

PROJECT AGREEMENT

(Small and Medium Enterprise Regional Development Project)

between

ASIAN DEVELOPMENT BANK

and

COMMERCIAL BANK OF CEYLON LIMITED

DFCC BANK

NATIONAL DEVELOPMENT BANK OF SRI LANKA PLC

SAMPATH BANK LIMITED

DATED 18 DECEMBER 2007

## **PROJECT AGREEMENT**

PROJECT AGREEMENT dated 18 December 2007 between ASIAN DEVELOPMENT BANK ("ADB") and COMMERCIAL BANK OF CEYLON LIMITED, DFCC BANK, NATIONAL DEVELOPMENT BANK PLC , AND SAMPATH BANK LIMITED (hereinafter called the "PCBs").

### **WHEREAS**

(A) by a Loan Agreement of even date herewith between the Democratic Socialist Republic of Sri Lanka (the "Borrower") and ADB, ADB has agreed to make to the Borrower a loan in various currencies equivalent to thirty two million two hundred and twenty six thousand Special Drawing Rights (SDR 32,226,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that the proceeds of the Loan be made available to the PCBs and that the PCBs agree to undertake certain obligations towards ADB as set forth in this Project Agreement; and

(B) the PCBs, in consideration of ADB entering into the Loan Agreement with the Borrower, have agreed to undertake the obligations set forth in this Project Agreement;

NOW THEREFORE the parties agree as follows:

## **ARTICLE I**

### **Definitions**

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

## **ARTICLE II**

### **Subloans**

Section 2.01. (a) The amount of the Loan may be withdrawn from the Loan Account to finance (i) the reasonable foreign-currency cost of Goods and Works required for the subproject; and (ii) a portion of the local-currency cost of Goods and Works required for the subproject.

(b) Except as ADB may otherwise agree, the proceeds of each part of the Loan shall be used only for making a subloan to a subborrower in respect of which such part of the Loan was withdrawn from the Loan Account and shall be applied exclusively to the

cost of Goods and Works required to carry out the subproject in respect of which such part of the Loan was withdrawn.

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

Section 2.02. (a) Each subloan shall carry interest at an appropriate rate and shall be made on terms whereby the PCB shall obtain, by a written agreement with the subborrower in form acceptable to ADB, rights adequate to protect the interests of the Borrower, the PCB, and ADB.

(b) Except as ADB may otherwise agree, the amortization schedule applicable to each subloan shall not extend beyond fifteen (15) years, including any grace period not exceeding three (3) years, from the date when such subloan is approved or authorized for withdrawals from the Loan Account pursuant to Section 2.02(a) or (b) of this Project Agreement.

Section 2.03. Without limiting the generality of the foregoing provisions of Section 2.02 of this Project Agreement and in addition to any other provisions which a prudent lender would request, each subloan agreement shall include provisions to the effect that:

- (i) the subborrower shall carry out and operate the subproject with due diligence and efficiency and in accordance with sound administrative, financial, business and environmental practices, including maintenance of adequate accounts and records;
- (ii) the proceeds of the Loan shall be used only for procurement in eligible source countries as specified by ADB, in accordance with procedures acceptable to ADB;
- (iii) the Goods and Works to be financed out of the proceeds of the Loan shall be used exclusively in the carrying out of the subproject;
- (iv) ADB and the PCB shall each have the right to inspect such Goods and Works, the subborrower, the subproject and any relevant records and documents;
- (v) the subborrower 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 financed out of the proceeds of the Loan 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;
- (vi) ADB and the PCB shall each be entitled to obtain all such information as each shall reasonably request relating to the subloan, the Goods

and Works financed out of the proceeds of the Loan, the subproject, the subborrower and other related matters; and

- (vii) the PCB shall be entitled to suspend or terminate further access by the subborrower to the use of the proceeds of the Loan upon failure by the subborrower to perform its obligations under its agreement with the PCB.

Section 2.04. Each PCB shall promptly and effectively exercise its rights in relation to each subproject in accordance with the standards of a prudent lender and in such manner as to protect the interests of the Borrower, the PCB, and ADB.

### **ARTICLE III**

#### **Particular Covenants**

Section 3.01. (a) Each PCB shall carry out the Project with due diligence and efficiency and in conformity with sound banking, administrative, financial, engineering, environmental and business practices.

(b) In the carrying out of the Project and in the conduct of its business, each PCB shall perform all the obligations set forth in Schedule 5 to the Loan Agreement to the extent that they are applicable to the PCBs, a copy of which is set out in the Schedule to this Project Agreement.

(c) Except as ADB may otherwise agree, each PCB shall not substantially amend its Charter unless required by law.

Section 3.02. Each PCB shall not make a subloan to any subborrower unless such subborrower 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 subborrower for the carrying out of the subproject in respect of which the subloan is to be made.

Section 3.03. Each PCB shall maintain records and accounts adequate to record the progress of the Project and of each subproject (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, the operations and financial condition of the PCB.

Section 3.04. (a) ADB and each PCB shall cooperate fully to ensure that the purposes of the Loan will be accomplished.

(b) Each PCB shall promptly inform PSC 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 Subsidiary Loan Agreement, or the accomplishment of the purposes of the Loan.

(c) ADB and each PCB 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, the PCB and the Loan.

Section 3.05. (a) Each PCB shall furnish to PSC 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 subborrowers, the subprojects and the subloans; (iv) the administration, operations and financial condition of the PCB; and (v) any other matters relating to the purposes of the Loan.

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

(c) Promptly after the closing date for withdrawals from the Loan Account, but in any event not later than three (3) months after the said closing date or such later date as ADB may agree for this purpose, each PCB 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 subprojects, their costs, the performance by the PCB of its obligations under this Project Agreement and the accomplishment of the purposes of the Loan.

Section 3.06. (a) Each PCB shall have its accounts and financial statements (balance sheet, statement of income and expenses, and related statements) audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB, and shall, promptly after their preparation but in any event not later than 6 months after the close of the fiscal year to which they relate, furnish to ADB (i) certified copies of such audited accounts and financial statements and (ii) the report of the auditors relating thereto (including the auditors' opinion on the use of Loan proceeds and compliance with the financial covenants of the Loan Agreement), all in the English language. Each PCB shall furnish to ADB such further information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) Each PCB shall enable ADB, upon ADB's request, to discuss the PCB's financial statements and its financial affairs from time to time with the auditors appointed by the PCB pursuant to Section 3.06(a) hereabove, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the PCB unless the PCB shall otherwise agree.

Section 3.07. Each PCB shall enable ADB's representatives to inspect any subborrower, any subproject, the Goods and Works financed out of the proceeds of the Loan, and any relevant records and documents.

Section 3.08. (a) Each PCB 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) Each PCB shall at all times conduct its business in accordance with sound banking, administrative, financial, environmental and business practices, and under the supervision of competent and experienced management and personnel.

(c) Except as ADB may otherwise agree, each PCB shall not (i) sell, lease, transfer or otherwise dispose of any of its assets, except in the ordinary course of its business; or (ii) establish or acquire any subsidiary other than in the ordinary course of banking business.

Section 3.09. Each PCB shall comply with all applicable prudential regulations and guidelines of CBSL as certified by an auditor acceptable to ADB.

Section 3.10. Except as ADB may otherwise agree, each PCB shall ensure that there shall be less than 15% of non performing loans for the entire loan portfolio of the PCB and less than 10% of non performing loans of its subloan portfolio, provided that any PCB having more than 10% non performing subloans portfolio shall also have a general provision for loan losses, where when combined with the special provision of that PCB, amounts to at least 25% of the total loan volume of all non performing loans, and a board of directors' approved strategy for reduction of non performing subloans to below 10% within two years.

Section 3.11. Each PCB shall cause each of its subsidiaries (if any) to observe and perform the obligations of the PCB under this Project Agreement to the extent to which such obligations may be applicable thereto in respect of the Project, as though such obligations were binding upon each of such subsidiaries.

Section 3.12. Except as ADB may otherwise agree, each PCB 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.

## **ARTICLE IV**

### **Effective Date; Termination**

Section 4.01. This Project Agreement shall come into force and effect on the date on which the Loan Agreement shall come into force and effect. ADB shall promptly notify each PCB of such date.

Section 4.02. (a) This Project Agreement and all obligations of the parties hereunder shall terminate on the earlier of the following two dates:

- (i) the date on which the Loan Agreement shall terminate in accordance with its terms; or
- (ii) a date 20 years after the date of this Project Agreement.

(b) If the Loan Agreement terminates in accordance with its terms before the date specified in paragraph (a)(ii) of this Section, ADB shall promptly notify the PCB of this event.

Section 4.03. All the provisions of this Project Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the Loan Agreement.

## **ARTICLE V**

### **Miscellaneous**

Section 5.01. 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 or by mail, telegram, cable, telex, facsimile or radiogram 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  
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) 636-2337.

For Commercial Bank of Ceylon Limited

Commercial House  
21 Bristol Street  
Colombo 1  
Sri Lanka

Facsimile Number:

(94-11) 2449889.

For DFCC Bank

P.O. Box 1397  
73/5 Galle Road  
Colombo 3  
Sri Lanka

Facsimile Number:

(94-11) 2440376.

For National Development Bank PLC

P.O. Box 1825  
No. 40 Navam Mawatha  
Colombo 2  
Sri Lanka

Facsimile Number:

(94-11) 2440262.

For Sampath Bank Limited

No. 110 Sir James Peiris Mawatha  
Colombo 2  
Sri Lanka

Facsimile Number:

(94-11) 2300144.

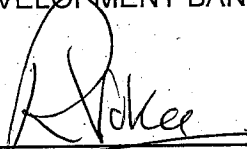
Section 5.02. (a) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Project Agreement by or on behalf of each PCB may be taken or executed by its Chief Executive or Managing Director, or General Manager or by such other person or persons as he shall so designate in writing notified to ADB.

(b) Each PCB shall furnish to ADB sufficient evidence of the authority of each person who will act under paragraph (a) of this Section, together with the authenticated specimen signature of each such person.

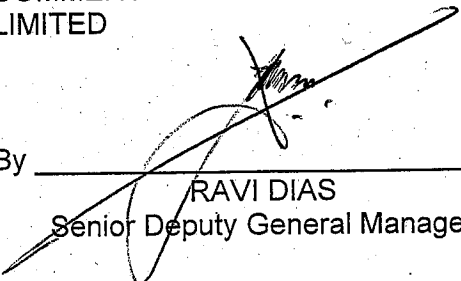
Section 5.03. No delay in exercising, or omission to exercise, any right, power or remedy accruing to either party under this Project Agreement upon any default shall impair any such right, power or remedy or be construed to be a waiver thereof or an acquiescence in such default; nor shall the action 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 and to be delivered at the principal office of ADB, as of the day and year first above written.


ASIAN DEVELOPMENT BANK

By   
RICHARD W.A. VOKES  
Country Director  
Sri Lanka Resident Mission

COMMERCIAL BANK OF CEYLON LIMITED

By   
RAVI DIAS  
Senior Deputy General Manager

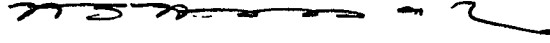
DFCC BANK

By   
HEWA ANNAKAGE ARIYARATNE  
Executive Vice President (Lending)

NATIONAL DEVELOPMENT BANK PLC

By   
ERAN WICKRAMARATNE  
Deputy Chief Executive

SAMPATH BANK LIMITED

By   
ANIL AMARASURIYA  
Managing Director/CEO

## SCHEDULE

### Project Management and Implementation; Financial Matters

#### A. Arrangements and responsibilities for Project Management and Project Implementation

##### 1. Project Executing Agency and Implementing Agencies

1. MOFP shall be the Project Executing Agency and shall have the overall and final responsibility for the timely and satisfactory implementation of the Project.

2. Each eligible PCB shall be an Implementing Agency.

##### 2. Project Steering Committee

3. Within one month of the Effective Date, MOFP shall establish a PSC to oversee Project implementation. The PSC shall be chaired by the Secretary of MOFP or, in his absence, Deputy Secretary, Treasury and shall comprise a representative from CBSL, as well as a representative from each PCB. The PSC may, from time to time, co-opt representatives from other relevant agencies. The PSC shall meet whenever necessary, but not less than once every two months. An ADB representative may attend the PSC meetings.

4. The PSC shall be responsible for (a) monitoring the continued eligibility of PCBs based on the eligibility criteria agreed upon between the Borrower and ADB as set forth in Appendix 6 to the RRP; (b) monitoring eligible disbursements against estimated PCB targets to regional SMEs and SME value chain clusters; (c) fostering dialogue with the PCBs on implementation progress for complementary components 2 and 3 as set forth in Schedule 1 to this Loan Agreement. The chair of the PSC shall be responsible for liaising with ADB.

5. The PSC shall be supported by a secretariat that shall be established within CBSL. The Director of the Regional Development Department at CBSL shall be the Secretariat Project Director. (S)he shall be responsible for (a) liaising with the PSC; (b) liaising with all PIU Project Directors; and (c) the overall supervision of the PSC Secretariat. (S)he shall be supported by an Alternate Secretariat Project Director who shall be the Deputy Director of the Regional Development Department at CBSL, and who shall be responsible for overseeing the budgeting, accounting, and reporting of all financial transactions related to the implementation of the Project. The Alternate Secretariat Project Director shall be supported by a finance officer for the reporting of all financial transactions, and by an accounts officer for all budgeting and accounting matters. Both the finance officer and the accounts officer shall be from CBSL's Regional Development Department.

##### 3. Project Implementation Units

6. Within one month of the Effective Date, each PCB shall establish a PIU in its SME Department. Each PIU shall be responsible for coordinating with the relevant PCB units to ensure that (a) all information and reporting requirements related to PCBs and subloans are met; and (b) all necessary accounts and related financial statements as well as all disbursement records are submitted to the PSC.

7. The Director of the SME Department of each PCB shall be the PIU Project Director for such PCB. (S)he shall be responsible for (a) liaising with the PSC; (b) liaising with the Secretariat Project Director as well as with the other PIU Project Directors; and (c) the overall supervision of the PIU. (S)he shall be supported by an Alternate PIU Project Director who shall be the Deputy Director of the SME Department of each respective PCB and who shall be responsible for overseeing the budgeting, accounting, and reporting of all financial transactions related to the implementation of the allocated funds to each respective PCB. The Alternate PIU Project Director shall be supported by a finance officer for the reporting of all financial transactions, and by an accounts officer for all budgeting and accounting matters. Both the finance officer and the accounts officer shall be from the SME Department of each respective PCB.

## **B. Project implementation matters**

### **1. Relending and onlending terms and financial issues**

8. The Borrower, through CBSL, shall re-lend the proceeds of the Loan in local currency to each PCB for onlending to eligible subborrowers, at the AWDR, under a Subsidiary Loan Agreement which term shall not exceed 20 years and not be less than 15 years. The Borrower shall bear the foreign exchange risk.

9. The allocation of the proceeds of the Loan among the PCBs, and assuming that each PCB remains eligible throughout the Project period, shall be as follows:

- (i) fifteen million dollars (\$15,000,000) equivalent to Commercial Bank of Ceylon;
- (ii) fifteen million dollars (\$ 15,000,000) equivalent to DFCC Bank;
- (iii) ten million dollars (\$10,000,000) equivalent to National Development Bank of Sri Lanka; and
- (iv) ten million dollars (\$10,000,000) equivalent to Sampath Bank.

10. ADB shall have the right to disallow disbursements to any PCB if such PCB no longer satisfies the eligibility criteria agreed upon between the Borrower and ADB as set forth in Appendix 6 to the RRP, until such time as the PCB is able to satisfy such criteria. Such PCB shall be required to remedy any default of eligibility criteria within six months of default and in any event, within the disbursement period of the Loan.

11. The PCB loans shall be disbursed over a period of three (3) years from the Effective Date, subject to a mid-term review after eighteen (18) months from the Effective Date to assess the progress of disbursement. At the end of the three (3) year period, PSC and ADB shall reassess the progress of disbursement as well as the allocation of the proceeds of the Loan to each PCB, based on whether disbursement targets to SMEs by each PCB were reached. Reallocation of the proceeds of the Loan, whether among the PCBs or to a newly eligible PCB, shall be subject to prior agreement between the Borrower and ADB and changes to the Subsidiary Loan Agreement.

12. In the event of default of a PCB of the selection criteria and such PCB's failure to remedy such default (as referred to in paragraph 10 of this Schedule), the Borrower and ADB shall jointly select a new PCB as an Implementing Agency for the Project, such selection shall be done in accordance with the same eligibility criteria as those applied for the four initial PCBs as set forth in Appendix 6 to the RRP.

13. The Borrower shall ensure that PCBs shall onlend to subborrowers at an interest rate that reflects their cost of funds plus a spread to cover transaction costs and risks. PCBs shall have full autonomy to select subprojects, provided the subprojects comply with the eligibility criteria set out in paragraph 16 of this Schedule. The PCBs shall bear the credit default risk. Each PCB shall ensure that the maximum subloan size shall be 20 million Rupees (SLRs 20,000,000), that each subloan shall not exceed seventy five percent (75%) of total subproject costs, that the Loan proceeds shall not exceed fifty six and a quarter percent (56.25%) of the total subproject costs and that each subloan shall have a minimum term of 4 years.

14. The Borrower shall ensure that a satisfactory financial management system is maintained throughout the duration of the Project.

## **2. Eligibility criteria for subborrowers and subprojects**

15. The Borrower shall cause each PCB to ensure that each subborrower shall satisfy the following criteria in order to be eligible for any financing under the Project:

- (a) the subborrower shall be a start-up SME or an SME undertaking expansion or modernization, provided that its annual turnover does not exceed SLRs three hundred (300) million and its fixed assets – excluding land and buildings – do not exceed SLRs one hundred (100) million; or
- (b) the subborrower shall be a SME value chain cluster.

16. The Borrower shall cause each PCB to ensure that each subproject shall satisfy the following criteria in order to be eligible for any financing under the Project: the subproject shall

- (a) be located outside the Borrower's Western Province;
- (b) be economically and financially viable;
- (c) either be for start-up, expansion, or modernization activities in any of the eligible subsectors as agreed between the Borrower and the ADB, or for financing BDS requirements of SMEs or SME value chain clusters;
- (d) comply with the Borrower's and ADB's environmental and social safeguard policies; and
- (e) not entail any activities that would generate involuntary resettlement, whether permanent or temporary, including for squatters.

## **3. Safeguard issues**

17. The Borrower shall ensure not to relend the proceeds of the Loan to any PCB, unless such PCB shall have recruited the necessary safeguard implementation staff. Each PCB shall ensure that the positions of safeguard implementation staff shall remain filled throughout Project implementation.

18. The Borrower shall ensure that within one month of the Effective Date, each PCB shall have established or updated its Environmental Management System (EMS) in accordance with the EMS framework agreed upon between the Borrower and ADB as set forth in Appendix 5 to the RRP. Each PCB shall implement the Project in full compliance with such EMS, as may be amended from time to time in line with the EMS framework.

#### **4. PCB related matters**

19. The Borrower shall cause each PCB to advise PSC (and PSC shall immediately advise ADB) in advance of any major decision on events such as mergers and acquisitions, changes in key management officers, and any charter changes that may have a significant adverse impact on the organization, management, policies, procedures, or operations of such PCB. In such event, the Borrower and ADB jointly, shall have the right to reallocate part of the funds provided under the Loan to the other PCBs or to relend the same to new eligible PCBs.

20. The Borrower shall ensure that throughout Project implementation, each PCB shall (a) be in compliance with all applicable prudential regulations and guidelines of the CBSL as certified by an auditor acceptable to ADB; and (b) maintain at least investment grade of a high credit quality, defined as A- and above (or equivalent) as rated by Fitch Ratings Lanka Ltd (or such other credit rating agency as may be acceptable to ADB) as reflected in an actual credit rating report submitted to CBSL.

21. The Borrower shall through the PSC monitor the PCBs' progress reports under the International Finance Corporation funded South Asia Enterprise Development Fund.

#### **5. Project reviews and reporting**

22. The Executing Agency, CBSL, the PCBs, and ADB shall conduct annual performance reviews based on annual progress reports to be prepared by each PCB.

23. The Borrower shall ensure that annual Project reports, prepared by the PSC based on annual progress reports submitted by the PCBs, shall include at least the following information: (a) emerging sector policy issues; (b) continuing compliance of PCBs with agreed eligibility criteria; (c) performance of all PCBs; (d) subproject performance; (e) subborrower repayment performance; (f) subprojects' contribution towards achieving Project objectives; (g) lessons learned; and (h) benefit monitoring in terms of output and employment.

24. In addition to the annual performance review mentioned in paragraph 21 above, the Project Executing Agency, CBSL, the PCBs, and ADB shall conduct a mid-term

review (MTR) within eighteen (18) months after the Effective Date. The MTR shall (a) evaluate the scope, design, and implementation arrangements of the Project; (b) assess implementation performance against Project indicators; (c) review and establish compliance with covenants of this Loan Agreement; (d) identify problems and constraints, and if necessary, recommend changes in the design or implementation arrangements.

25. Within three months of the completion of the Project, the Borrower shall ensure that the EA, through the PCBs, furnish to ADB a Project completion report containing a detailed evaluation report of project design, costs, PCB performance, social and economic impact, and other details as may be requested by ADB.

#### **6. Project Performance Monitoring System (PPMS)**

26. The Borrower shall cause CBSL and the PCBs at all times throughout Project implementation to maintain a PPMS, satisfactory to ADB, that will be included in the PCBs management information system. The key performance indicators and assumptions in the design and monitoring framework in Appendix 1 to the RRP shall be the basis for the PPMS. Within four (4) months of the Effective Date, CBSL and the PCBs' shall have developed baseline data.