

GOVERNMENT TAKE OVER OF SERVICING OF OUTSTANDING LOANS COVERED UNDER THE EXCHANGE RISK ASSUMPTION FUND AMOUNTING TO AN EQUIVALENT OF KSH. 736,959,824 FROM INDUSTRIAL DEVELOPMENT BANK.

1. The following information is laid before the National Assembly for consideration and approval.
2. Following the dissolution of the Exchange Risk Assumption Fund pursuant to regulation 11 of the Exchaquer and Audit Act Cap. 412 and taking into account the financial projections of Industrial Development Bank, the Government of Kenya recognised the need to harmonize the capital structure of the Bank with other parastatals in the banking sector.
3. In restructuring Industrial Development Bank, the Cabinet approved a debt swap of the outstanding ERAF claims due to IDB from the Government with the remaining loans quaranteed by the Government under the ERAF scheme.

The ERAF scheme was set up by the Government under Legal Notice No. 14 of 29th January, 1991. The purpose of this fund was to absorb losses incurred on loans extended to projects by IDB, among other development financial institutions, under the existing lines of credit. Under the scheme the Bank was required to convert foreign currency loans into local currency loans with effect from 1st July, 1989. Subsequent loans were also supposed to be converted into local currency loans using the exchange rates prevailing at the time of disbursement. The Bank was required to pay to the Fund a fee or a premium of 2.5% per annum on the principal amounts outstanding at the end of each half year and in return be cushioned against losses resulting from foreign exchange fluctuations.

Under the ERAF regulations IDB was meeting all external obligations first and then claim after every six months any loss if amount paid was more than it should have paid using the exchange rates prevailing at the time of loan conversion or disbursement for new loans. Otherwise IDB should have paid to the Government as a credit to the Fund the amount of exchange gains.

In compliance with the Legal Notice, IDB converted its foreign currency portfolio into local currency on 30th June, 1991 and backdated the effective conversion date to 1st July, 1989 as required by the law. Consequently, IDB borrowers signed contracts to repay their foreign currency loans at fixed rates ruling at 1st July, 1989. All other loans made since then under the credits covered by ERAF were also denominated in local currency using the exchange rates prevailing at the time of disbursement. This caused IDB serious cash flow problems as Treasury, due to budgetary and liquidity problems was not honouring the provisions of the Legal Notice on ERAF.

4. Prior to 1989 IDB was able to service her external debts in the absence of exchange loss reimbursement due to improved debt collection from projects following restructuring of the Bank as well as receipts from receiverships and equity divestiture. However since 1st July, 1989, as a result of the depreciation of the Kenya shilling against the hard currencies, the Bank has paid substantial amounts on behalf of projects without getting reimbursements against claims lodged with Treasury. In addition, the diversion of funds to external debt servicing meant that there was no funds to build up the portfolio which is currently weak and cannot generate sufficient funds to service current and future external debt and other obligations.
5. Due to change of policy, the Government discontinued underwriting future obligations in June, 1994 through Legal Notice No. 182, "Notice of Intention to dissolve the Fund". The credits that had been initially covered, have been taken over by the Government in a debt swap arrangement with effect from 30th June, 1997.
6. The Cabinet noted with concern, the unsatisfactory financial situation facing Industrial Development Bank and agreed that the Government, through the Ministry of Finance, enters into a debt swap arrangement. The swap arrangement approved by the Cabinet is such that, the Government agreed to swap all the outstanding ERAF claims from IDB with the outstanding future maturities on foreign loans covered under the ERAF. This therefore entails that the Government takes over the servicing of the remaining maturities by taking over the loans.

The Government has not been able to reimburse the losses claims, due to budgetary constrains. In order therefore to assist IDB in its current situation and also settle the indebtedness between the two parties, the following measures were approved by the Cabinet:-

- (a) The amounts owed to Treasury by IDB as at 30th June, 1997 in respect of foreign loans paid on behalf of IDB and Risk Premium on ERAF be offset against the ERAF claims due to IDB as at 30th June, 1997. The net ERAF amount due to IDB as at that date stood at Ksh. 643,834,144.
- (b) The net arrears of ERAF claims due to IDB under (a) above of Ksh. 643,834,144 plus future claims of Ksh. 205,288,539 be swapped with foreign outstanding loans under the ERAF sheme amounting to an equivalent of Ksh. 736,959,824. The Treasury therefore took over the servicing of these loans instead of paying ERAF claims to IDB.
- (c) After implementing (b) above, there is a balance of Ksh. 112,162,859 due to IDB.

- (d) The Exchange Risk Assumption Fund regulations in relation to IDB's credits under the scheme was discontinued with effect from 30th June, 1997. Thus IDB cannot from this date claim any exchange losses from the Government.
- (e) The loans in (b) above reverted to the Government, who will service them as and when they fall due as part of its own liabilities at the ruling Exchange rates.
7. The National Assembly is requested to note the assumption of foreign outstanding loans under ERAF scheme amounting to an equivalent of Ksh. 736,959.824 by the Government of Kenya and the net balance of Ksh. 112,162.859 due to IDB as at 30th June, 1997, in order to clean up the balance sheet of Industrial Development Bank, in preparation for the overall restructuring of the bank.



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