

GRANT AGREEMENT
(Special Operations)

(Private Sector and Financial Market Development Program)

between

ISLAMIC REPUBLIC OF AFGHANISTAN

and

ASIAN DEVELOPMENT BANK

DATED 14 March 2007

**GRANT AGREEMENT
(Special Operations)**

GRANT AGREEMENT dated 14 March 2007 between ISLAMIC REPUBLIC OF AFGHANISTAN (the "Recipient") and ASIAN DEVELOPMENT BANK ("ADB").

WHEREAS

(A) ADB has received from the Recipient a development policy letter dated 9 November 2006 (hereinafter called the Policy Letter), setting forth certain objectives, policies and actions, described in Schedule 1 to this Grant Agreement, designed to develop the Recipient's private sector (the "Program");

(B) the Recipient has applied to ADB for a grant from its Special Funds resources for the purposes of the Program;

(C) the Recipient has likewise applied to ADB for a grant for assisting the Government of the Islamic Republic of Afghanistan (hereinafter called the Government) in building its capacity to undertake reforms to promote the development of the private sector and the financial markets, and by a grant agreement of even date herewith (hereinafter called the Project Grant Agreement), ADB has agreed to give the Recipient a grant of four million dollars (\$4,000,000);

(D) ADB has, on the basis inter alia of the foregoing, agreed to provide a grant to the Recipient from ADB's Special Funds resources upon the terms and conditions hereinafter set forth;

NOW THEREFORE the parties agree as follows:

ARTICLE I

Grant Regulations; Definitions

Section 1.01. All the provisions of the Special Operations Grant Regulations of ADB, dated 7 February 2005 (the "Grant Regulations"), are hereby made applicable to this Grant Agreement with the same force and effect as if they were fully set forth herein, subject, however, to the following modifications:

(a) Section 2.01(15) is deleted and the following is substituted therefore:

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

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

(c) Section 2.01(17) is deleted and the following is substituted therefore:

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

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

(e) Section 5.01(a) is deleted and the following is substituted therefore:

(a) Subject to any conditions or restrictions specified in the Grant Agreement, the Recipient shall be entitled to withdraw from the Grant Account such amounts as shall be required to meet payments for expenditures required for the Program and to be financed under the Grant Agreement.

Section 1.02. The terms defined in the Grant Regulations are incorporated into this Grant Agreement, unless the context requires otherwise. In addition, the following terms have the following meanings:

(a) "Afghani" means afghani, the lawful currency of the Recipient.

(b) "Counterpart Funds" means the Afghani accruing to the Recipient and generated from the Grant proceeds under the Program, and referred to in paragraph 7 of Schedule 4 to this Grant Agreement;

(c) "DAB" means Da Afghanistan Bank, the Recipient's central bank, or any successor thereto;

(d) "Eligible Items" means the goods imported under the Program (except those specifically excluded pursuant to Attachment 1 to Schedule 2 to this Grant Agreement), the foreign exchange costs of which are eligible for financing out of the proceeds of the Grant;

(e) "First Tranche" means the portion of the proceeds of the Grant in an amount not exceeding the equivalent of twenty eight million dollars (\$28,000,000) to be initially withdrawn and utilized;

(f) "MOC" means the Ministry of Commerce of the Recipient, or any successor thereto;

(g) "MOF" means the Ministry of Finance of the Recipient, or any successor thereto;

(h) "Policy Letter" has the meaning specified in Recital A hereto;

(i) "Policy Matrix" means the policy matrix agreed between the Recipient and ADB which sets forth the actions to be taken by the Recipient under the Program;

(j) "Program Executing Agency" means, for the purposes and within the meaning of the Grant Regulations, MOF, which is responsible for the carrying out of the Program;

(k) "Program Implementing Agency" means MOF, DAB, or MOC, as applicable;

(l) "Program Period" means the period commencing on the Effective Date and ending on 31 December 2009 or such other date as may from time to time be agreed between the Recipient and ADB;

(m) "Public Interest Entities" means the entities that are of significant public interest because of their business, size, number of employees, or corporate status such that they have a wide range of stakeholders; and

(n) "Second Tranche" means the balance of the proceeds of the Grant remaining after the utilization of the First Tranche, to be withdrawn after 31 December 2008 pursuant to and subject to the provisions of paragraph 5 of Schedule 2 to this Grant Agreement.

ARTICLE II

The Grant

Section 2.01. ADB agrees to make available to the Recipient from ADB's Special Funds resources on terms and conditions set forth in this Grant Agreement an amount of fifty six million dollar (\$56,000,000).

ARTICLE III

Use of Proceeds of the Grant

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

Section 3.02. The proceeds of the Grant may be withdrawn from the Grant Account only for the purposes of financing expenditures incurred for Eligible Items under the Program in accordance with the provisions of Schedule 2 to this Grant Agreement, as such Schedule may be amended from time to time by agreement between the Recipient and ADB.

Section 3.03. Except as ADB may otherwise agree, all Eligible Items to be financed out of the proceeds of the Grant shall be procured in accordance with the provisions of Schedule 3 to this Grant Agreement.

Section 3.04. Withdrawals from 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 3.05. Except as ADB may otherwise agree, no withdrawals shall be made from the Grant Account in respect of expenditures for Eligible Items incurred more than one hundred eighty (180) days prior to the Effective Date.

Section 3.06. The Grant Closing Date for the purposes of Section 8.02 of the Grant Regulations shall be 30 June 2010 or such other date as may from time to time be agreed between the Recipient and ADB.

ARTICLE IV

Particular Covenants

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

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

(b) The Recipient 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 6.04 of the Grant Regulations, the Recipient shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning 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 6.04 of the Grant Regulations, the Recipient 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

Suspension

Section 5.01. The following is specified as an additional event for suspension of the right of the Recipient to make withdrawals from the Grant Account for the purpose of Section 8.01(k) of the Grant Regulations: the Recipient shall have failed to perform any of its obligations or make satisfactory progress in the implementation of the activities specified under the Project Grant Agreement.

ARTICLE VI

Effectiveness

Section 6.01. The following are specified as additional conditions to the effectiveness of this Grant Agreement for the purpose of Section 9.01(e) of the Grant Regulations:

- (a) The Project Grant Agreement shall have been duly executed and delivered on behalf of the Recipient, and all conditions for its effectiveness (other than a condition requiring the effectiveness of this Grant Agreement) shall have been fulfilled;
- (b) The Government shall have approved the liquidation or privatization through asset sales of 10 state-owned enterprises (excluding the state-owned enterprises to be divested under the Agriculture Sector Program approved on 4 May 2004 by ADB); and
- (c) MOF shall have appointed the liquidation committees for the 10 state-owned enterprises to implement their liquidation or privatization through asset sales.

Section 6.02. The following is specified as additional matter, for the purposes of Section 9.02(c) of the Grant Regulations, to be included in the opinion or opinions to be furnished to ADB: the Project Grant Agreement has been duly ratified by, and executed and delivered on behalf of the Recipient, and has become legally binding upon the Recipient in accordance with its terms, subject only to the effectiveness of this Grant Agreement.

Section 6.03. A date ninety (90) days after the date of this Grant Agreement is specified for the effectiveness of the Grant Agreement for the purposes of Section 9.04 of the Grant Regulations.

ARTICLE VII

Miscellaneous

Section 7.01. The Minister of Finance of the Recipient is designated as representative of the Recipient for the purposes of Section 11.02 of the Grant Regulations.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the Grant Regulations:

For the Recipient

Ministry of Finance
Islamic Republic of Afghanistan
Kabul
Afghanistan

Telephone Number:

93-20 210-3157

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Cable Address:

ASIANBANK
MANILA

Telex Numbers:

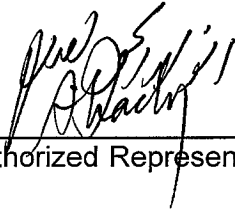
29066 ADB PH (RCA)
42205 ADB PM (ITT)
63587 ADB PN (ETPI)

Facsimile Numbers:

(632) 636-2444
(632) 636-2424

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

ISLAMIC REPUBLIC OF AFGHANISTAN

By  _____
Authorized Representative

ASIAN DEVELOPMENT BANK

By  _____

SCHEDULE 1**Description of the Program**

1. The principal objective of the Program is to promote private sector-led growth and the scope includes the following components:
 - (i) Strengthening the enabling environment for private sector development;
 - (ii) Disengaging the Government from business activities through the liquidation of state-owned enterprises; and
 - (iii) Improving the private sector's access to financial services.
2. The Program is described in more detail in the Policy Letter, including the Policy Matrix. The Program will be implemented during the Program Period.
3. In support of the Program:
 - (a) the proceeds of the Grant shall be used to finance the costs of Eligible Items; and
 - (b) the Counterpart Funds shall be used to finance the local currency costs relating to the implementation of certain programs and other activities consistent with the objectives of the Program, pursuant to the provisions of paragraph 7 of Schedule 4 to this Grant Agreement.
4. The proceeds of the Grant are expected to be utilized by 31 December 2009.

SCHEDULE 2

Allocation and Withdrawal of Grant Proceeds

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

2. (a) Withdrawals from the Grant Account shall be made for the financing of the cost of Eligible Items.

(b) No withdrawals from the Grant Account shall be made in respect of any expenditures which have been financed by credits from official international or bilateral aid agencies or any other grants or loans made by ADB.

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

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

(c) For the purposes of this paragraph, the term "Eligible Imports" means the total imports of the Recipient during the relevant period minus the following imports during the same period:

- (i) imports from countries which are not members of ADB;
- (ii) imports for ineligible items specified in Attachment 1 to this Schedule; and
- (iii) imports financed from credits from official international or bilateral aid agencies or any other loans or grants made by ADB.

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

4. (a) Prior to submitting the first application to ADB for withdrawal from the Grant Account, the Recipient shall open an account (the Deposit Account) at DAB into which all withdrawals from the Grant Account shall be deposited. The 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 Deposit Account shall be maintained in accordance with consistently maintained sound accounting principles. Upon ADB's request, the Recipient shall have the Deposit Account audited by independent auditors, whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with appropriate auditing standards. Promptly after their preparation but in any

event not later than six (6) months after the date of ADB's request, certified copies of such audited accounts and records shall be furnished to ADB, all in the English language.

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

5. Notwithstanding any other provisions of this Grant Agreement or the Grant Regulations and except as ADB may otherwise agree, no withdrawals shall be made from the Second Tranche unless ADB shall be satisfied, after consultation with the Recipient, that (a) sufficient progress has been achieved by the Recipient in the carrying out of the Program; and, in particular, (b) the Recipient has fulfilled the conditions for the release of the Second Tranche specified in Attachment 2 to this Schedule.

Negative List

1. Grant proceeds will finance the foreign currency expenditures for the reasonable cost of imported goods required during the Program.
2. No withdrawals will be made for the following:
 - (i) expenditures for goods (included in the following Standard International Trading Commodity chapters or headings):

Table A12: Ineligible Items

Chapter	Heading	Description of Items
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
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)
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), nonirradiated for nuclear reactors

Source: United Nations.

- (ii) expenditures in the currency of the Recipient or of goods supplied from the territory of the Recipient;
- (iii) payments made for expenditures incurred more than 180 days before the effectiveness date of the Grant;
- (iv) 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 loans from the Asian Development Bank;
- (v) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
- (vi) expenditures for narcotics; and
- (vii) expenditures for pesticides categorized as extremely hazardous or highly hazardous in classes I-a and I-b, Classification of Pesticides by Hazard and Guidelines to Classification.

Conditions for Release of the Second Tranche

1. The Government shall have approved and submitted to the Parliament a Commercial Arbitration Law to facilitate out-of-court settlement of business disputes, satisfactory to ADB.
2. MOC, in coordination with the municipal governments, shall have streamlined the business registration process in the municipalities to facilitate market entry of private enterprises.
3. The Government shall have approved the liquidation or privatization through asset sales of 10 state-owned enterprises (excluding the state-owned enterprises to be divested under the Agriculture Sector Program approved on 4 May 2004 by ADB).
4. MOF, through the liquidation committees, shall have issued liquidation/asset sales announcements for 20 state-owned enterprises, including calls for creditors and claimants.
5. MOF, through the liquidation committees, shall have issued bidding invitation for the assets of 20 state-owned enterprises.
6. MOF shall have allocated a budget for its State-owned Enterprises Department in line with the restructuring plan approved by the Independent Administrative Reform and Civil Service Commission.
7. MOF shall have allocated adequate budget for the social safety net program for redundant employees of divested state-owned enterprises for 2007 and 2008.
8. DAB shall have (i) drafted a standard memorandum of understanding to be signed by DAB and foreign banking sector supervisory agencies that includes clear and workable protocols for (a) ongoing supervision of cross-border establishments, (b) on-site examinations, (c) protection of confidentiality, and (d) the establishment of a system of regular and as needed meetings among supervisory authorities; and (ii) submitted this draft memorandum of understanding to its counterpart banking sector supervisory agencies.
9. DAB shall have drafted policies and procedures on conservatorship, receivership and forced liquidation of distressed banks.
10. DAB shall have drafted detailed regulations on credit risk, operational risk, and market risk management.
11. DAB shall have enhanced disclosure by publishing the financial statements of individual banks on its website.
12. The Government shall have approved and submitted to Parliament an Accounting Law and an Audit Law, satisfactory to ADB, which shall include, inter alia, a timetable for adopting International Financial Reporting Standards and International Standards on Auditing (ISA) for Public Interest Entities.

SCHEDULE 3

Procurement

1. Except as ADB may otherwise agree, the procedures referred to in the following paragraphs of this Schedule shall apply in the procurement of Eligible Items to be financed out of the proceeds of the Grant.

2. (a) Except as provided in subparagraph (b) of this paragraph, each contract for Eligible Items shall be awarded on the basis of either the purchaser's normal commercial procurement practices, in the case of procurement by the private sector, or the Recipient's prescribed procurement procedures, in the case of procurement by the public sector, having due regard for the principles of economy and efficiency.

(b) Each supply contract for Eligible Items which are commonly traded commodities shall be awarded on the basis of procedures appropriate to the trade and acceptable to ADB.

SCHEDULE 4

Program Implementation and Other Matters

Coordination and Administration

1. MOF shall be the Program Executing Agency and shall be responsible for the overall implementation of the Program. MOF shall also be the Program Implementing Agency responsible for (i) overseeing the liquidation of state-owned enterprises and the implementation of the accounting and auditing reforms, including the drafting of the Accounting and Auditing Law and the establishment of the Accounting and Auditing Board; and (ii) coordinating and monitoring the drafting of the Immovable Property Formalization Law. MOC shall be the Program Implementing Agency responsible for (i) overseeing the drafting of the Commercial Arbitration Law; and (ii) coordinating with municipal authorities the streamlining of business registration processes and the lifting of municipal price controls. DAB shall be the Program Implementing Agency responsible for overseeing the implementation of the financial supervision reforms and capacity building of its staff.
2. MOF shall set up an inter-agency coordination committee headed by the Deputy Minister for Finance, and comprising representatives of MOC, Ministry of Justice, DAB and ADB to coordinate and ensure effective implementation of the policy reforms envisaged under the Program (Inter-agency Coordination Committee). The Inter-agency Coordination Committee shall meet at least once every quarter.

Implementation of the Policy Letter

3. The Recipient shall (i) ensure that the policies adopted and actions taken as described in the Policy Letter, including the Policy Matrix, prior to the date of this Grant Agreement continue in effect for the duration of the Program period and subsequently; and (ii) promptly adopt the other policies and take the other actions indicated in the Program as specified in the Policy Letter, including the Policy Matrix, and ensure that such policies and actions continue in effect for the duration of the Program period and subsequently.

Policy Dialogue

4. The Recipient shall keep ADB informed of, and the Recipient and ADB shall from time to time exchange views on, sector issues, policy reforms and additional reforms during the Program Period that may be considered necessary or desirable, including the progress made in carrying out the Program.
5. The Recipient shall engage in policy dialogue with ADB, in a timely manner, on problems and constraints encountered during Program implementation and on desirable changes to overcome or mitigate such problems and constraints.
6. The Recipient shall keep ADB informed of policy discussions with other multilateral or bilateral agencies that have implications for implementation of the Program, and shall provide ADB with an opportunity to comment on any resulting policy proposals. The Recipient shall take ADB's views into consideration before finalizing and implementing any such proposals.

Counterpart Funds

7. The Recipient shall ensure that the Counterpart Funds shall be used, first, to support the adjustment costs for reforms to be initiated and implemented under the Program, and, second, to finance expenditures for the general development purposes of the Recipient.

Monitoring of the Program

8. The Recipient shall cause MOF to (i) establish and maintain a program performance evaluation system, which will include a data base on the status of policy measures and program indicators based on the Policy Matrix and the design and monitoring framework for the Program; (ii) submit to ADB semiannual reports on the implementation of the Program and accomplishment of the measures set forth in the Policy Letter and the Policy Matrix, which will describe progress made, and, any problem encountered and remedial actions taken; and (iii) submit to ADB a Program completion report within 3 months of Program completion.

9. ADB will monitor the implementation of the Program through regular reviews and progress reports throughout the implementation period. Based on these reviews, modifications and improvements will be considered. To facilitate such review, the Recipient shall assist ADB by providing relevant data and information in such detail as ADB may reasonably request.

10. Approximately six (6) weeks before the anticipated withdrawal of the Second Tranche, or such other time as the Recipient and ADB may agree, a review shall be carried out concerning the Recipient's progress in implementing the policy reforms under the Program set out in the Policy Letter and the Policy Matrix, including the fulfillment of the conditions listed in Attachment 2 to Schedule 2 to this Grant Agreement.