process and outcome of the inspection and supervision undertaken by NRB of licensed BFIs.
29. “Unified Directives” means the document issued by NRB in July 2014, comprising of directives issued by NRB to licensed BFIs under the NRB Act, and including Directive no. 6/071.

Section II. Modifications to the General Conditions

The modifications to the General Conditions are as follows:

1. The last sentence of paragraph (a) of Section 2.03 (relating to Applications for Withdrawal) is deleted in its entirety.
2. Sections 2.04 (*Designated Accounts*) and 2.05 (*Eligible Expenditures*) are deleted in their entirety, and the subsequent Sections in Article II are renumbered accordingly.
3. Sections 4.01 (*Project Execution Generally*), and 4.09 (*Financial Management; Financial Statements; Audits*) are deleted in their entirety, and the remaining Sections in Article IV are renumbered accordingly.
4. Paragraph (a) of Section 4.05 (renumbered as such pursuant to paragraph 3 above and relating to *Use of Goods, Works and Services*) is deleted in its entirety.
5. Paragraph (c) of Section 4.06 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

“Section 4.06. *Plans; Documents; Records*

... (c) The Recipient shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Financing until two years after the Closing Date. The Recipient shall enable the Association’s representatives to examine such records.”

6. Paragraph (c) of Section 4.07 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

“Section 4.07. *Program Monitoring and Evaluation*

... (c) The Recipient shall prepare, or cause to be prepared, and furnish to the Association not later than six months after the Closing Date, a report of such scope and in such detail as the Association shall reasonably request, on the execution of the Program, the performance by the Recipient and the Association of their respective obligations under the Legal Agreements and the accomplishment of the purposes of the Financing.”

7. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:

- (a) The definition of the term “Eligible Expenditure” is modified to read as follows:

“‘Eligible Expenditure’ means any use to which the Financing is put in support of the Program, other than to finance expenditures excluded pursuant to the Financing Agreement.”

- (b) The term “Financial Statements” and its definition as set forth in the Appendix are deleted in their entirety.

- (c) The term “Project” is modified to read “Program” and its definition is modified to read as follows:

“‘Program’ means the program referred to in the Financing Agreement in support of which the Financing is made.” All references to “Project” throughout these General Conditions are deemed to be references to “Program”.