

9

AGREEMENT

between

THE GOVERNMENT OF THE ITALIAN REPUBLIC

and

THE GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN

Regarding the

ITALIAN CONTRIBUTION TO

THE MICROFINANCE INVESTMENT SUPPORT FACILITY FOR AFGHANISTAN

ITALIAN SUPPORT TO AFGHAN MICROFINANCE AND ENTERPRISES

ISAME PROJECT

The Government of the Italian Republic and the Government of the Islamic Republic of Afghanistan,

- *Inspired by the desire to further enhance their friendship;*
- *Intending to promote further the economic and social development of Afghanistan and appreciating positively their ongoing cooperation activities;*
- *Following the signing of the Compact and the approval of the Afghanistan National Development Strategy;*
- *In line with the commitment of the International Community to contribute to the achievement of the development objectives of Afghanistan, as well as to contribute to the achievement of the Millennium Development Goals;*
- *In recognition of and with respect for the democratic principles and fundamental human rights;*

have come to the following agreement:

Article 1

Definitions

For this Agreement purposes, unless otherwise stated, the terms below have the following meaning:

1. 'Competent Authorities' in the case of the Government of the Italian Republic refer to the Ministry of Foreign Affairs, Directorate General for Development Cooperation (DGCS) Rome, and in the case of the Government of the Islamic Republic of Afghanistan, the Ministry of Finance (MoF), or for both parties any other authority empowered to perform the functions exercised by the said authorities.
2. 'The Parties' refer to the Competent Authorities.
3. 'Grant' refers to funds granted by the Directorate General for Development Cooperation of the Ministry of Foreign Affairs of the Italian Republic (GoRI) to the Ministry of Finance of the Islamic Republic of Afghanistan (GoIRA) in order to implement the programme.
4. The programme component documents refer to: (1) the Project Document agreed by the Afghan Ministry of Finance of the Islamic Republic of Afghanistan and the Italian Ministry of Foreign Affairs; (2) the Microfinance Investment Support Facility for Afghanistan's (MISFA) Operation Manual; (3) the standard Credit Facility Agreement between MISFA

and Da Afghanistan Bank (DAB); and (4) the standard MISFA LTD Grant & Loan Agreement; and the MISFA Partner Product Details list. These four documents are attached as Annex I of this Agreement and hence are an integral part the Agreement. The Project Document is a description of the programme and its disbursement, procurement, reporting, monitoring and evaluation and auditing procedures and shall govern the Project implementation.

Article 2

Objectives of the Project

Building on the current MISFA, the objectives of the programme are:

1. To enhance the support to low income people, promoting and strengthening the development and growth of a long-term, strong and healthy microfinance sector in Afghanistan that provides high quality and efficient financial services. This is achieved through a grant and loan process that identifies strong partner organizations and encourages "best practice" delivery of appropriate microfinance products and services by these partners.
2. To support the development of an SME window within MISFA that on-lends funds through local banks for small and medium enterprise loans;
3. To strengthen the Afghan microfinance programme's outreach that has seen a substantial growth and expansion during the past few years. As of February 2009, the Microfinance Institutions (MFI) – with a network of 286 branches in 24 of Afghanistan's 34 provinces – are currently serving 441,838 savings and loan clients, with an outstanding portfolio of US\$ 103.8 million. Since inception in 2003, the program has disbursed a total of almost 1.4 million loans worth US\$ 581, 3 million across Afghanistan.
4. To increase the sustainability of the microfinance sector, supporting the MISFA's MFI partners in their efforts of achieving operational sustainability and surpluses, also providing trainings to loan officers and managers, as well as strategic advice to banks and/or financial institutions.
5. To enhance the Afghanization of the microfinance sector providing employment to Afghan workers, focusing on professional and management positions in the sector.

Article 3

Outcomes of the Project

The expected outcomes of the programme are:

1. A strengthened microfinance network in the Provinces of Herat and Badghis and Farah, servicing low income people, including vulnerable groups – such as returnees and internally displaced people – as well as promoting women's entrepreneurship and participation in social life.
2. An enhanced attention to credit to SMEs in the Provinces of Herat, Badghis and Farah. Considering the current low rate of development in terms of microcredit services availability, specific and appropriate actions will be taken to expand Project activities in Farah Province.
3. An increased number of low income people – especially members of vulnerable groups including women – able to gain access to micro credit.

4. An increase in employment opportunities through the support to SMEs' entrepreneurs obtaining loans through the MISFA programme. A recent study on MISFA's activities showed that a majority of the credit is used to establish new businesses or sustain and build existing businesses, with each loan creating or sustaining 1.5 new jobs for microenterprises and up to 20 jobs for SMEs.

Article 4

Project Document

1. The Project Document is attached as part of Annex I, together with the manuals and the technical annexes, and is an integral part of this Agreement. The Project Document is a description of the programme and its disbursement, procurement, reporting, monitoring and evaluation and auditing procedures and shall govern the Project implementation. The Project Document may be reviewed and updated on the basis of requests by any of the two Parties according to procedures set forth in Art. 18.

Article 5

Obligations of the Government of the Islamic Republic of Afghanistan

Under this Agreement, the GoIRA shall:

1. Promptly inform Italy of any conditions interfering with or threatening the successful implementation of the Project.
2. Ensure the smooth flow of funds for the successful implementation of the programme activities within the period of validity of this agreement.
3. Ensure that the GoIRA inputs, specifically key staff indicated as provided by the GoIRA, are available. Human resources inputs from the GoIRA should, as far as possible, match the planned activities under the components.

Article 6

Obligations of Government of Italy

1. The Government of Italy will provide up to **Euro 6,400,000.00 (six million four hundred thousand)** for the effective implementation of the Project as per the following:

MICROFINANCE CREDITS (EURO)	2.000.000,00	31.2 %
SMEs CREDITS (EURO)	2.100.000,00	32.8 %
TRAINING (EURO)	400.000,00	6.3 %
OPERATING COSTS (EURO)	1.900.000,00	29.7 %
TOTAL (EURO)	6,400,000.00	100.0 %

2. Any reallocation among the amounts in table showed at Art. 6.1 agreed value – shall be formalized according to procedures described at Art. 18.1.1.
3. Funds will be committed after signature and disbursed after entry into force of this Agreement, in compliance with provisions set in Art. 16. by crediting the Special Account at DAB, in the name of the Ministry of Finance (according to the procedures in Art. 8.3). These funds will then be disbursed in one or more instalment(s) to a dedicated MISFA Special Account-MSA (according to the procedures in Art. 8.3).

4. The amount specified in Euro under this Agreement cannot be exceeded.
5. Procedures for procurement, financial reporting, accounting and auditing shall be handled as described in the current version of the MISFA's Operations Manual found in Annex I of this Agreement.

Article 7

Italian Grant Earmarking

1. Eligible beneficiaries from the following selected Provinces shall be given priority for the supply of micro credits and SMEs credits to be provided in the framework of the MISFA with Italian funds. The selected Provinces are: Herat, Badghis, Farah.
2. Special arrangements for ensuring the proper visibility of Italian funds will be adopted by the MISFA, within the donor community, Afghan Institutions and the public for reporting and publication. Visibility includes providing information about credit lines and credits products utilized and type of beneficiaries (number and characteristics) having received financing from this agreement per agreed upon reporting and tracking mechanisms.

Article 8

On-lending agreements, interest rates and revolving funds

1. The Italian Grant will be used through contracts with a selected group of local financial institutions, the MFIs, participating in the MISFA. Conditions of on-lending agreements with local financial institutions will be the prevailing ones set by MISFA as mentioned in Project Document.
2. Interest rates applied to borrowers – being either microcredit or SMEs loans – will be the same already agreed in the framework of MISFA applied by local financial institutions.
3. Funds reimbursed by local financial institutions to MISFA will be placed in the MISFA repayment account and transferred to MSA for the Project for further support of the microfinance/SME sector via on-lending facilities or capacity building grants. At the termination of the Project, any balance of the Italian funds remaining in the MSA shall be transferred to the MoF Special Account. Their destination will be agreed upon with the Italian Government through an exchange of letters. After each three years period from the crediting of the funds to MISFA, the Parties shall jointly evaluate the results achieved through the Italian financing. The MoF undertakes to keep the Embassy of Italy informed about the repayment level and outcome after completion of this Project.

Article 9

Information, monitoring and evaluation

1. The Parties shall collaborate fully to ensure that the purpose of this Agreement is accomplished. To that end, the Parties shall exchange views with regard to matters relating to the Project and provide each other with all data, documentation and information available to them, shall give all appropriate mutual assistance required in discharging of the Parties' duties and provide all necessary support, in particular in all administrative questions, to facilitate the due implementation of the Project.
2. To the end of establishing a reliable mechanism of interaction and coordination between the Italian and the Afghan competent bodies involved in the present Agreement, the Italian side

may hire, following its internal procurement procedures and by establishing a specific funding facility on top of the grant of the present Agreement, Italian Consultants. These Consultants shall be facilitated by the Afghan side in performing their tasks related with external monitoring of the use of the Italian grant, exchange of information on the overall Project and promotion of micro credits among potential beneficiaries. If needed and required by the Afghan side, the Consultants will provide technical support and advice.

3. Italy shall have the right to carry out any technical or financial appraisal that it considers necessary to follow the execution of the Project. MISFA will invite Italy to participate in any joint donor supervision exercises. It is also expected that Italy will be invited to participate in all major reviews and evaluations undertaken by the World Bank. To facilitate the work of the person or persons instructed to carry out such a monitoring mission, GoIRA shall provide all relevant assistance, information and documentation.
4. Evaluation of the Project may be carried out at the request of either Party.
5. Italy shall have the right to carry out monitoring and evaluation according to this article after the termination of the Project.

Article 10 Project Management

1. The Project is managed by MISFA through its own internal organization and procedures, as set in the Operations Manual included in Annex I.
2. A Steering Committee is to be established to discuss and assess matters of mutual interest. The Steering Committee is composed by the Minister of Finance (or a person appointed), the Ambassador of Italy (or a person appointed), one representative of MISFA and one representative of the Italian Cooperation Office in Kabul. The Steering Committee endorses the annual audited Financial Statement, as provided by MISFA's external auditors and relevant narrative reports. The Steering Committee shall meet at least two times per year. Additional meetings may be convened at the discretion of the Steering Committee.

Article 11 Irregularities. Anti-Corruption Clause

1. If serious irregularity in the Project or suspicion thereof has been ascertained, either party may suspend programme implementation, wholly or in part, until the suspending party decides to resume the implementation.
2. No offer, payment, consideration or benefit of any kind, which could be regarded as an illegal or corrupt practice shall be made, promised, sought or accepted – neither directly, nor indirectly – as an inducement or reward in relation to activities funded under this Agreement, including tendering reward, or execution of contracts.
3. Either party may cancel the agreement or sub-agreement covering specific activities if with respect to any contract to be financed by Italy, it determines that corrupt or fraudulent practices were engaged in by representatives of the donor country, the recipient country, or of a beneficiary of the funds during procurement or during the execution of the contract without the party in question having taken timely and appropriate action satisfactory to the party wishing the rescind the Agreement in order to remedy the situation.

Article 12
Labour clause

The authority, organisation and/or consultant shall abide by the GoIRA laws and by applicable international instruments, including the UN Convention on the Rights of the Child and International Labour Organisation conventions.

Article 13
Financial management, reporting and audit

1. Procurement, reporting and auditing procedures will follow the MISFA's operations manual attached in Annex I.
2. MISFA shall submit to the Embassy of Italy to Afghanistan its Monthly Performance Report for the sector and Donor Quarterly Reports along with the annual audited Financial Reports concerning the overall MISFA (see item. 3 below). These Monthly and Quarterly Reports shall clearly show the amount of funds disbursed by the local financial institutions in the Provinces listed in Article 7.
3. The MoF shall submit to the Embassy of Italy to Afghanistan an annual audited financial statement following the same reporting procedures mentioned for ARTF funds in the Operations Manual and Financial Management Manual of MISFA.
4. On completion of the Project, the MISFA shall prepare a Completion Report, certified by an international auditing firm, and submit it to the Ministry of Finance for onward submission to the Embassy of Italy to Afghanistan.
5. Any spent amount of funds which remain unaudited after completion of Project activities shall be returned to the Government of Italy.
6. Representatives of the concerned Bodies of the Italian Government shall have the right to:
 - a. Carry out any audit or inspection considered necessary as regards the use of the Italian grant in question based on all relevant documentation.
 - b. Inspect accounts and records of suppliers and contractors relating to the performance of the contract, and to perform a complete audit.

Article 14
Other Stipulations

1. Firms may be barred from contracts financed by Italian Grant, either indefinitely or for a specified period of time if the Government of Italy determines that the firm is engaged in corrupt or fraudulent practices in competing for, or in executing, a contract financed by Italian Grant.
2. All funds shall be channelled through the Ministry of Finance using the established procedures.
3. Funds received by MISFA through the Ministry of Finance will be on lent to selected SMEs and implementing organizations on the basis of MISFA standard contracts and procedures. In case that standard contracts and procedures cannot be applied, any deviations shall be agreed upon through exchange of letters between the Italian Embassy in Kabul and MoF.

4. Purchase under this Project shall be in accordance with the MISFA's operations manual.
5. All correspondence and meetings between the Parties shall be conducted in the English language.

Article 15

Settlement of disputes

1. Any dispute concerning the interpretation or implementation of this Agreement shall be settled by negotiation between the Parties through diplomatic channels.

Article 16

Entry into Force, Commitment and Disbursement of the Contribution

1. This Agreement shall enter into force on the date of the receipt of the last of the two Verbal Notes by which the Parties shall officially have notified to each other the completion of their respective ratification procedures.
2. Funds under this Agreement will be committed by the Italian side after signature and disbursed in one instalment upon entering into force of this Agreement.

Article 17

Extension or Termination

1. This Agreement shall remain in force from the date of signature for a three-year period and may be extended for a following three year period. Possible further extensions may be agreed between the Parties for a period to be agreed upon through an exchange of letters between the Italian Embassy in Kabul and the GoIRA. Any unspent funds that have not been committed or funds which have not been spent for the Project after termination of this Agreement shall be returned to the GoRI by the GoIRA, unless otherwise agreed upon by the Parties through an exchange of letters according to provision of Art. 18.
2. The Parties may terminate the Project at any time by agreement through diplomatic channels. In this case, unspent and uncommitted funds will be returned to the GoRI by the GoIRA, unless otherwise stipulated.
3. In witness hereof the undersigned Representatives, duly authorised by their respective Governments, have signed the present Agreement.

Article 18

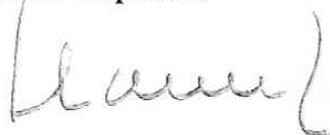
Amendments

1. The Parties, at any time, may change the content of this Agreement through Amendments, pursuing the same programme purpose, according to the following procedures:
 - 1.1. -increases or decreases of less than 15% on each Budget Line of table at Art. 6.1 as set in Article 6.2, shall be formalized through an exchange of letters between the Embassy and MoF and do not require an amendment to the present Agreement;
 - 1.2. -all other variations, causing an increase or decrease of more than 15% on any Budget Line of table at Art. 6.1, will represent an amendment to the present Agreement and shall be formalised through an exchange of Verbal Notes between the Parties;

- 1.3. -at the termination of the Project, any balance of the Italian fund remaining in the MSA, interests accrued included, if any, shall be transferred to the MoF and their destination shall be agreed upon with the Italian Government through an exchange of letters according to the provision of Art. 8.3;
- 1.4. -if standard contracts and procedures cannot be applied, any deviations will be agreed upon between the Italian Embassy in Kabul and MoF through an exchange of letters according to the provisions of Art. 14.3;
- 1.5. -any other modification shall require an amendment to the present Agreement.

Done in Kabul, on _____, in two originals in the English language.

**For the Government of the
Italian Republic**



**For the Government of the
Islamic Republic of
Afghanistan**

