

**REPUBLIC OF KENYA**



# **PUBLIC DEBT AND BORROWING POLICY**

**JUNE 2020**

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## **ABBREVIATIONS AND ACRONYMS**

BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CMA	Capital Markets Authority
CRA	Commission on Revenue Allocation
DPSRM	Debt Policy Strategy and Risk Management
DRS	Debt Recording and Settlement
DSA	Debt Sustainability Analysis
GDP	Gross Domestic Product
GoK	Government of Kenya
IBEC	Inter-governmental Budget and Economic Council
MDAs	Ministries, Departments and Agencies
MTDS	Medium Term Debt Management Strategy
NT	National Treasury
OTC	Over the Counter
PAC	Public Accounts Committee
PIPM	Public Investment and Portfolio Management
PDMO	Public Debt Management Office
PFM	Public Finance Management
PPP	Public Private Partnership
RMD	Resource Mobilization Department
SOE	State-Owned Enterprise

## **DEFINITIONS**

In this policy—

“Accounting officer” means— (a) an accounting officer of a National Government entity referred to in section 67 of the PFM Act 2012;

(b) An accounting officer of a County Government entity referred to in section 148 of the PFM Act 2012;

“Budget Policy Statement”, in relation to a financial year, means the Budget Policy Statement referred to in section 25 of the PFM Act 2012;

“Cabinet Secretary” means the Cabinet Secretary responsible for matters relating to finance;

“County Executive Committee member for finance” means the member of a County Executive Committee responsible for the financial affairs of the County and for the County Treasury;

“County Fiscal Strategy Paper”, in relation to a County Government, means the County Fiscal Strategy Paper referred to in section 117 of the PFM Act 2012;

“Inter-governmental Budget and Economic Council” means the Council established under section 187 of the PFM Act 2012;

“National Government entity” includes any department or agency of the National Government and any authority, body or other entity declared to be a National Government entity under section 4(1) of the PFM Act 2012;

“National Treasury” means the National Treasury established by section 11 of the PFM Act 2012;

“Sinking Fund” means the fund established by section 50(6) of the PFM Act 2012;

## **FOREWORD**

Public debt management is an integral part of macroeconomic environment in any economy. It has implications on public expenditure and a direct bearing on macroeconomic stability.

Kenya's debt sources include external creditors (multilateral, bilateral and commercial lenders) and domestic market through loans and issuance of debt securities. The debt stock in nominal terms has been growing over time due to fiscal deficits incurred to support expenditure on development projects.

The cost and risk characteristics of the debt portfolio have also evolved over time, driven mainly by the diversification of funding sources and declining financing from the concessional sources following the reclassification of the country to a lower middle-income status, coupled with the changing landscape in the international capital markets.

Kenya's debt stock remains sustainable as gauged against the sustainability thresholds prescribed by the World Bank. Since 2009, Kenya has been formulating the annual Medium-Term Debt Management Strategy to guide on the instrument-mix for financing fiscal deficits, and the issuance scenarios.

In the pursuit of reducing vulnerabilities to risks of public debt, the National Treasury has formulated this Public Debt and Borrowing Policy (hereafter simply referred as 'the Debt Policy')

The policy is meant to act as a guide for public debt and borrowing practices of the National and County Governments, including the issuance process and management of the debt portfolio. With this policy, there will be improvement in the quality of decisions, better articulation of policy goals, clearer guidelines for the structure of debt issuance, and a demonstration of commitment to long-term capital and financial planning.

The policy emphasizes the need to adhere to the laws and regulations governing public debt management. The Government is committed to ensuring debt sustainability and to meeting debt obligations in a timely manner. The policy, prepared in line with the best practices, will serve as a guide to all parties involved in public debt management in an endeavour to effectively guide public borrowing practices and coordinate decisions in debt management.

The policy will come into effect upon approval by the Cabinet. It is anticipated that Parliament will enact legislation required by this policy to align it to existing legislation. For purposes of new legislation, upon approval of this policy, the Attorney General, in consultation with the National Treasury will prepare the relevant Bills for tabling in Parliament as soon as reasonably practicable to enable Parliament to enact the legislation.

**HON. AMB. UKUR YATTANI, EGH**  
**CABINET SECRETARY/THE NATIONAL TREASURY AND PLANNING**

## **PREFACE**

Formulation of a comprehensive Public Debt and Borrowing Policy has come at the right time for Kenya when public debt has been in public debate, and the debt stock has become a matter of concern to fiscal sustainability. The policy will play a major role in guiding on the optimal process of procuring debts/loans and management of the same in a way that optimizes benefits and minimizes costs and risks.

The lead work on the policy was by the National Treasury. However, the policy has been prepared through a participatory process in line with Constitutional requirement for public participation in matters of public finance. The initial draft policy was posted on the National Treasury website and sent to various stakeholders inviting comments and inputs as a way of providing opportunity for the public to contribute in shaping it. The National Treasury also held a two-day consultative forum for members of County Executive Committee in charge of finance, where invaluable comments and feedback were provided. In addition, a one-day validation workshop was held with the various stakeholders to demonstrate that all their comments on the policy had been considered and where necessary, incorporated in the policy.

I thank everyone for their tireless work and collaborative effort in coming up with a policy document that will take our country forward in matters concerning public debt.

**JULIUS MUIA, PhD, CBS**  
**PRINCIPAL SECRETARY/NATIONAL TREASURY**

## **1. INTRODUCTION**

### **1.1 Purpose**

1. The Public Debt and Borrowing Policy provides guidance on raising resources through borrowing to finance the budget and managing the public debt portfolio at minimum cost and prudent level of risk while ensuring public debt remains within sustainable level over the long term. The policy also seeks to promote the development of domestic market for Government debt securities.
2. The policy is anchored in the Constitution of Kenya 2010, specifically the principles of public finance. It provides for a strong accountability framework in borrowing and management of the public debt portfolio. Parliament, Auditor General, Controller of Budget, Commission on Revenue Allocation and the Central Bank of Kenya play a key role in the management of public debt and borrowing.
3. Under delegated authority of the Cabinet Secretary, the Public Debt Management Office (PDMO) within the National Treasury will be responsible for the day to day operations of public debt management, which include sourcing required funds, negotiating and processing loan contracts, and disbursements and settlement of debt service obligations accurately and timely. Further, the PDMO will maintain the public debt register, undertake periodic debt sustainability analysis, prepare statistical and analytical debt reports, and promote dissemination of information on public debt and borrowing.
4. The PDMO is required to, among other things, have clear roles and responsibilities, processes and procedures in the conduct of public debt management operations guided by the relevant laws and best practices. The staff will subscribe to a code of conduct/ethics and conflict of interest guidelines. It will have adequate resources including skilled and competent human resource to manage borrowing and public debt.

### **1.2 Rationale and Context**

5. Kenya's public debt has gradually risen to Ksh 6.0 trillion (US\$ 60 billion) as of end December 2019, split broadly equally between external and domestic debt, and the structure continues to evolve with economic transformation of the country. Public debt is primarily driven by fiscal deficit as the country resorts to borrowing to fill the budgetary resource gap to finance development needs of the two levels of government. The costs and risks characteristics of the public debt portfolio have significantly changed over time due in part to increase in stock and its components, and due to decline in grants from development partners. Consequently, debt service obligations have risen and fiscal consolidation to stem

expenditure pressures need to be sustained to avoid undesirable outcomes.

6. Sound public debt, fiscal, and monetary policies, and financial policies promote sustained macroeconomic stability, economic growth and development to enhance the general welfare of the citizens. This policy seeks to strengthen coordination in implementation of monetary and fiscal policy operations to minimise costs and risks inherent in the management of public debt and borrowing. Further, the development of domestic debt market for Government securities hinges in part on financial sector reforms, and better coordination in the execution of monetary policy operations and government borrowing activities in the domestic market.
7. The PDMO will prepare annual Medium-Term Debt Strategies (MTDS) specifying plans on how to finance budget deficits and specific measures to address emerging issues in the public debt portfolio. Notwithstanding the increase in size, cost and risk of the public debt, the country does not have a clear policy on public debt and borrowing. Debt and borrowing policy is required to define the scope and limits within which decisions on borrowing and debt management are taken for effective outcome of borrowing to the country. It is against this background that this policy has been developed. Effective implementation of this policy supported by robust MTDS and other macroeconomic policies will safeguard the country's debt sustainability level.

## **2. OBJECTIVES, SCOPE AND COORDINATION**

### **2.1 Objectives**

8. The objectives of the debt and borrowing policy are to:

- i) Ensure Government financing needs and its payment obligations will be contracted at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk. The structure of public debt will mitigate/balance the costs and risks including refinancing risk, foreign exchange risks, size of the economy, public revenues, debt liabilities currency vis-a-vis revenue currency, etc;
- ii) Ensure public debt remains sustainable and that it does not place unbearable burden on its current and future generation. In this regard, management of public debt will seek to safeguard National Government's ability to service debt without compromising the fiscal capability to fund provision of public services and development projects;
- iii) Ensure regional equity in the distribution of benefits and costs arising from debt funded projects; and
- iv) Promote the development of domestic debt market for Government debt securities.

### **2.2 Scope**

9. Public debt will have the meaning as defined in the Constitution. The scope of this policy will be National Government, County Government, and their entities.

### **2.3 Coordination with Fiscal and Monetary Policies**

10. The PDMO will communicate to the Fiscal Policy Unit the impact of proposed Government financing requirements (fiscal deficits) and debt levels on borrowing costs and risks. The fiscal framework will take into account the concerns raised by the PDMO in relation to minimizing costs and risks of the debt portfolio.

11. Due to their interdependence, there will be a mechanism to advice on fiscal deficits, borrowing, and monetary policy operations. It is critical that an effective mechanism is in place for information sharing and synchronization of borrowing by the National Treasury and monetary operations by the Central Bank of Kenya. Coordination of policy implementation is necessary to ensure that the National Treasury and the Central Bank of Kenya are executing policy operations that are, to the extent possible, not unduly in conflict with each other, while at the same time ensuring separation of accountabilities for the different functions.

12. The Cabinet Secretary will set up a Debt, Fiscal and Monetary Affairs Coordination Committee comprised of high-level representatives from the PDMO, the unit responsible for fiscal and macroeconomic affairs of the National Treasury, and the Central Bank of Kenya.
13. The role of the Debt, Fiscal and Monetary Affairs Coordination Committee will be: to provide guidance on the level of fiscal deficits; the implementation of borrowing operations prescribed by the Medium Debt Management Strategy; sound coordination of implementation of borrowing, monetary operations and public financial policies to minimise cost and risks; and promote macroeconomic and financial markets stability and economic growth and safeguard the general welfare of Kenyan citizens.
14. The Cabinet Secretary and the Governor of the Central Bank of Kenya (CBK) will ensure that the Debt, Fiscal and Monetary Affairs Coordination Committee meet regularly, and at least quarterly.

### **3. TRANSPARENCY AND ACCOUNTABILITY**

#### **3.1 The Legal Basis for Borrowing**

15. Subject to the provisions of the Constitution of Kenya and other relevant laws, the Government, through the Cabinet Secretary may borrow or raise money from any reputable source for purposes of economic management and development of the country. The Cabinet Secretary may guarantee or raise a loan on behalf of Government or any other public institution, authority or person as authorised by or under an Act of Parliament.

#### **3.2 Principles of Public Finance**

16. The Constitution of Kenya stipulates the following principles to guide all aspects of public finance management. The principles will apply to public borrowing and debt management.
- a) There will be openness and accountability in borrowing and management of public debt;
  - b) Public debt management will promote an equitable society;
  - c) The burdens and benefits of the use of resources and public borrowing will be shared equitably between present and future generations;
  - d) Public money will be used in a prudent and responsible way; and
  - e) Borrowing and management of public debt will be responsible and fiscal reporting will be clear.

#### **3.3 Decision Making**

17. The decision to borrow on behalf of the Government rests with the Cabinet Secretary.
18. In addition to this policy, the Cabinet Secretary will be guided by the:
- a) Constitution of Kenya, PFM Act 2012 and the relevant laws and Regulations;
  - b) Kenya External Resources Policy and other Government policies;
  - c) Budget Policy Statement and Medium-Term Debt Strategy; and
  - d) Annual Budget Estimates approved by the National Assembly.

#### **3.4 Audit of Public Debt and Borrowing**

19. The Office of the Auditor General will audit all public debt management operations in accordance with the law.

### **3.5 Control of Loan Proceeds and Payments**

20. The Controller of Budget will authorize withdrawal of funds for debt management operations – receipts and payments – and prepare reports on public debt and borrowing in accordance with the law.

### **3.6 Settlement of Debt Service Obligations**

21. Public debt service will be settled on due date in accordance with the provisions of the underlying loan contracts/agreements.

22. All laws governing public debt management operations and laid down procedures must be strictly followed in the settlement of public debts.

### **3.7 Proceeds of Borrowing**

23. All loan proceeds will be credited into the National Exchequer Account or any other account provided by law.

### **3.8 Disclosures**

24. Public debt and borrowing processes will be conducted in a transparent and open manner. In enhancing fiscal transparency, the National Treasury will: -

- a) Publish and publicize debt reports and information as guided by the relevant laws;
- b) Set-up and avail relevant information on a Government website;
- c) Be responsive to the public on debt management issues;
- d) Engage as needed with the potential lenders, creditors/investors in Government securities and media; and
- e) Undertake any other necessary measures to achieve this objective.

#### **4. GUIDELINES FOR PUBLIC DEBT MANAGEMENT**

25. The Government will raise resources through borrowing to finance the approved budget while maintaining within sustainable levels the debt accumulation, costs and risks. The management of public debt will be in accordance with the relevant laws and international best practice.

##### **4.1 Purpose for Borrowing**

26. The National Government may borrow or guarantee debt for any of the following purposes:

- a) Financing government budget deficits;
- b) Honoring obligations under National Government guarantees;
- c) Refinancing and pre-financing existing debts;
- d) Cash management;
- e) To mitigate against adverse effects caused by an urgent and unforeseen event in cases where the contingency fund is depleted;
- f) Enhance official foreign exchange position; and
- g) Meet any other development policy objectives that the Cabinet Secretary will deem necessary, consistent with the law.

27. The Cabinet Secretary for finance will ensure that the level of fiscal deficits set out in the Budget Policy Statement is consistent with the principles of public finance as set out in the Constitution of Kenya and the objectives of this policy.

##### **4.2 Managing Costs and Risks**

28. The MTDS will guide public borrowing and issuance of guarantees, taking into account the cost and risks associated with the various borrowing options. Borrowing decision will take into account creditor concentration, type of credit finance, purpose, amount, repayment terms, currency of contract, and any other risks.

29. Short-term borrowings will be for management of temporary cash flow fluctuations during the financial year.

30. Development/capital expenditures will be financed through long-term borrowing to maximize the benefits of long repayment periods of these type of loans.

31. The grace period for any loan should be sufficient to enable effective completion of the project/programme to minimize costs and risks.

32. Kenya will endeavour to the extent possible to contract loans on concessional terms. For avoidance of doubt, concessional loans is a financing agreement with a grant element of thirty-five (35) percent or more calculated at a discount rate of five (5) percent.
33. To the extent possible, proceeds from commercial borrowing will be applied to fund projects that demonstrate potential compensating revenue streams or credible environmental protection value, environmental rehabilitation projects or refinancing debt related to green-eligible projects.
34. The currency mix of the public external debt portfolio will, to the extent possible, match that of the country's foreign exchange reserves or foreign trade earnings.

#### **4.3 Public Debt Sustainability**

35. In deciding whether or not to contract new debt, emphasis will be placed on monitoring the level of total public debt, and to assess the potential cost and risk of new debt measured against the available fiscal space and the vitality of the economy to ensure that future borrowing will maintain outstanding debt within sustainable levels. The ratios to be monitored include solvency and liquidity indicators. These ratios include:
  - a) Debt to GDP;
  - b) Debt service to GDP;
  - c) Debt service to revenues and exports;
  - d) External debt service to foreign reserves;
  - e) Interest payments to GDP;
  - f) Interest payments to revenues and exports;
  - g) Present value of debt over exports;
  - h) Present value of debt over fiscal revenue; among others.
36. In addition, other emerging Debt Sustainability Indicators will be tracked, reported and monitored to provide early warning signals on sustainability of public debt.

#### **4.4 Public Debt Ceiling**

37. Public debt ceiling as set out in the relevant public finance management laws will be consistent with the East African Monetary Union convergence criteria.
38. The annual budget estimates presented by the Cabinet Secretary will specify the net borrowing for the financial year and the resultant debt limit

for the year. The strategy of borrowing to finance Government budget will be outlined in the MTDS.

39. For purposes of monitoring compliance with the borrowing limits, the amount of Government debt and guarantees that are not denominated in shillings will be calculated at the prevailing mean exchange rate published by the Central Bank of Kenya.

#### **4.5 Absorption of Proceeds of Debt**

40. Loan proceeds from Official Development Assistance (ODA) will be utilized to finance projects in accordance with the relevant laws to ensure optimal absorption of borrowed funds.
41. All Ministries Departments and Agencies (MDAs)/County Governments must ensure that all ongoing projects are completed before initiating new projects. Sanctioning of new projects must receive express authority from the National Treasury. The National Treasury's authority to sanction any new project in accomplishment of Kenya's development priorities and strategies must be demand driven and demonstrate priority of the people of Kenya.
42. Debt financed projects will be those that support the achievement of Government policy objectives outlined in public policy statements and reports.

#### **4.6 Mandatory Checklist and Conditions Precedent to Debt Contracting**

43. In order to mitigate the Government against any potential financial risks of paying commitment fees and other charges on loan amounts due to delays in commencement of project implementation, the following checklist of mandatory requirements must be provided to the National Treasury by Ministries, Departments and Agencies (MDAs), National Government entities and County Governments before contracting external financial support:
  - a) Feasibility study report inspected and approved by the relevant Government entity informing the project economic viability, costing and design and social and environmental risks mitigation plans;
  - b) Confirmation of the land and way-leave acquisition for the project. The Resettlement Action Plan (RAP) report should be provided, if necessary;
  - c) Commitment to relocate public utilities;
  - d) Confirmation of adequate human resources capacity for project implementation. Where there is a shortfall, the Implementing

Ministries, Departments, Agencies (MDAs) and County Governments must commit to develop a strategy to fill the gap;

- e) Prioritization and commitment of the counterpart funding by all MDAs/County Governments where necessary;
  - f) Due diligence report to ascertain the financial, technical and legal competency for the firm procured competitively to undertake the project implementation. This will mainly apply to the projects that are undertaken under Engineering, Procurement, Construction and Financing (EPCF) Model;
  - g) Any other requirements depending on either Bilateral or Multilateral Framework Agreement with the respective development partner;
  - h) Funding, including but not limited to land and way-leave compensations, among others, that form part of counterpart funding must be prioritized under the MDA's sector allocation through the normal Medium-Term Expenditure Framework (MTEF) budgeting process in accordance with the requirements of the loan agreement; and
  - i) Compliance with any existing laws and circulars.
44. All project proposals should be forwarded to the National Treasury through the Line Ministries and not through financiers and/or contractors. The National Treasury will review such project proposals to assess suitability for debt financing, taking into account the objectives of this policy.
45. To enhance absorption of funds by the implementing entities of debt funded projects, the National Treasury will conduct completion rate analysis from time to time and recommend to the Cabinet Secretary to take certain measures for project loans that are not being absorbed due to action or inaction of the implementing entities of debt-funded projects.
46. The absorption capacity of implementing entity should match the disbursement profile of the loan to minimize commitment charges that accrue on undisbursed loan balances. The track record of project completion rates in relevant entities will determine eligibility for funding of new projects.
47. The implementing units will work with the National Treasury to ensure Conditions Precedent (CPs) are met first before signing of project financing agreements. During the project implementation period, implementing entities of debt-funded projects will provide quarterly project implementation status reports to the National Treasury.

#### **4.7 Loan Cancellations**

48. Un-drawn loan balances for non-performing and or completed projects will be reviewed on a regular basis to allow modification of project

implementation or loan cancellation if necessary, and to revise the level of new borrowings to be approved in subsequent periods. It is therefore mandatory that implementation of projects is closely monitored by the implementing agencies.

#### **4.8 Sources of Debt Financing**

49. The Government will borrow from multilateral, bilateral and reputable financial institutions or through issuance of debt instruments in the financial market. Government borrowing will be guided by the need to lower cost and minimize risks, particularly of foreign exchange, interest rate, refinancing and settlement risks. Further, it will not be undertaken in a manner that undermines access of credit to the private sector.
50. The Government will endeavour to implement sound macroeconomic policies and structural reforms to strengthen its credit rating to enhance its access to a wider array of sources of financing at lower cost and risk while maintaining overall debt within sustainable levels. The Government will seek to promote development of the local domestic debt market to play an increasing role in funding government requirements without crowding out the private sector. The issuance of debt securities should be transparent, predictable and the pricing reflect prevailing market conditions.

#### **4.9 Transparency in Contracting debt Financing**

51. The Government will consider and negotiate the terms and conditions offered by different potential lenders when contracting debt.
52. Except for ODA provided under the provisions of the Kenya External Resource Policy, there is need to demonstrate that the Government has engaged in a transparent and competitive process consistent with the public procurement law to identify potential lenders for commercial loans to ensure least cost and risk financing.
53. Marketable securities will be issued through a transparent and efficient automated settlement and trading system. The auction process along with the operations of the secondary market will be conducted in a transparent manner. Securities trading will be undertaken on a transparent and efficient trading system, whether through a regulated exchange or Over-the-Counter (OTC) market system.
54. The Cabinet Secretary may authorize issuance of marketable debt securities through private placement or any other method in either local or foreign currency.
55. The Cabinet Secretary will endeavour to implement a retail government domestic debt securities issuance programme to promote financial inclusion, financial literacy and savings.

## **5. INSTITUTIONAL FRAMEWORK**

56. The institutional framework for managing public debt and borrowing will include Parliament, the Cabinet, Cabinet Secretary and Public Debt Management Office.

### **5.1 Parliament**

57. The public debt management responsibilities include:

- a) Enacting laws governing public debt management;
- b) Approving Annual Budget Estimates, BPS and MTDS;
- c) Setting public debt ceiling and annual Government borrowing limit;
- d) Approving Government guarantees; and
- e) Oversight of the executive arm of Government on public debt management.

### **5.2 Cabinet**

58. The public debt management responsibilities include consideration and approval of:

- a) Public debt and borrowing policy;
- b) Annual Budget Estimates, BPS (stating size of the fiscal deficit);
- c) MTDS (outlines financing strategies for fiscal deficit); and
- d) Approval of new projects in accordance with the relevant laws.

### **5.3 Cabinet Secretary**

59. The responsibilities on public debt management include:

- a) Develop the policy and financial framework in accordance with Constitutional principles within which the PDMO operates;
- b) Raise loans or grants on behalf of the National Government within or outside Kenya subject to relevant laws;
- c) Execute loan documents or authorize any other person in writing to execute loan documents for borrowing by the National Government. For borrowing by the National Government entity, relevant laws will provide for the persons authorised to execute loan documents.
- d) Issue National Government securities;

- e) Enter into derivative financial transactions on behalf of the National Government;
- f) Guarantee a loan of a County Government or any other borrower with the approval of Parliament;
- g) Delegate to the head of PDMO the operational decisions on borrowing and debt management and the day-to-day management of the PDMO;
- h) Ensure the PDMO has the resources and skills to manage the debt and borrowing according to international best practices for liability management;
- i) Be accountable to Parliament for the work of the PDMO;
- j) Appoint advisers, agents and underwriters for raising loans and issuing and managing National Government securities;
- k) Enter into agreements with the advisers, agents and underwriters appointed on the role to be undertaken by them and remuneration to be paid;
- l) Issue guidelines on amendment of National Government securities register;
- m) Submit MTDS to Parliament on an annual basis;
- n) Make regulations on public debt management;
- o) Approve government entity's intended borrowing programme.

#### **5.4 Public Debt Management Office**

60. The PDMO will have operational independence in management of public debt. An Act of Parliament will prescribe the roles and mandate of the PDMO.

##### **5.4.1 Role of PDMO**

61. The role of the PDMO will include:

- a) Raising funds through borrowing or grants to finance the budget deficit at minimum cost and prudent level of risk over the long-term;
- b) Managing the public debt portfolio to lower costs and risks in accordance with best practice;
- c) Maintaining the public debt records including the public debt register;
- d) Preparing public debt management reports;
- e) Designing and implementing the MTDS;

- f) Carrying out periodic debt sustainability analysis;
- g) Undertake investor relations on public debt management;
- h) Promote the development of domestic markets for government debt securities;
- i) Managing financial transactions on public debt and borrowing;
- j) Support county governments and public entities on debt management and capacity development;
- k) Appoint agents to provide technical advice or undertake administrative functions for the management of debts; and
- l) Perform any other function as may be assigned by the Accounting Officer in accordance with the relevant laws.

#### **5.4.2 Public debt management functions**

62. In accordance with international best practices, the public debt management function will be performed in three (3) distinct functional areas of Front, Middle and Back Office with clearly demarcated/separated functions as an operational risk management strategy.

##### **5.4.2.1 Front office functions**

63. The functions include:

- a) Undertake domestic and foreign borrowing including raising of grants in accordance with this policy, Kenya External Resource Policy and relevant laws;
- b) Implementation of government securities auction calendar;
- c) Undertaking investor relations activities, roads shows, net shows, liaison and coordination with creditors and market participants;
- d) Seeking legal opinions from the Attorney General on loan negotiations and liaising with implementation agencies to ensure that conditions precedents are fulfilled in time to save government from undue costs on commitment fees;
- e) Facilitate acquisition of work permit for external consultants.
- f) Formulating annual borrowing plan and, in consultation with the fiscal agent, prepare the annual domestic debt issuance calendar;
- g) Processing of Government Guarantees;
- h) Coordinate missions and technical assistance from cooperating development partners; and

- i) Manage withdrawal of loan funds to development projects.

#### **5.4.2.2 Middle office functions**

64. The functions include:

- a) Prepare, implement and review the MTDS;
- b) Undertake periodic public debt sustainability analysis, portfolio risks and costs analysis and prepare relevant reports;
- c) Establish and update debt risk management framework;
- d) Review public debt management policy and guidelines;
- e) Analyse fiscal risks associated with Government Guarantees and Public Private Partnerships (PPPs);
- f) Prepare periodic analytical and other debt management reports for the Cabinet Secretary;
- g) Prepare statutory debt related reports for the Cabinet Secretary;
- h) Advise and coordinate domestic debt market for government debt securities;
- i) Advise on public debt management and issuance strategies.

#### **5.4.2.3 Back office functions**

65. The functions include:

- a) Process and settle debt service;
- b) Process disbursement of loans and grants;
- c) Prepare, reconcile and maintain financial statements on debt and grants related transactions and submit to the Accounting Officer responsible for finance;
- d) Maintain public debt registry;
- e) Maintain a comprehensive and reliable debt database for public debt and grants; and
- f) Monitor and report disbursement of loans and grants.

#### **5.5 Code of Conduct**

66. All staff in the PDMO will be subjected to code-of-conduct and conflict-of-interest guidelines as issued by the Cabinet Secretary from time to time.

## **5.6 Indemnity**

67. Indemnity for officers handling public debt matters will be provided under relevant laws.

## **5.7 Debt and Borrowing Reports**

68. The PDMO will prepare the following:

- a) The Medium-Term Debt Strategy consistent with the Budget Policy Statement;
- b) The Government borrowing plan for the approved Annual Budget;
- c) Statistical and analytical reports on debt and borrowing;
- d) The annual performance reports of the PDMO;
- e) Report of all loans made to the National Government, County Governments and their entities;
- f) Report on loan balances, drawings and amortization on new loans obtained outside Kenya or denominated in foreign currency;
- g) Report of all guarantees given by the National Government in a financial year.

## **5.8 Adequacy of Staff and Resources in PDMO**

69. The Cabinet Secretary will ensure that sufficient resources are availed to the PDMO to carry out its mandate under the relevant laws and sufficient to safeguard its ability to provide independent policy advice and maintain the integrity of public debt management.

## **5.9 Relationship of PDMO with other Agencies**

### **a) Communicating with lenders, development partners, investors and rating agencies**

70. The PDMO will undertake investor relations including with development partners, the rating agencies and the public on matters of public debt management.

### **b) County Governments**

71. The PDMO will monitor County Government debt operations; and maintain a debt database including report on performance of County Government guarantees. The PDMO will assist a County Government at its request in its debt management and borrowing.

**c) Central Bank of Kenya**

72. The Central Bank of Kenya (CBK) performs the following functions in relation to public debt management:

- a) Acts as Fiscal Agent for the National Treasury in making external and domestic debt payment services;
- b) Acts as registrar of Government domestic debt securities;
- c) Maintains bank accounts of public funds including Treasury Single Account;
- d) Advises the Government on public debt management;
- e) Provides depository facilities for Government domestic debt securities;
- f) Provides clearing and settlement arrangements for trade in Government domestic debt instruments; and
- g) May provide advance to the Exchequer Account in accordance with relevant laws.

**d) Office of the Attorney General**

73. In the management of public debt, the National Treasury will seek advice, legal clearance and legal opinion on financial contracts, framework agreements and Memorandum of Understanding (MoUs) from the Attorney General as required by the relevant laws.

**e) Ministries, Departments and Government Agencies (MDAs)**

74. In relation to public debt management, the MDAs will perform the following duties:

- a) Participate in the loan negotiation process for financing projects under their mandate; and
- b) Comply with all relevant laws governing optimal utilization of proceeds from loans and grants to ensure value for money.

**f) Public Private Partnership (PPP)**

75. In accordance with the relevant Act, the PDMO will assess and advice on fiscal risks and contingent liabilities associated with PPP projects.

**g) Capital Market Authority**

76. The PDMO will collaborate with the CMA in developing a robust and vibrant domestic debt market for Government securities.

**h) Commission on Revenue Allocation**

77. The PDMO will submit the MTDS to the Commission on Revenue Allocation (CRA) as required under the relevant laws.

**i) Auditor General**

78. All public debt and borrowing will be subject to audit in accordance with the law.

**j) Intergovernmental Budget and Economic Council**

79. The PDMO will submit the MTDS and any information on guarantees to County Governments and their entities to IBEC as required under the relevant laws.

## **6. PUBLIC DEBT RISK MANAGEMENT**

### **6.1 Risk Management Framework**

80. The PDMO will establish a risk management framework to enable identification and management of the trade-offs between expected cost and risk in the Government debt portfolio.
81. The public debt management roles will be performed through three (3) distinct functional areas clearly demarcated, i.e. Front, Middle and Back Office in accordance with international best practices to mitigate against operational risks.
82. To assess risk, the PDMO will conduct regular DSA and update the MTDS regularly to ensure that overall borrowing is within sustainable limits. PDMO will conduct regular stress tests for the country's debt portfolio to determine the potential impact of economic and financial shocks the country is potentially exposed to. These shocks include, among others, exchange rates, GDP growth rate and interest rates. The PDMO will conduct an analysis on the effect of each new loan on the total debt stock and the ability of the country to service the debt, to ensure that it does not affect negatively the country's debt sustainability.
83. To manage cost and risks, the PDMO will employ liability management tools as per best practice to re-profile public debt structure.
84. The National Treasury will establish a Sinking Fund for managing refinancing and settlement risks in the public debt portfolio.
85. The PDMO may apply the following tools and techniques, among others:
  - a) Debt restructuring including debt securities buy backs, switches and exchanges;
  - b) Swapping fixed rate to floating rate debt and vice versa;
  - c) Currency swapping;
  - d) Use of a Sinking Fund;
  - e) Debt pre-payments;
  - f) Providing for use of alternative currencies for disbursement, repayment of debt in the financial agreements; and
  - g) Diversifying currency of public debt.
86. The National Treasury may undertake other derivative transactions in line with any relevant laws and in accordance with best practices to lower cost and minimize risk in the debt portfolio.

87. The PDMO will endeavour to establish sound business recovery procedures to mitigate debt management activities against the risk of natural disasters, terrorism or social unrest.

## **6.2 Medium Term Debt Strategy**

88. The National Treasury and County Governments will prepare a Medium-Term Debt Management Strategy (MTDS) for a period of three years that will be reviewed annually. The objective of the MTDS will be to guide the overall debt management operations of the National and County Governments with respect to debts, guarantees and proposed borrowing.

89. The MTDS will be prepared taking into account:

- (a) The stock of existing debt;
- (b) Potential sources of loans and guarantees given;
- (c) Principal risks associated with the loans;
- (d) Assumptions underlying the MTDS, including macroeconomic environment, borrowing needs, and prevailing market conditions;
- (e) The broad strategic priorities and policy goals set out in the Budget Policy Statement; and
- (f) Analysis of sustainability of the amount of actual and potential debt.

90. The annual borrowing limit set out in the BPS will be financed as set out in the MTDS.

91. The MTDS will guide the borrowing mix on a rolling yearly basis. Ceilings for different borrowing instruments will be set in the MTDS and the Annual Borrowing Programme.

92. The Government will develop and revise Annual Borrowing programme, which will indicate planned issuances of Government securities and disbursement of loans for each fiscal year.

93. The Annual Borrowing Programme will take into account:

- a) The maturity profile of the existing debt to avoid bunching up of maturities;
- b) An assessment of the ability to refinance debt at lower cost and risks;
- c) Prevailing domestic and international market conditions;
- d) The prevailing secondary market conditions within the financial year;
- e) The need to lengthen the maturity structure of the existing public debt;

- f) The need to develop liquid benchmark bonds;
- g) The currency composition of existing debt;
- h) The interest rate composition and any recommendations on interest rate composition for entering into future debt; and
- i) The need to diversify sources of borrowing and diversify creditor base.

## **7. DEVELOPMENT OF DOMESTIC MARKET FOR GOVERNMENT DEBT SECURITIES**

### **7.1 Domestic Debt Market Development**

94. One of the principal objectives of public debt management is to promote the development of domestic debt market. The PDMO in collaboration with relevant stakeholders will implement initiatives to develop and deepen Government securities' secondary markets to ensure pricing transparency, liquidity, competitiveness and efficiency in securities issuance, trading and settlement systems that lead to reduction in Government securities yield to support reduction in the cost of debt, affordability of credit to private sector and overall economic development.
95. The PDMO will strive to achieve a broad investor base for its domestic and foreign borrowings to minimise creditor concentration risk.
96. Retail securities may be issued not necessarily for financing fiscal deficits but primarily as vehicles for promoting financial education and literacy, savings culture and market development in general.

### **7.2 Secondary Debt Market Development**

97. The PDMO and its fiscal agents will conduct debt management operations in the secondary market in accordance with the MTDS and the relevant laws.
98. To improve transparency and efficiency, debt securities issuance and trading will be conducted through an electronic primary auction mechanism.
99. Primary issuance and secondary trading will be guided by rules anchored on international best practice and consistent with the law.

## **8. PROCEDURES FOR BORROWING**

### **8.1 Debt Ceiling**

100. Any borrowing will be within the debt ceiling set by Parliament.

101. For external and domestic borrowing, the National and County Governments and their agencies will be subject to the following:

#### **8.1.1 National Assembly**

102. In the case of National Government, the following approvals must be obtained annually from the National Assembly prior to any consideration of requests for borrowing by the Government and its agencies:

- a) Budget Policy Statement;
- b) Medium Term Debt Strategy;
- c) Annual Budget estimates.

#### **8.1.2 County Assembly**

103. A county Government seeking to borrow must obtain the following approvals prior to consideration of request for guarantee by the National Government:

- a) County Strategy Paper;
- b) County MTDS;
- c) Annual Budget Estimates.

#### **8.1.3 Procedural requirements**

- a) For domestic borrowing, the PDMO in consultation with the department responsible for cash management and CBK will prepare the Annual Borrowing Plan to assist in financing the budget deficit. For external borrowing, the PDMO will provide the composition of net external borrowing during the fiscal year.
- b) The National Treasury will initiate the process of contracting loans.
- c) The National Treasury will contract loans only from other Governments, their agencies or reputable financial institutions or through issuance of Government securities in the market in accordance with best practice.
- d) All borrowing by the National and County governments will be issued/contracted by the Cabinet Secretary/County CECs through a transparent, accountable process, at the lowest possible risk, and in

accordance with the Annual Borrowing Plan.

- e) A checklist of conditions precedent to signing any financing agreements by the Cabinet Secretary will be submitted by the project implementing agency in a format prescribed by the Cabinet Secretary.
- f) The issuance of domestic Government debt securities will take into account:
  - i) The borrowing programme, which is consistent with the MTDS;
  - ii) Pricing of the securities;
  - iii) Refinancing risks of the securities; and
  - iv) Domestic market stability and development.

#### **8.1.4 List of Key Documents**

104. The PDMO will prepare or facilitate preparation of the following key documents to guide its effectiveness in public debt management functions:

- a) Legal framework governing public debt management;
- b) Public Debt and Borrowing Policy;
- c) Medium-Term Debt Management Strategy;
- d) Annual Borrowing Programme and Issuance Calendar;
- e) Procedure manuals on debt management operations;
- f) Debt statistical reports;
- g) Risk Management Framework for debt management;
- h) Debt Sustainability Analysis Reports;
- i) Public Debt Management Reports; and
- j) Agency Agreement between the National Treasury and fiscal agents.
- k) Bilateral cooperation agreements between the Government and development partners.

#### **8.1.5 Loan negotiation and signing of agreement**

105. Upon project approval, the Cabinet Secretary will constitute in each case: a negotiation committee for each external loan and grant, a Government securities auction committee for issuance of domestic securities, and a committee for issuance of Government securities in the local or

international bond market. The mandate of each committee will be set out in the relevant regulations.

106. Upon finalization of negotiations of a loan agreement and legal clearance by the Attorney General, the Cabinet Secretary will sign a loan agreement as per the relevant law.
107. Official Development Assistance to the Government will be channelled through the National Treasury without any exception.

## **9. BORROWING ON BEHALF OF COUNTY GOVERNMENT AND GOVERNMENT ENTITY**

108. The National Government may borrow, as and when requested and on-lend to a County Government or a National Government-owned public entity. On-lent loans will be repaid in accordance with the terms and conditions set in the subsidiary loan agreements and the relevant laws. The National Government entity or County Government shall demonstrate that it is financially capable of meeting debt service obligations as and when they fall due.

109. The Cabinet Secretary will institute recovery mechanism for any on-lent or guaranteed debt in the event of default by any entity.

### **9.1 Conversion of On-Lent Loans into Grants or Equity**

110. The Cabinet Secretary may in special circumstances consider and recommend converting on-lent loan(s) into a grant(s) or equity in accordance with any underlying commercial contracts and relevant laws.

111. In the consideration for conversion of loan into grant(s) or equity, the Cabinet Secretary will seek prior approval of the Cabinet, which approval may be given only after taking into account any recommendations of the National Treasury regarding the financial implications of the investment. For the best interest of Government, the Cabinet Secretary will secure arrangements to convert loans into grants or equity in writing prior to conversion.

## **10. PUBLIC GUARANTEES AND ON-LENDING**

### **10.1 Guarantees to Borrowing Entities**

112. The National Government may consider guaranteeing borrowings of National Government entities, County Governments and any other borrower in line with the Constitution and relevant laws, if satisfied that the project to be financed for development is viable and/or of national interest. The relevant laws will stipulate terms and conditions for county borrowing and guarantees provided by the National Government.
113. The Cabinet Secretary will evaluate guarantee requests from public entities against Loan Guarantee Guidelines and stated national development priorities to determine eligibility for the guarantee.
114. The Cabinet Secretary will seek prior approval of the Cabinet to issue Government Guarantee before submitting the request to Parliament for consideration. The Cabinet will be informed on the circumstances leading to the request for guarantee, the terms and conditions of the guarantee in accordance with the relevant laws.
115. The Cabinet Secretary will take into account the opinion of the IBEC when issuing guarantees.
116. In seeking approval from Parliament, the Cabinet Secretary will submit the request for Guarantee in form of a Sessional Paper, which content will be:
- a) Objective of the Sessional Paper
  - b) The background of the subject matter
  - c) Analysis of the problem
  - d) Options on the way forward
  - e) Financial implications

### **10.2 Called Guarantees**

117. Money paid by the Cabinet Secretary on a called guarantee, including any expenses incurred by the Cabinet Secretary in respect of the guarantee, shall be:
- a) A debt due to the National Government from the borrower whose loan was guaranteed; and
  - b) Recoverable from the borrower as a debt due to the National Government in accordance with the relevant laws.

## **11. DISCLOSURE AND REPORTING OF CONTINGENT LIABILITIES**

### **11.1 Reporting on Fiscal Commitments and Contingent Liabilities**

118. A Fiscal Commitments and Contingent Liabilities policy shall guide the management and operations of Government fiscal commitments and contingent liabilities.

119. The National Treasury unit responsible for providing current information on outstanding contingent liabilities of all state-owned enterprises shall compile and report all fiscal commitments and contingent liabilities (explicit and implicit obligations), and on-lending arrangements. The report will include all contingent liabilities for each public private partnership project, SOE, the amounts, date incurred, type of obligation, and total outstanding for each SOE and shall be made available and included in the annual financial statements of the National Treasury.

### **11.2 Role of PDMO in Reporting on Fiscal Commitments and Contingent Liabilities**

120. The annual debt management report will disclose the quantum of explicit and to the extent possible implicit guarantees.

## **12. IMPLEMENTATION OF THE DEBT AND BORROWING POLICY**

### **12.1 Commencement Date**

121. This policy will come into effect upon approval by the Cabinet.

### **12.2 Implementation and Enforcement**

122. This policy will be enforced through relevant laws. Parliament may enact any legislation necessary to operationalize the policy.

123. The National Treasury will be responsible for implementation of the policy in collaboration with relevant Ministries, Departments and Agencies, Public investments, County Governments and other key stakeholders. The annual debt management report will report on progress in implementation of this policy.

124. The PDMO will prepare and implement the Operational Manuals for the Front, Middle and Back Offices, Loan Guarantee Guidelines and Government Securities Auction Committee rules anchored on this policy and relevant laws.

### **11.3 Amendment to the Policy**

125. The policy may be amended from time to time with the approval of the Cabinet to reflect the evolving operating environment and international conventions to which Kenya ascribes.

## **ANNEX 1: CONSEQUENTIAL LEGISLATION**

1. Upon approval of this Policy, the Attorney General, in consultation with the National Treasury may prepare the relevant Bills for tabling in Parliament, as soon as reasonably practicable, to enable Parliament undertake legislation.
2. Parliament may enact any legislation necessary to enforce this Policy or amendments to existing legislation to align to this Policy.
3. The National Treasury will review existing Regulations to ensure compliance with the Policy.
4. Where new rules and regulations are necessary to give force to the Policy, the National Treasury will initiate the drafting of such rules and regulations in accordance with the relevant laws.
5. Rules of conduct addressing conflict of interest for both auction committee and market participants will be developed and approved by the Cabinet Secretary to govern securities auction process, procedures and market participation.