



THE NATIONAL TREASURY

GOVERNMENT OF THE REPUBLIC OF KENYA

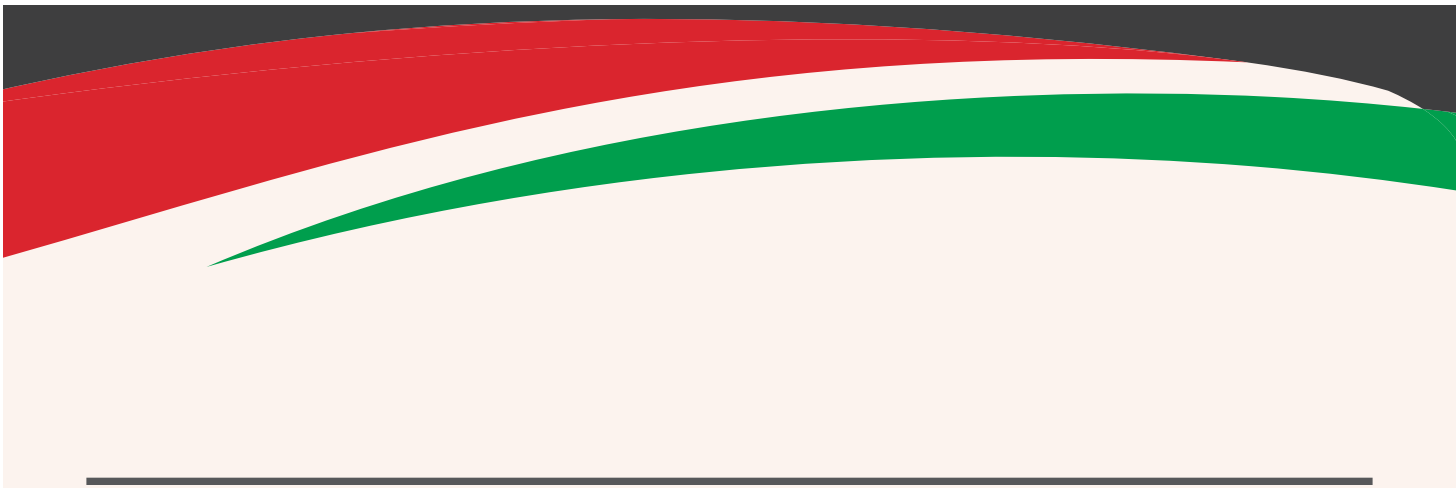
THE NATIONAL TREASURY AND PLANNING

POLICY ON THE ISSUANCE OF GOVERNMENT SUPPORT MEASURES IN SUPPORT OF INVESTMENT PROGRAMMES

**TOWARDS PROMOTING PRIVATE SECTOR CAPITAL
MOBILIZATION IN GOVERNMENT INVESTMENT
PROGRAMMES**



GOVERNMENT SUPPORT MEASURES POLICY OCTOBER 2018



Nairobi, October 2018

Any part of this document may be freely reviewed, quoted, reproduced or translated in full or in part, provided the source is acknowledged. It may not be sold or used in conjunction with commercial purposes or for profit.

Government Support Measures Policy 2018

Published by:

**The National Treasury and Planning
The Treasury Building
Harambee Avenue
PO Box 30007 Nairobi 00100**



EXECUTIVE SUMMARY

This Policy Statement declares the Government of Kenya's practice and stance on the conditions under which Government may make various supports available to implementers of public projects, in order for such investments to be more secure and bankable. It defines what a Government Support Measure is, traces the history of their usage and applications in Kenya, identifies the problems faced under current administrative practices supporting their issuance, and declares the specific policy rules that will, from the date of this Policy, apply to the practice of providing Government Support Measures.

The Policy is being declared at a time when Government has intensified implementation of its policy on a private sector-led growth strategy, and in the wake of extensive and expansive commitment to scaling up of public infrastructure across all economic sectors. Government understands that Government Support Measures impose various financial costs on public finance, and create varied forms of contingent liabilities on Government, with the risk that in the event such contingent liabilities crystallize, their financial impact on public finance may become substantially disruptive. This Policy is aimed at establishing practice principles that minimize and manage the risks created by every Government Support Measure.

The Policy applies to all public institutions at both national and county levels of Government. It also applies to all private sector parties involved in public investment programmes, including their financiers. Ultimately, this Policy promotes the intentions and spirit of the Constitution with respect to public finance management, by advancing the cause of fiscal responsibility, sustainability and accountability.

In Section 1, this Policy declares the objectives and rationales for its issuance. In Section 2, it identifies the 11 main problems with the current practice, and charts a historical outlook on the evolution of Government Support Measures. In Section 3, the current legal and institutional framework is reviewed, in a situational analysis that establishes the current practice is sub-optimal, and needs to be improved. In Section 4, the 10 main policy directions by way of policy statements are set out, covering the entire value chain of a Government Support Measure. In Section 5, the legal and institutional implications of this new policy framework are set out.

This Policy will be implemented immediately upon approval, and it is expected it will greatly contribute to Government's overall financial risk management strategy and frameworks.



ACRONYMS

MDAs	Ministries, Departments and Agencies
SOEs	State Owned Enterprises
GoK	Government of Kenya
GSMs	Government Support Measures
LoS	Letter of Support
FCCLs	Fiscal Commitments and Contingent Liabilities
MAGA	Material Adverse Governmental Action
MDA	Ministries, Departments, Agencies
PDMO	Public Debt Management Office
PFMA	Public Finance Management Act, 2012
PPP	Public Private Partnerships
PPPA	Public Private Partnerships Act, 2013
PPAD	Public Procurement and Asset Disposal Act, 2015
VGF	Viability Gap Funding

TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
ACRONYMS	5
CHAPTER 1	8
OVERVIEW, KEY POLICY DRIVERS AND THE POLICY OBJECTIVES	8
1. Introduction	8
1.1 Types of GSMs	8
1.1.2 GSM Issues	9
1.2 Policy Objectives	9
1.3 Policy Targets	10
CHAPTER 2	11
PROBLEM STATEMENT	11
2.1 The Main Challenges	12
2.2 Reflections on the Main Challenges	12
CHAPTER 3	13
CURRENT INSTITUTIONAL AND LEGAL FRAMEWORK FOR ISSUANCE OF GSMs IN KENYA	13
3.1 Institutional Framework for GSMs in Kenya	13
3.2 Legal Framework	14
3.2.1 Framework under the Constitution of Kenya	14
3.2.2 Framework under Public Finance Management Act, 2012	14
3.2.3 Framework under the Public Private Partnerships Act, 2013	15
3.3 Constraints with Current Legal and Institutional Framework	15

CHAPTER 4	16
POLICY DIRECTIONS ON ISSUANCE OF GOVERNMENT SUPPORT MEASURES	16
4.1 GSM Policy Statement 1: Categories of Available GSMs	16
4.2 GSM Policy Statement 2: To Whom and When May a GSM Issue	16
4.3 GSM Policy Statement 3: Scope of Risks covered by GSMs	16
4.4 GSM Policy Statement 4: Issuance of GSMs at County Level	17
4.5 GSM Policy Statement 5: Application and Approval Process	18
4.6 GSM Policy Statement 6: Budgeting and Accounting for GSMs	19
4.6.1 Budgeting for Explicit and Implicit Obligations	19
4.6.2 Accounting for Explicit and Implicit Obligations:	20
4.7 GSM Policy Statement 7: Management Principles	20
4.8 GSM Policy Statement 8: Valuation and Computation of GSMs	21
4.9 GSM Policy Statement 9: Documentary Requirements for Attorney General	21
4.10 GSM Policy Statement 10: Savings and Transitions	21
CHAPTER 5	22
LEGISLATIVE, INSTITUTIONAL AND FINANCIAL IMPLICATIONS	22
5.1 Legislative Implications	22
5.2 Institutional Implications	22
5.3 Financial Implications	22

Chapter 1

OVERVIEW, KEY POLICY DRIVERS AND THE POLICY OBJECTIVES

Introduction

The Government of Kenya acknowledges that deeper private sector participation in public investment programmes is key to sustainable development in Kenya. For such investments to happen, it is essential that risks are appropriately allocated, and resourced, based on the principles of which party between the public and private sectors possesses the greater ability to manage, absorb or mitigate the given risk.

In the past, the Government of Kenya provided different mechanisms for de-risking public investments, in respect of private capital mobilization for public investment and public infrastructure developments.

These Government de-risking mechanisms in various forms are termed as "Government Support Measures" under this Policy (hereafter, "GSM" or "GSMs"), and are better detailed in the next sub-section. The practice by Government in availing GSMs to the private investors realized substantial investment results for the country. For instance, since the mid-1990s, by utilizing GSMs, the Government has successfully supported electricity generation off the Government balance sheet. The cogent local experience and evidence of well utilized GSMs demonstrate the positive returns for the economy and with the Government strategy on promoting private sector participation in public infrastructure development, there will certainly be need to continue the issuance of GSMs. This will be done through this Policy that seeks to establish a framework that is transparent, and which ensures that there is accountability for public finance when the Government delivers equity and equitable development for today's and future generations.

This Policy Statement serves to clarify matters of process, as well as to provide administrative clarity to the process by which project developers may submit requests for varying forms of Government Support Measures that allows for better risk pricing and overall cost-effectiveness and fiscal sustainability in public investment. The Policy further establishes the conditions that govern the application for, assessment of and conditions for the issuance and management of GSMs in support of development of strategic public infrastructure

projects. The main objective of this Policy is to facilitate a predictable, stable and transparent framework for private sector participation in public infrastructure development.

1.1 Types of GSMs

The Government, through the National Treasury as well as other state agencies, has in the past granted various support tools for purposes of promoting private sector participation in public investment programmes which have included (but have not been limited to some of) the following:-

- 1.1.1. political risk cover, such as assurances of protection against expropriation and change in law, civil commotions, termination and similar state or country actions;
- 1.1.2. assurances on the commercial viability of state owned enterprises (SOEs), or that their successors, where they are replaced, will be equally capable of performing the obligations of the SOE under contract;
- 1.1.3. repayment guarantees or obligations in support of state corporations or county government borrowings and undertakings;
- 1.1.4. direct undertakings by the Government to financiers that project finances made available in support of public investments will be repaid when due, and where necessary, that any counterpart funding on the part of GoK will be appropriated in timely manner for project execution success.
- 1.1.5. Sovereign guarantees – used to guarantee borrowings by Government and its entities;
- 1.1.6. Letters of Support and Comfort – used variously to provide different forms of GoK undertakings, commitments and assurances in support of a project;
- 1.1.7. Project-based Guarantees usually undertaken or granted through contract provisions;
- 1.1.8. Partial Risk Guarantees (accompanied by Indemnity Agreements) – to backstop third party risks arising from various situations of project default;

1.1.9. Government Notes and Letters of Exchange – committing Government to a recognition of a bilateral or other government to government led transaction, and to the doing of specific tasks to actualize the undertakings of the parties under such instruments;

1.1.10. Co-investments in public investment projects and programmes (whereby the GoK co-invests with the private party to enhance the credit rating of the project).

The foregoing instruments and measures that are termed as Government Support Measures in this Policy, operate as credit-enhancement tools thereby enabling financing institutions to accept the financing risk profiles of public transactions. Attracting local and international capital has historically been founded on an implicit assurance that the Government will protect private sector interests and that the investor will receive a reasonable return on its investment. Ultimately, this level of fiscal comfort to third parties to a transaction has significant reputational benefits to the issuing government, especially if the framework for its grant is structured, predictable and unambiguous.

For these reasons, GSMs will continue to be a prominent feature where private sector participation in respect of strategic substantial public investment programmes are concerned.

1.1.2 GSM Issues

The use of GSMs and their attendant financial implications, can collectively pose significant risk to the Government's financial standing. A significant number of the GSMs are not currently recognized in the formal financial risk management practice: they are episodically acknowledged and monitored as potential contingent liabilities that may or may not crystallize.

These contingent liabilities may either be explicit – e.g., those that satisfy section 58 of the PFMA as is the case with sovereign guarantees; or implicit – e.g., those in which the Government opts to intervene in order to maintain financial sector stability or the existence of strategic national assets, or where they are deemed necessary for reducing premia factored for political risks in public investment programmes involving the private sector.

The Government is currently advocating for and supporting a private sector-led growth strategy. This strategy seeks to contribute to faster delivery of GoK's growth agenda

through expanding the quality and quantity of public investment programmes. For public private partnership projects specifically, which are structured around long-term contractual commitments, GSMs provide higher certainty about the security of the investments.


However, the provision of GSMs has to be aligned with the constitutional principles of fiscal responsibility in public finance and the overall philosophy of the Public Finance Management Act, 2012 that public finance should remain sustainable, equitable and stable.

1.2 Policy Objectives

For the avoidance of doubt, not all projects may be supported by a GSM. A GSM shall be issued in exceptional circumstances for projects that are considered strategic and that are of public interest, as approved in principle by Cabinet. It shall be the policy of Government to encourage investors to structure transactions in a manner that minimizes the need for issuance of a GSM.

The main objectives for adopting a comprehensive policy on GSMs are therefore to:

- 1.2.1 Standardize meaning, treatment and categories of GSMs: GSMs shall be issued in accordance with this Policy (as from time to time revised), and with such limitations as shall be declared to attach to them at the point of issuance.
- 1.2.2 Establish a clear and predictable framework for the management of Government's project-linked financial risks and contingent liabilities: Eligible contingent liabilities should be those that have been identified, quantified and approved on the basis of affordability and sustainability, and subject to monitoring and evaluation, mitigation and retirement of the GSM. Eligible financial commitments should be those that have been budgeted for within the Government's Medium Term Expenditure Framework or other approved planning cycle.
- 1.2.3 Provide a structure for confident decision-making: By defining a structured and predictable process for issuance of GSMs, informed decisions can be made on the eligibility for GSMs in strategic public investment programmes involving the private sector.
- 1.2.4 Eliminate ambiguity and minimize deviations from best practice: The rules of engagement are made clearer for both



public and private players. This makes the practice of GSMs predictable, accountable and more open to monitoring, evaluation and review.

- 1.2.5 Centralize the source of GSMs: GSMs shall be approved in principle by Cabinet and issued by the National Treasury.

1.3 Policy Targets

By issuing this Policy on GSMs, the Government anticipates that it shall:

- 1.3.1 Address and cure the risks and anomalies as well as practice gaps on issuance of GSMs as will be identified in this Policy document;
- 1.3.2 Give process and functional clarity to the Government and to private sector involved in public investment programmes about the issuance of GSMs;
- 1.3.3 Strengthen the risk management framework and management of GSMs in accordance with the Constitution and the Public Finance Management Act (PFMA), 2012.
- 1.3.4 Minimize the likelihood of completely unexpected or unforeseen financial obligations on Government by building a filter structure around which all such requests are processed (essentially, through an institutionalized due diligence mechanism) before they are contracted by the Government.

Chapter 2


PROBLEM STATEMENT

This Chapter addresses the problem stemming from current practice in the GSM issuance regime. The Main Problems

2.1 The Main Challenges

The main challenge has been the issuance of GSMs without a formal policy and administrative framework for issuance of GSMs. The weaknesses of this system has been manifested in the following practices:-

- 2.1.1 An ad-hoc system of administration on the issuance practice which has made it difficult to clearly identify what the Government policy on the GSMs is;
- 2.1.2 Lack of administrative clarity and centralized platform on the process of applications and Issuance of GSMs: the current practice does not specify answers to many foundational questions, key among which are: which projects qualify? Who should submit an application for a GSM, and at what stage ought an application request be lodged? What are the roles of MDAs and county governments at the point of application? What supporting documentation should be provided by the applicant? What, when, by whom and how should assessment and approval actions be given?
- 2.1.3 Lack of a Long-Term Risk Management Framework: Government currently lacks a Financial Commitment and Contingent Liabilities Risk Register.
- 2.1.4 Inconsistency in the scope of risks covered – prevailing practice does not standardize the risks that are issued project to project within the same type of investment activity, hence admitting unwarranted variance in scope of contingent liability risk for Government.
- 2.1.5 Upfront expectation on the part of potential investors to be issued with GSMs – increasing instances are being observed where intending investors view guaranteed assurance that a GSM will be issued as a pre-requisite to their making of an investment decision, usually even before they have conducted preliminary project due diligence, thus establishing an “entitlement mentality”.
- 2.1.6 Transferability of the instrument of a GSM – current wording of GSM instruments do not clearly state that a GSM is not transferable without the express approval of the Government. This is a gap that has in some instances triggered disputes between GoK and succeeding investors. It also potentially creates a negative market for trade in GSMs, with non-serious opportunity-seekers posing as investors, securing GSMs, and then auctioning the investment opportunity, complete with the GSM, to the highest bidder, without GoK consent or awareness.
- 2.1.7 Lack of time limitations or sunset clauses in GSMs -A sunset clause is essentially a date by when the validity of a GSM is deemed to have expired, releasing GoK from any liability beyond the stated date. Absence of a sunset clause potentially allows project developers and any other benefiting third party to hold onto a GSM for an indeterminate time period without penalty, and ostensibly for longer than is properly necessary to de-risk investments. It is essential that all GSMs should carry a sunset clause.
- 2.1.8 Lack of sufficient specificity in some clauses within the GSM with the effect that risk is too widely defined. The consequence is that risk is either over-allocated, misallocated or poorly differentiated and not always directly linked to primary contractual clauses.
- 2.1.9 Lack of a Monitoring and Evaluation System: Once GSMs have been issued, there is no formal Monitoring and Evaluation mechanism to ensure that timely preventative measures are undertaken to monitor, manage and contain any public investment contract related problems that may materialise. Systematic monitoring will ensure prompt measures are taken in managing the potential risk of either the contracting authority or private partner’s failing.
- 2.1.10 Non-differentiation of risk to Government: There is little differentiation between types of risks peculiar to different types of projects. The nature of projects determines the level, extent and intensity of the risks associated with such projects. Risk allocation structures and trigger mechanisms to the extent these are secured under GSMs should be carefully balanced to ensure that risks are allocated to the party that is best placed to handle them.



2.1.11 Linkage to Contract Documentation: In some instances, there has been observed a tendency by project investors to seek wider protections under a GSM, beyond what the primary contract documents create by way of obligation on GoK. In other instances, GSMs are requested almost as an after-thought, in that one finds no anticipation in primary transaction documentation, but parties make the request for a GSM at an advanced stage of project development. This is imbalanced risk allocation. A good practice should be that GSMs are linked and limited to specific items or clauses of the project contract. Such clauses should disclose a very clearly and specifically defined risk event that triggers government intervention, and requires the defined GSM. There should be no variance between the terms, clauses and wording of an issued GSM and the related contract document. Ultimately, GSMs will not be crafted in a manner that results in the creation of parallel (i.e., extra-contractual) obligations: GSMs will only underwrite and backstop contract-based obligations.

2.2 Reflections on the Main Challenges

From the foregoing examples, it can be concluded that if the problems surrounding GSMs are left unaddressed, they may undermine proper due diligence in the assessment of potential projects, encourage investors to view GSMs as upfront as opposed to final assurances, invite and present opportunities for financial mischief. In addition, current practices undermine the National Treasury's financial risk management and control function, obscuring the National Treasury's scanning capacity to identify and track potential financial risks. This simply multiplies opportunities for policy and financial ambush, and with that, undermines the Treasury's credibility as a prudent financial manager. These are some of the problems this Policy is designed to address.

Chapter 3

CURRENT INSTITUTIONAL AND LEGAL FRAMEWORK FOR ISSUANCE OF GSMs IN KENYA

This chapter reviews the current legal and institutional framework supporting the issuance of GSMs in Kenya. It traces the full value chain of the GSM application, consideration and approval process, and links it to prevailing legal frameworks. It concludes with a short critical reflection on the adequacy of the prevailing legal and institutional framework for GSM issuance in Kenya.

3.1 Institutional Framework for GSMs in Kenya

The issuance of a GSM currently involves several institutional actors as follows:-

- Project Developers/investors - who submit the initial request;
- Primary MDA or county government with whom a contractual relationship exists with the developer;
- Parent Ministry having the overall mandate for the contracting Department or Agency, where applicable;
- The National Treasury; and
- The Attorney-General.

In July 2015, the National Treasury issued a Practice Guidance to the Energy Sector titled "Structure and Framework on Issuance of Government Letters of Support in the Energy Sector" which defined the minimum documentary requirements to be availed with an application for a GoK Letter of Support.

These requirements are:-

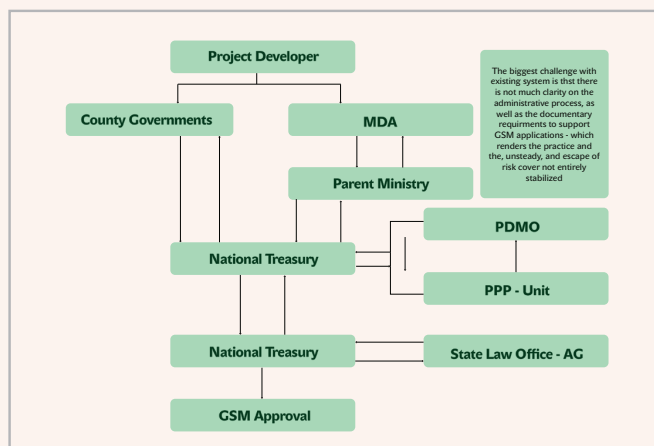
- Detailed and comprehensive Feasibility Study Report demonstrating viability of the proposed project;
- Due Diligence Report on the investors conducted by a Contracting Authority confirming that the private party has the relevant experience and expertise in undertaking projects of a similar nature;
- Environmental and Social Impact Assessment Report;
- Initialed Project Agreement;

- Draft Letter of Support populated with the project-specific information; and
- Demonstration by a Contracting Authority of how the proposed project fits into its larger development program, certifying that the application for the GSM applied for meets all the requirements.

The National Treasury at the same time established an ad-hoc Technical Committee on the Government Letters of Support to assist it in the assessment of the foregoing documentary requirements and to advise the National Treasury on the appropriateness of issuing the requested support measure.

While the foregoing stipulation was addressed to the Energy Sector, the good practice that has emerged from it has now, by administrative practice, been extended to all GSM applications since 2016. Nonetheless, the practice has remained ad-hoc, and requires institutionalization for standardization of practices.

In the process chart below, the current practice that is implemented with respect to the application for and approval of GSMs (particularly the Letter of Support), described above, is clearly depicted.



The primary issuer is the Cabinet Secretary of the National Treasury following requests or applications by MDAs or county governments. The process is triggered by an application by the person in need of the GSM. The procedural steps are well elaborated, flowing through the sector ministry or host county government, and once it is submitted to the National Treasury, is subjected to a review and recommendation exercise by various departments of the Treasury, prior to an approval being granted by the Cabinet Secretary.

Once approved, the draft GSM is submitted to the Attorney-General for legal clearance.

3.2 Legal Framework

The current legal framework for GSMs is mainly grounded on the Constitution of Kenya, the Public Finance Management Act, 2012, and the Public Private Partnerships Act, 2013. The relevant provisions from these legal instruments are summarized below.

3.2.1 Framework under the Constitution of Kenya

Articles 201 and 202 of the Constitution of Kenya lay down the core principles that guide all aspects of public finance in Kenya. These principles are among others that public finance shall be open and accountable, and allow for public participation. In addition, the public finance system is required to promote an equitable society through ensuring that the burden of taxation is shared fairly, that revenues raised across the country is shared equitably between the national and county governments, and that expenditure promotes equitable development in the country. This is particularly significant for GSMs, because GSMs are tools used to promote public infrastructure development. The choices on which to locate infrastructure are governed and controlled by the same notions of equity, fairness, and balanced development. Lastly, these constitutional provisions require prudence and responsibility in the use of public money – which in public infrastructure development are particularly critical notions, bound up in the idea of affordability, value for money, optimal risk allocation and public service delivery.

Under Article 227, the Constitution adds an important guiding principle in public infrastructure development: the idea that procuring the development of public infrastructure projects needs to ensure fair, equitable, transparent, competitive and cost-effective outcomes. Furthermore, this Article creates obligations for inclusive public procurement practices that among others guide decisions on categories of preference in the allocation of contracts, the protection or advancement


of persons, categories of persons or groups previously disadvantaged by unfair competition or discrimination, sanctions against contractors that have not performed according to professionally regulated procedures, contractual agreements or legislation, and sanctions against persons who have defaulted on their tax obligations, or have been guilty of corrupt practices or serious violations of fair employment laws and practices.

As a subset of public finance tools, GSMs are inherently and inextricably bound to these constitutional standards.

3.2.2 Framework under Public Finance Management Act, 2012

The Public Finance Management Act, 2012 was enacted pursuant to Chapter 12 of the Constitution to establish a framework for resource mobilization and management of public finance at both the national and county government levels. Some of the issues under that Act that have direct bearing on this policy framework include provisions in sections 58 and 65 of the PFMA 2012, which establish the following principles –

- a. The National Treasury has capacity and legal authority to guarantee loans by county governments and national government agencies or entities, where the borrowing is for the development of capital projects, and where the borrower is capable of repaying the loan and paying interest and other charges associated with the loan;
- b. Any borrowing must be within approved ceilings for national debt stock;
- c. A private borrower may be guaranteed, where that private borrower is borrowing to develop a public capital project, and the private party has capacity to provide adequate security for such borrowings;
- d. Any borrowing must adhere to the principles governing public finance under the Constitution including particularly compliance with the fiscal responsibility principles and financial objectives of the national government;
- e. Borrowing needs to take into account equity between the national and the county government's interests so as to ensure fairness;
- f. The borrowing must be affordable, and the recommendation of the Public Debt Management Office is made a key requirement for both borrowings and issuance of guarantees.



From the foregoing, it is clear that a framework for the grant of a GSM for borrowing by MDAs and county governments exists in law. This policy is designed to address unregulated GSM tools, so excludes sovereign guarantees under the PFMA, 2012.

3.2.3 Framework under the Public Private Partnerships Act, 2013

The PPP Act 2013 gives power to the Cabinet Secretary of the National Treasury to issue non-sovereign guarantees, binding undertakings and letters of comfort where such are deemed to be necessary to support projects in order to reduce premiums factored for political risks. Under this Act, guarantees may include demand or revenue guarantees where Government retains demand or market risk in public infrastructure projects development structured to rely on user fees as the revenue base. Under this law, the GSMs mentioned are aimed at supporting public private partnership projects.

The administrative process for the grant of a GSM under the PPP Act 2013 requires a recommendation of the PPP Committee to be made to the Cabinet Secretary. In practice, the PPP Committee makes such a recommendation at the time of approving negotiated contract terms for PPP projects. Thereafter, the Unit, working in close collaboration with the Public Debt Management Office, processes actual requests by project developers, negotiates the terms of the GSM instrument, and submit, through the Principal Secretary of the National Treasury, the negotiated GSM to the Cabinet Secretary for approval and issuance.

3.3 Constraints with Current Legal and Institutional Framework

Although there is a legal and institutional framework that currently governs the practice on the issuance of GSMs as set out above, the current framework does not comprehensively address the entirety of the identified problems.

It is noted from the problem statement that the main constraint resides in the process of issuance of GSMs. The procedure is for the Cabinet Secretary of the National Treasury to issue a GSM upon the request of MDAs or county governments and in doing so consults the PDMO and PPP Committee.

This administrative practice has not always been clear to MDAs and county governments, which has resulted in requests for these instruments being channeled to different offices. In addition, the basic language of the law does not on its face prescribe the stage in a project cycle when such a request may be made, which has led to the submission of requests for such instruments at widely different stages in a project cycle.

Furthermore, the wording in the law, coupled with actual administrative practice, does not provide clarity on who the actual applicant for the support instrument ought to be with the result that in some cases, it is project developers who submit the request and in other cases the MDAs or county governments themselves.

An assessment of the legal framework for GSMs also establishes that there is no clear structure to the considerations that may be brought to bear on whether or not an application for a GSM should be granted. Similarly, there are no regulatory standards defining what conditions must occur for a GSM to be deemed to be effective – with the outcome that a GSM is a bankable instrument from the moment it is signed, exposing Government to contingent liability crystallization from the date it is issued. The lack of liability exclusion clauses may drive moral hazard situations where a project developer can call on the GSM even when no actual investment activity has taken place. In principle, every GSM instrument, where applicable, should have a clear liability exclusion provision which delimits the risk exposure of Government.

Lastly, no specific guidance is provided either in the relevant legislative provisions or in actual administrative practice on the supporting documentation that needs to accompany an application for the support instrument which results in variances on the considerations that inform the decision whether or not to issue the support instrument.

This Policy thus establishes that there is need for scaling up the administrative and legal framework to cover all types of GSMs and also making that framework known to all MDAs and county governments.

Chapter 4

POLICY DIRECTIONS ON ISSUANCE OF GOVERNMENT SUPPORT MEASURES

To address the constraints identified in the preceding chapters, the following policy statements are adopted to inform, guide and regulate the issuance of GSMs from the date of this Policy.

4.1 GSM Policy Statement 1: Categories of Available GSMs

The GoK may issue the following categories of GSMs in support of public investment programs -

- (a) Letter of Comfort;
- (b) Letter of Support;
- (c) Non-sovereign Guarantees such as Minimum Revenue Guarantees, Market or Volume Guarantees, Partial Risk Guarantees, Credit Guarantees, Foreign Exchange Guarantees, Refinancing Guarantees, among other forms of guarantees;
- (d) Binding Undertakings;
- (e) Contract-based guarantees; and
- (f) Any other GSM, provided it is approved in principle by the Cabinet upon the recommendation of the Cabinet Secretary of the National Treasury.

4.2 GSM Policy Statement 2: To Whom and When May a GSM Issue

The GoK will issue a GSM following the request of a Ministry, State Department, Agency or County Government, in the manner prescribed in this Policy.

A GSM will be issued to the project Developer, and will stand to the benefit of the project developers, their financiers and the Government, under its terms.

In considering whether or not to issue a GSM, the Cabinet Secretary, and the FCCL Unit, as the circumstances of each application for a GSM may dictate, other public agencies such as the PPP Committee, will make recommendations to Cabinet on the advisability of such GSM being necessary for successful project implementation.

For the avoidance of doubt, not all projects may be supported by a GSM. A GSM shall be issued in very exceptional circumstances for projects that are considered strategic and that are of public interest, as approved by Cabinet. It shall be the policy of Government to encourage investors to structure transactions in a manner that minimizes the need for issuance of a GSM.

A request to Cabinet for approval under this Policy Statement should include:

- (a) the broad elements of the proposed GSM to be issued,
- (b) a confirmation that a cost benefit analysis with an assessment of the implications of the terms of the GSM has been undertaken by the National Treasury,
- (c) a confirmation that a detailed allocation of risks in the project and the proposed mitigation measures has been undertaken by the National Treasury,
- (d) an outline of the financial risk to the Government should the GSM crystallize, and
- (e) an outline of the monitoring and evaluation framework that will be implemented to ensure the fiscal commitments and contingent liabilities of GoK under the GSM are managed.

4.3 GSM Policy Statement 3: Scope of Risks covered by GSMs

Risks should be allocated to the party that is best placed to handle the risks. However, in order to minimize risk exposure to Government, a GSM instrument underwriting defined risks will feature the following core elements at a minimum -

- (a) It will be limited to acts of Government (not inaction);
- (b) It will be controlled by material adverse impact that impairs the ability of the investor to perform its obligations under a project agreement;
- (c) It will be limited to actions of Government that occur within the Republic of Kenya;
- (d) It will be limited to a closed list of specified events;

- (e) It will set out express qualifications of liability, or the exclusion of liability linked to specific events;
- (f) It will set out specific conditions to effectiveness; and
- (g) Any other matter the Government may from time to time add to this list, subject to this Policy.

In each GSM, the covered risks will be a closed list of risks, and GSM will exclude the use of the phrase “including but not limited to the following”, typically seen in GSM instruments, and importing the notion that the list of covered risks is merely illustrative and not conclusive. Each GSM will establish a conclusive list of risks, consistent with the FCCL Management Framework that enables GoK to quantify and therefore properly assess the implications of each GSM on public finance.

GoK will to the extent possible incorporate the terms of what would be contained in a GSM, into project agreements, as contracted terms, in order to minimize the usage of standalone GSM instruments. **It is Government’s intention over the medium to long term to greatly reduce the utility and scope of GSMs, as private parties build stronger trust in public investments.**

In addition to the foregoing general principles, the following key features will be included in every GSM that imposes financial or contingent liabilities on the GoK –

- (a) non-negotiable conditions that protect Government’s interests upfront, such as the exclusion of coverage for project risks expressly allocated to a non-public actor under a project agreement, or capping of Government’s overall obligation under the GSM even where a risk is allocated to the GoK, and excluding all insurable risks as well as project company statutory liabilities – these may also be termed as “Liability Exclusion Clauses of a GSM”;
- (b) a date by when it becomes effective, defined by clear preconditions;
- (c) conditions to effectiveness (which at a minimum will include attainment of financial close, issuance of a NEMA license for the project, securing all project land-related conditions under a project agreement, and satisfaction of any relevant conditions precedent on public agencies under a project agreement);
- (d) a termination date;
- (e) an amendment clause;

- (f) a clause disqualifying a transfer of the GSM instrument to a third party without the consent and approval of the National Treasury, and each GSM instrument shall additionally include a statement imposing its automatic lapse should it be transferred contrary to this policy;
- (g) explicit identification and allocation of the risks to be borne by the public sector partner in a project, by reference to the clauses in the primary commercial or project document;
- (h) a declaratory statement linking its issuance to an obligation of the GoK under the primary project document, and no GSM will be issued where the primary project documentation do not disclose, expressly and on their face, an intention and obligation of the GoK to so issue the GSM in question;
- (i) where obligations are dependent on a public agency not party to the primary project agreement, the GSM will be structured in a manner that makes the performance of such obligations a precondition to the effectiveness of the GSM instrument in order to ensure that the secured contingent liabilities never crystallize.

The National Treasury will develop and issue Guidelines, Practice Notes and Templates for the practice on Government Support Measures, within 6 months of the date of this Policy.

4.4 GSM Policy Statement 4: Issuance of GSMs at County Level

Where a county government is required to issue a GSM for a county investment programme, it may do so where the proposed GSM instrument does not –

- (a) give rise to risks that cannot be handled fully within the fiscal framework of such county government,
- (b) create financial obligations beyond the financial ability of the county government to meet out of its own budget;
- (c) create contingent liabilities that cannot be resolved by the county government should they crystallize;
- (d) provide for a multi-year payment obligation, which would require budget ring-fencing at the county level unless such commitments are approved for county governments by the County Assembly.

Where any of the foregoing conditions exist, a county

government or other sub-national entity seeking to issue such a GSM shall first seek and obtain the written approval of the National Treasury, in the manner provided under this section.

A GSM that is capable of being issued at the county government level will be issued by the County Executive only after approval by the County Assembly. In submitting an approval application to the County Assembly, the County Executive shall include the following information in support of the application -

- (a) the proposed GSM to be issued,
- (b) a cost benefit analysis with an assessment of the implications of the terms of the GSM,
- (c) detailed allocation of risks in the project and the proposed mitigation measures,
- (d) details of the financial risk to the county government should the GSM crystallize
- (e) a monitoring and evaluation framework that ensures the fiscal commitments and contingent liabilities of county government under the GSM are managed.

Where a county government is required to issue a GSM requiring National Treasury approval, it shall submit an application to the National Treasury in accordance with the requirements of GSM Policy Statement 5.

4.5 GSM Policy Statement 5: Application and Approval Process

Any National Government Entity or County Government seeking to have a GSM issued by the National Treasury for one of its projects, will be required to inform the National Treasury, in writing, before the start of the contract negotiation process, that the project will require a GSM issued by National Treasury. In reviewing such information, the National Treasury will be guided by strategic nature of the project and any other parameters that the Cabinet may prescribe. The National Treasury will then communicate its concurrence or otherwise to the applying National entity or County Government.

In all cases, the National Treasury will reserve the discretionary right and flexibility, on a case by case basis, to revoke such concurrence, should significant shifts in the project risk structure occur subsequently.

In addition, no GSM will be issued where the primary project documents do not disclose an intention and agreement of the parties that a GSM is a necessary ingredient to make the transaction

framework work, regardless of whether the public agency had sought and obtained the early in-principle concurrence of the Cabinet as set out under paragraph one of this section.

The application and approval process for issuance of a GSM by the National Treasury shall be as follows:

- a) a project developer requiring a GSM originates the request for the desired GSM, and directs that request to the User Department or contracting authority;
- (b) a review of the request is undertaken by the User Department or contracting authority and if supported, is sent to the parent ministry at the sector level for certification and recommendation, and onward transmission to the National Treasury for a National Government entity, and, for county government projects, to the Governor for the County in conformance to the GSM Policy Statement 4;
- (c) Issuance reviews will be undertaken by mandated entities within the National Treasury; and
- (d) a GSM shall only be issued in conformance with GSM Policy Statement Two.

Every GSM application to the National Treasury, whether for a national or county level project under this Policy Statement 5, will be presented under cover of a formal application letter and supported by the following documents at a minimum:-

- (a) Detailed and comprehensive Feasibility Study Report demonstrating viability of the proposed project, including documentary evidence of the study's approval or acceptance by the contracting authority or other mandated GoK entity;
- (b) Current Due Diligence Report on the investors conducted by the Contracting Authority confirming that the private party has the legal capacity, financial capability to undertake the project, possesses the relevant technical experience in undertaking similar projects, and has demonstrated expertise or track record in undertaking projects of a similar nature;
- (c) Environmental and Social Impact Assessment Report with or without NEMA approval, but with evidence of its acceptance by the implementing public sector partner;
- (d) Initialed or signed Project Agreement;
- (e) Draft of the proposed GSM, aligned in principle terms to

this Policy (as may from time to time be amended by the Cabinet Secretary of the National Treasury), populated with the project-specific information;

- (f) A comprehensive risk matrix in the manner prescribed in this paragraph, in which the MDA or county government explicitly quantifies its risk(s) either as explicit fiscal commitments and/or implicit contingent liabilities. The project risk matrix for a GSM application will be prepared by the applying entity in the following manner –
- It will be presented in tabular format;
 - It will identify the key project risks allocated to the private party;
 - It will identify the key project risks allocated to the public party;
 - It will provide an estimated financial impact value for the risks allocated to the public partner;
 - It will bear notes to the table identifying the main areas, events and circumstances likely to trigger risk crystallization for risks borne by the public partner.
- (g) A risk management and mitigation plan to reduce the likely impact of the identified risks if and when they occur;
- (h) A statements evidencing the availability of adequate budgetary provisions and or a credible financing plan to meet explicit obligations imposed on the public agency as well as the strategy intended to be implemented in securing a source of liquidity to meet implicit obligations accepted under a GSM when they arise;
- (i) A report by the Contracting Authority confirming how the proposed project fits into its larger development program within the wider national development agenda;
- (j) A certification by national or county government public agency that the application for the GSM meets all the requirements and the documents submitted are in order.

In making the application, a developer will be required to indicate what type of GSM it is seeking.

For purposes of (b), (e), (f), (g) (i) and (j) above, the National Treasury will, within six (6) months from the date of this Policy, prepare the relevant templates and tools that will enable National and County Governments promote the objectives of this Policy by complying with the procedural requirements for

the grant of a GSM – which shall include a template for the due diligence report, standardized templates for all categories of GSM instruments, template for a project risk matrix, and a template for a public agency's certification report.

For the avoidance of doubt, no GSM will be issued before a project agreement is executed. A Contracting Authority may include statements in tender documents relating to potentially available GSMs only with the prior approval of the Cabinet.

Upon receipt of an application, the MDA or county government will satisfy itself that the application is consistent with the project's requirements and is complete with regard to all evidentiary requirements set out in (a) to (i) above

When a decision to grant a GSM is reached, and the form and scope of the GSM agreed upon by all relevant parties, clearance in writing shall be sought and obtained from the Attorney-General and the Cabinet respectively, before the GSM instrument is executed.

4.6 GSM Policy Statement 6: Budgeting and Accounting for GSMs

A GSM may relate to explicit obligations as well as implicit obligations.

An explicit obligation is a clear, known and priced fiscal obligation placed on a public agency at either the national or county government level under a project agreement, and whose payment triggers are known, documented and dated. In other words, explicit obligations constitute positive contractual obligations on a GoK counterpart to a project agreement, requiring availability of funding sources for the same.

An implicit obligation is contingent in nature, and has known triggers, but its timing is not known or knowable. In addition, the extent of its impact is not knowable prior to its occurrence, and may as a consequence require time extensions (a relief event) for the parties to perform their obligations, or compensation (restoration of economic balance) or termination (with consequential costs). Contingent liabilities may not be budgeted for wholly, but a source of liquidity for their management will need to be found and implemented by the parties to a project agreement, more so, public sector parties.

4.6.1 Budgeting for Explicit and Implicit Obligations

On Explicit Obligations: Government will ensure adequate budgets are provided for all explicit obligations. A public agency

at either level of Government will, to this end, be required when submitting an application for a GSM, to include in its certification, statements evidencing the availability of adequate budgetary provisions and or a credible financing plan to meet such explicit obligations imposed on the public agency.

On Implicit Obligations: For implicit obligations, national and county government public agencies will be required to provide a credible plan on how they intend to build up a source of liquidity for the satisfaction of such obligations when they arise. Without prejudice to such plans, National Government or County Government entities seeking a GSM to cover an implicit obligation from the National Treasury may be required to contribute a percentage of their budgets into a contingent liability liquidity facility under the control and management of the National Treasury. The level of contribution will be set by the Cabinet Secretary, National Treasury and may vary across sectors. This Liquidity Facility will serve as a source of liquidity for dealing with contingent liability risks that crystallize, and may be payable once or over the lifetime of the project being supported by the GSM, in accordance with the terms of the primary project agreement.

4.6.2 Accounting for Explicit and Implicit Obligations:

Every entity that issues or is the recipient of a GSM from the National Treasury will have an obligation to disclose in their financial statements, by way of a note, any contingent liability arising from the GSM and provide a quantification for the contingent liability. The National Treasury, in consultation with the relevant government authorities, will provide a template for how such disclosures will be made. This will then be communicated to all national government entities and County Governments by way of a circular. The National Treasury will make this template available within six (6) months of the date of this Policy by Cabinet.

4.7 GSM Policy Statement 7: Management Principles

For better management of risks related to issued GSMs, the following management principles will be implemented:

(a) The National Treasury will establish a GSM Risks Register, under which each category of GSM issued will be booked. The Register will be closely aligned to the Fiscal Commitments and Contingent Liabilities Management Framework of the National Treasury.

(b) Every National Government entity or County Government that has received a GSM will be required to promptly notify the National Treasury of any changes proposed to be made to the substance or form of the primary contract document, such as risk allocation structure, payment obligations crystallizing among other significant shifts in transaction structure. Failure to inform the National Treasury of any changes will form a basis for the invalidation and consequent cancellation of the GSM by GoK, and for the avoidance of doubt, no such changes will be approved by way of subsequent ratifications, and such unapproved changes shall be of no consequence to the scope of liability of the GoK under the issued GSM or project agreement.

(c) Once the notification is made, the National Treasury will consider whether to accommodate the altered transaction under the GSM. If approved, the National Treasury will update the GSM register and adjust the risk classification of the project. If the GSM is cancelled, the National Treasury will notify the project developer through the relevant National or County Government entity. The National Treasury will report to Cabinet any such changes within sixty (60) days of such changes being approved.

(d) The Fiscal Commitments and Contingent Liabilities Management (FCCL) Unit of the National Treasury will prepare and issue bi-annual reports to the Cabinet Secretary National Treasury, or sooner if required, on the status of the GSMs issued, with a focus on any troubled projects.

(e) Where a project slips into trouble and risk crystallization under a GSM heightens, the Cabinet Secretary, National Treasury and the Cabinet Secretary or County Governor of the project(s) whose Contingent liabilities are likely to crystallize, shall meet to agree on how best to mitigate the risk drivers and prevent any exposure to Government.

(f) Every GSM instrument that is issued will be required to embed a Risk Management Committee, whose core mandate will be to monitor the performance of obligations by all parties to a GSM to ensure no circumstances arise that give rise to risk crystallization under a GSM. It will be the responsibility of the implementing agencies of projects to ensure that the Risk Management Committees are timely constituted, and operational. A risk crystallizing under a GSM that is attributable to the non-operationalization of a Risk Management Committee will lead to accountability

liability on the part of the Contracting Authority. A Risk Management Committee will adopt the institutional characteristics set out in this Policy.

- (g) Where there arise significant changes to a project's structure evidenced through amendments to the primary contract document due to policy shifts, changes in the economic environment in the country, changes in a project's affordability or value for money due to causes beyond the control of the project developer, the Government may exercise its right to amend a GSM. Such amendments can only take effect after approval by the National Treasury and the Office of the Attorney-General.
- (h) If any Government entity or project developer which has been issued with a GSM, seeks to cancel or substantially amend the primary contract upon which the GSM was based, then that entity will be required to seek and obtain the written approval of the National Treasury and the Office of Attorney General prior to such alteration or cancellation as the case may be. Further, no private developer who has been issued with a GSM shall transfer the primary contract upon which the GSM is based or carve out the GSM from the Primary contract without approval by the National Treasury. The National Treasury notify Cabinet of any changes it approves, pursuant to this paragraph, within a period of sixty (60) days from the date of such approval.

For the avoidance of doubt, any changes to a project that causes a project's value to increase by more than 15% will be considered significant.

Each national and county government entity's project in whose favour a GSM is issued, will be under continuous obligation to report every six (6) months to the National Treasury on the general state of affairs relating to a supported transaction, and in particular, will be under obligation to specifically report on any matter that arises which carries the risk of triggering or accelerating a GSM risk event. Under such circumstances, it shall also report on all actions it has and is taking to avert the crystallization of the risk, and will further outline any supporting actions required to be undertaken by any other GoK agency, including the National Treasury, to minimize the impact of the event, or altogether avert it.

Monitoring functions associated with contract management systems will require to be documented, and structured around the obligations of the Parties and reported to the National Treasury every six (6) months. These practices will need to

respond to any statutory requirements obtaining under Kenyan law and having direct impact on the project supported by a GSM.

4.8 GSM Policy Statement 8: Valuation and Computation of GSMs

Any National Government Entity or County Government seeking a GSM from the National Treasury will be required to undertake a value for money assessment on the project.

The National Treasury will prepare a value for money assessment template. This template will be communicated to the National Government entities and County Governments by way of a circular. The National Treasury will make this template available within six (6) months of the adoption of this Policy by Cabinet.

4.9 GSM Policy Statement 9: Documentary Requirements for Attorney General

Applications to the Attorney General for legal clearance of a GSM instrument prior to its issuance will, from the date of this Policy, be supported by the same documentary requirements set out under GSM Policy Statements 5, 6 and 8.

4.10 GSM Policy Statement 10: Savings and Transitions

Except with reference to Risk Management Committees, this Policy will apply to transactions that are not completed as at the date of this Policy.

For the avoidance of doubt, a transaction will be deemed to be complete for purposes of this Policy if a GSM has been granted or issued, under the hand of the Cabinet Secretary to the National Treasury.

The requirement for constitution of Risk Management Committees will apply to all issued GSMs, regardless of their date of issuance.

The GoK will from time to time revise, amend or expand this policy scope through issuance of appropriate circulars, but in broad conformance to the principles outlined in this Policy.

The National Treasury will develop and issue Guidelines, Practice Notes and Templates for the practice on Government Support Measures, within 6 months of the date of this Policy.

Chapter 5

LEGISLATIVE, INSTITUTIONAL AND FINANCIAL IMPLICATIONS

5.1 Legislative Implications

This Policy caters substantively for immediate implementation of GSMs, although there may be need for some amendment to relevant laws. However, in the long-term, it may be necessary to enact a specific legislation on the GSMs in order to have even greater certainty and predictability on the issuance of GSMs.

The need for a stand-alone legislation on GSMs will be reviewed within three (3) years of this Policy.

Some of the proposed amendments required are in respect of the following legislation

- (a) Amendment to the Public Private Partnerships Act, 2013 to, inter alia, expand section 27 by amending the meaning of the term 'binding undertaking' to include "letters of support" – this will remove any doubt about the absence of a legal framework for the issuance of letters of support, which are, in fact, by their very nature and character, binding undertakings;
- (b) Amendments, as appropriate, to the Public Procurement and Asset Disposal (PPAD) Act, 2015 and the Public Finance Management Act, 2012 to, inter alia, provide for:
 - (i) Value for money assessments for any GSM instrument; and
 - (ii) Issuance of GSMs under the PPAD Act 2015.

5.2 Institutional Implications

The implementation of this Policy will be undertaken by existing public institutions, and will not require the establishment or fundamental realignment of the existing system of Organization of Government Business. The accountability and transparency framework built into this Policy will involve a strong role for the National Treasury and the Office of the Attorney General and Department of Justice.

In view of the likely necessity to adopt new contracting models to better manage project risks, there will be need to realign the institutional relations and role allocation, and this may require the provision of institutional support to the MDAs and county governments.

5.3 Financial Implications

The implementation of this Policy will not require drastic shifts in Government's overall budget framework. However, provision of liquidity allocations in MDA line items to underwrite contingent liabilities may introduce new budgetary requirements. This is not anticipated to be significant in quantum, and should be accommodated within sector budget ceilings without impairing or adversely straining sector performance, overall.

In addition, the Policy recommends the need for contracting model adjustments to ensure that all conceivable project risks are appropriately allocated and accounted for, and shifting from Government Support Measures those risks that do not belong to such instruments, while ensuring their performance at appropriate levels and spaces within the public sector, where such risks are classified as public sector risks, be they commercial or political. The implementation of this Policy will require priority budgeting for administrative costs earmarked for awareness creation among MDAs and county governments.

**GOVERNMENT SUPPORT
MEASURES POLICY
OCTOBER 2018**

