# Government of Kenya: Financial and Legal Sector Technical Assistance Project - Contents

## *Project Implementation Plan*

**List of abbreviations**

| | |
|---|---|
| ADR | Alternative Dispute Resolution |
| BIS | Bank for International Settlements |
| BRPP | Bank Restructuring and Privatisation Project |
| BSD | Bank Supervision Department |
| CBK | Central Bank of Kenya |
| CDS | Central Depository System |
| CMA | Capital Markets Authority |
| CS-DRMS | Commonwealth Debt Recording System |
| DCA | Development Credit Agreement |
| DFI | Development Finance Institution |
| DFID | Department for International Development |
| DMO | Debt Management Office |
| DPF | Deposit Protection Fund |
| DvP | Delivery versus Payment mechanism |
| EAPSCH | East African Payments Systems Committee |
| EFTPOS | Electronic Funds Transfer at Point of Sale |
| ERSWEC | Economic Recovery Strategy for Wealth and Employment Creation |
| FARAH | Financial Reporting and Auditing Handbook |
| FIRST | Financial Sector Reform and Strengthening |
| FLSTAC | Financial and Legal Sector Technical Assistance Credit |
| FLSTAP | Financial and Legal Sector Technical Assistance Project |
| FMR | Financial Management Report |
| FMS | Financial Management System |
| GJLOS | Governance, Justice, and Law and Order Sector |
| GOK | Government of Kenya |
| HODs | Heads of Departments |
| IBRD | International Bank for Reconstruction and Development |
| IC | Insurance Commission |
| ICR | Implementation Completion Report |
| ICS | Integrated Controller System of the World Bank |
| IDA | International Development Association |
| ICPAK | Institute of Certified Public Accountants of Kenya |
| IEC | Information, Education and Communication |
| IMF | International Monetary Fund |
| IOSCO | International Organisation of Securities Commissions |
| JSAP | Judicial Strategy Action Plan |
| KCB | Kenya Commercial Bank |
| KPI | Key Performance Indicator |
| KPOSB | Kenya Post Office Savings Bank |

| | |
|---|---|
| KRA | Kenya Revenue Authority |
| M&E | Monitoring and Evaluation |
| MFI | Micro Finance Institution |
| MIS | Management Information Systems |
| MOF | Ministry of Finance |
| MOJCA | Ministry of Justice and Constitutional Affairs |
| MSMEs | Micro, Small and Medium Enterprises |
| NBK | National Bank of Kenya |
| NDO | National Debt Office |
| NPL | Non Performing Loan |
| NSE | Nairobi Stock Exchange |
| OAG | Office of the Attorney General |
| OTC | Over the Counter |
| PIP | Project Implementation Plan |
| PIU | Project Implementation Unit |
| PS | Permanent Secretary |
| PSC | Project Steering Committee |
| PvP | Payment versus Payment |
| RBA | Retirement Benefits Authority |
| RFP | Request for Proposal |
| RTGS | Real Time Gross Settlement |
| SACCOs | Savings and Credit Cooperatives |
| SSSS | Scripless Securities Settlement System |
| SWIFT | Society for Worldwide InterBank Financial Telecommunications |
| UNDP | United Nations Development Programme |

# 1 The project

## 1.1 Summary of project development objectives

A key priority of the Government of Kenya (GOK) is the reduction of poverty through economic recovery and promotion of sustainable growth. The Government recognises that in order to achieve this objective, it will have to address the structural weaknesses that have contributed to the decline in productivity and competitiveness of the economy in the last two decades. With the right investments, policy and institutional reforms - Kenya does have significant growth potential.

The GOK has prepared an Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) through a broad consultative process. Its first priority is to restore the economy on a path of high growth. Within this framework, the Government commits to maintaining a stable macroeconomic framework, reforming the financial sector and strengthening its regulation to increase savings and investment, implementing mechanisms for private sector participation in the provision of infrastructure services, and establishing a competitive environment able to attract increased private investment in productive sectors such as tourism, trade and industry.

The Government's ERSWEC has three pillars of growth, equity and poverty reduction, and governance. In order to achieve sustained growth, an accessible, efficient and reliable financial sector and justice system are essential for the mobilisation and allocation of resources. The proposed reform of the financial system will form an important part of the Government's effort to move towards a market-based economy which will contribute to a sustainable fiscal position and improved allocation of resources. Broad-based financial and legal sector reforms will directly contribute to improving equity and reducing poverty through expanding access to financial services and the justice system. Strengthening transparency and accountability in these key sectors represents a major contribution in itself to improved governance. Thus, the Financial and Legal Sector Technical Assistance Credit (FLSTAC) supports the achievements of these core ERSWEC objectives. Specifically:

> *"The overall development objective of the project is to create a sound financial system and strengthened legal framework and judicial capacity that will ensure broad access to financial and related legal services".*

## 1.2 Sector issues addressed by the project

The Kenyan banking sector is well developed and comprises 43 commercial banks, with the six largest accounting for about two-thirds of all assets, loans and deposits of the banking system. A defining weakness, however, is the severely constrained access to financial services by Kenyan households, notably in the rural areas, and by private enterprises, especially Micro, Small and Medium Enterprises **(MSMEs).** Sustained high interest spreads and transaction costs reflect structural problems.

Competition in the system is hampered by the presence of many weak banks, which are not able to exert competitive pressure on the few strong banks, and by deficiencies in the legal infrastructure. Non-performing loans (NFLs) amounted to about 25.7 percent of the total loan portfolio in December 2003. The Banking Supervision Department of the Central Bank of Kenya (CBK) has a well-founded off-site and on-site supervision programme but this has not always resulted in decisive corrective action. The performance of the payments system is hindered by the inadequate legal framework, lack of efficient payment instruments and long cycles of clearing and settlement.

Financial institutions outside the banking sector are diversified but also have some structural problems. The insurance sector comprises 41 licensed companies, four reinsurers, about 200 brokers and 400 active agents, all supervised by the Commission of Insurance. The commission is not operationally independent and does not have adequate resources to carry out effective supervision of the sector. The Kenya pension system has very limited coverage and does not provide adequate pension benefits. There are high levels of unfunded liabilities among many of the existing schemes. The Capital Markets Authority has limited capacity and does not have operational independence. Although the legal framework for capital markets has been largely put in place, the enforcement of market rules and supervision of market participants are both still weak.

In view of the above constraints, the Government has developed a programme of financial sector reform programme to address policy, institutional and legal issues impeding the efficient operation of the sector. In the medium term, the Government has indicated its intention to draw up a financial sector development strategy that will provide the framework for measures necessary for achievement of policy objectives. The Government has asked the World Bank and Department for International Development (DFID) for a Technical Assistance Credit to assist in the implementation of its financial and legal sector reform programme.

Good clear laws backed by a strong and credible judiciary and a competent legal profession are an essential element in creating an environment that is conducive to business and financial activity. The Government has developed a Governance Justice, and Law and Order Sector (GJLOS) Reform Programme aimed at addressing key weaknesses in the sector. Most of the activities to be supported in this Project fall within the key result areas of the GJLOS that will most support the strengthening of the financial sector.

## 1.3 Overall project description

Experience with financial sector reforms in other African Countries – and also other regions – demonstrates conclusively how closely the development of the financial sector depends on concomitant legal reforms. It is against this background that it was considered prudent to combine legal reforms with the financial sector operation into the Financial and Legal Sector Technical Assistance Project (FLSTAP). Proposed financing of FLSTAP totals US$ 30 million.

FLSTAP will become operational in February 2005 and is expected to be completed by 30 September 2009. It consists of eight components:

- Component 1: Financial and Judicial Sector Strategy Development which focuses on supporting the developing of comprehensive strategies
- Component 2: Restructuring and Privatisation of Financial Institutions which will support the establishment of a Bank Restructuring and Privatisation Project (BRPP). BRPP will support restructuring and divestiture of government-owned banks
- Component 3: Strengthening Financial Sector Regulators and the Deposit Protection Fund by reviewing, amending and/or drafting laws and regulations to enhance their effectiveness
- Component 4: Strengthening Debt Management and Debt Markets by setting up a unified and sustainable Debt Management Office, and making improvements to the operation of primary and secondary debt markets
- Component 5: Modernising the National Payments System by financing a Scripless Securities Settlement System, providing the necessary technical assistance and training, and overhauling the legal and oversight framework
- Component 6: Improving the Lending Environment through various interventions such as enhancing the Operations of the Department of the Registrar General, strengthening the land registration system, enabling the operation of a credit reference bureau by setting up a legal and regulatory framework and reviewing barriers to growth in the leasing industry
- Component 7: Legal and Judicial Reform covering a range of measures including but not limited to: establishing court and case management record systems; revising court procedures; staff education and training; harmonising and drafting laws in the financial and commercial sectors.

- Component 8: Project management includes the staffing of the PIU, the acquisition of an office and necessary working tools and equipment.

Between November 2004 and January 2005, officers from various GOK institutions were involved in planning the operationalisation of the FLSTAP. This work included establishing and documenting implementation requirements. The outcome of their work is set out in this Project Implementation Plan (PIP), which is structured as follows:

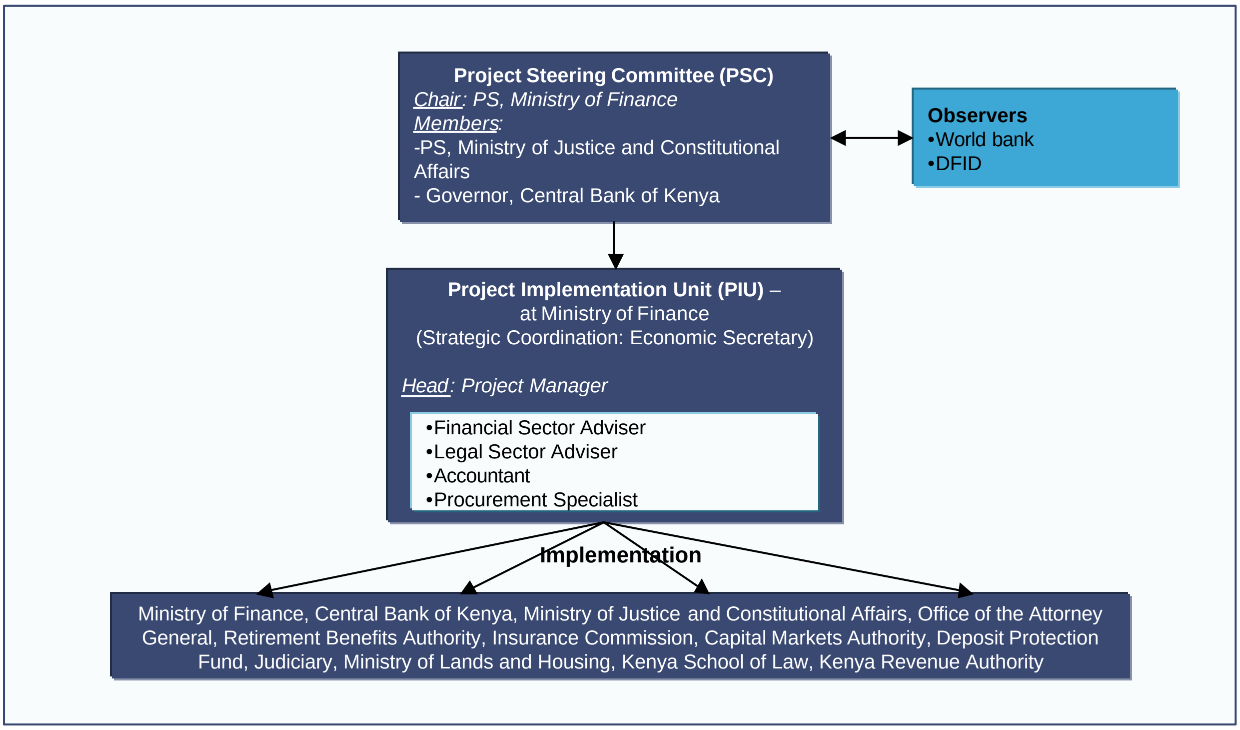
- Section 2 – Institutional arrangements
- Section 3 – Description by component
- Section 4 – Implementation and disbursements schedules for the project
- Section 5 – Monitoring and evaluation of the project.

# 2 Institutional arrangements

## 2.1 Organisations responsible for project implementation

**Figure 2.1.1** below shows the overall implementation arrangements for FLSTAC.

**Figure 2.1.1: FLSTAC Institutional Arrangements**



The administrative responsibility for day-to-day operations of the project will lie with the Project Implementation Unit (PIU) housed in the Ministry of Finance (MOF). This Unit will be headed by a full time Project Manager. The Project Manager will be supported by technical financial sector and legal sector advisors, an accountant and a procurement specialist. The PIU's key responsibilities will include:

- Offering support to beneficiary/implementing agencies through orientation, and by providing technical guidance, quality control and facilitation
- Promoting accountability for the project's implementation through regular consultation and communication with beneficiary/implementing agencies and other stakeholders

- Assessing and prioritising project proposals prepared by beneficiary institutions
- Project financial management, including: administering project funding and procurement processing; managing project accounts and the special account; following up on agreed financial covenants and disbursement conditions
- Providing Monitoring and Evaluation (M&E) support during project implementation including data collection and compilation, analysis, report generation, dissemination of results (including periodic progress reports) and proposing any necessary adjustments and amendments to implementation methods
- Acting as a focal point of contact between GOK and FLSTAP's financiers during the project implementation period.

The PIU will report to the Project Steering Committee (PSC) chaired by the Permanent Secretary (PS) of the MOF. Its other members will include the PS, Ministry of Justice and Constitutional Affairs (MOJCA) and the Governor of the Central Bank of Kenya (CBK).

The PSC will meet [*monthly*]. Its agenda at these meetings will cover:

- The review and approval of funding proposals submitted by implementing agencies via the PIU. Where deemed necessary, the PSC will indicate any changes to be made to proposals
- The assessment of performance against the time bound outputs, activities and the budget specified in this PIP
- Significant issues arising during implementation which need to be resolved by the PSC
- Monitoring and evaluation of the project against the PIP as well as the covenants contained in bilateral and multilateral agreements.

Heads of Departments (HODs) / technical task teams from the various institutions within the financial and legal sectors have been allocated responsibility, on the basis of their mandates, for implementation of FLSTAP and will receive support from the project (see Section 3). HODs/teams will be expected to:

- Ensure that decisions taken by the PSC are implemented
- Prepare project proposals which are informed by this PIP
- Draw up Terms of Reference, Requests for Proposals (RFPs) and specifications for goods and services where required
- Evaluate RFP's in collaboration with the PIU

- Coordinate and monitor initiatives, and report implementation progress to the PIU.

## 2.2 Role of other organisations

The buy-in and effective delivery of various outputs specified under Section 3 of this PIP will be dependent on participatory processes. In this regard, the PIP caters for extensive stakeholder consultations during the development of financial and judicial strategies, and revisions to or drafting of laws and regulations (e.g. with Parliamentarians, private sector, SACCOs etc.). In addition, the Project Manager will be expected to reach out to diverse stakeholder groups. He/she will make an effort to cultivate, formal and informal mechanisms for dialogue and collaboration with key stakeholders. Mechanisms include meetings and seminars where issues, problems and challenges, as well as progress in FLSTAP's implementation can be discussed. Also, from time to time, stakeholders from beneficiary agencies may be represented on the PSC to contribute to and deliberate on issues that impact upon the project's implementation.

## 2.3 Coordinating mechanisms

The Economic Secretary, MOF, will assist in the coordination of the activities of the PIU at the technical level leaving the PSC to focus on and coordinate strategic aspects. In this role, the Economic Secretary will support the PIU to ensure delivery of the project's outputs within the constraints set by this PIP. The Economic Secretary will periodically monitor and evaluate project implementation progress and report on the same to the PSC.

The PIU will work closely with the already established Project Coordination Office at GJLOS. This collaboration will entail cross-checking of work plans, joint assessment and prioritisation of project proposals prepared by beneficiary institutions and representation by the PIU's legal sector adviser at GJLOS Technical Coordination Committee and relevant thematic group meetings.

At another level, the broad-based structure of the project encourages inter-agency collaboration. In this regard, some outcomes and outputs will be dependent on project activities (e.g. see component 4) being jointly undertaken by a variety of stakeholders. The PIU will liaise with the various agencies involved to promote networking and ensure activities are synchronised.

The responsibility for the Law Reform sub-component is shared by the Legislative Drafting Department of the OAG and the Law Reform Commission. In order to achieve maximum output, it will be necessary to set up a coordinating Committee to provide guidance to the process of law reform. In the revision of laws, the

Coordinating Committee will also representatives include the National Council of Law Reporting which is already involved in revising laws.

The Law Reform Commission is also expected to set up a Task Force for the comprehensive review, enactment and prioritisation of business and commercial laws. The Task Force will draw membership from the Drafting Department of the OAG and also from all stakeholders in that respect.

## 2.4 Role of World Bank and other co-financiers during implementation

Under this Project, the Bank is working jointly with DFID who will provide co-financing. Representatives of the World Bank and DFID will attend PSC meetings as observers so as to offer policy guidance, ensure Project coordination and supervision, facilitate information exchange and improve the decision making process in the framework of implementation. Further, within the framework of overall financial and legal sector reform, the Bank team will support donor coordination in the respective sectors.

## 2.5 Monitoring and reporting arrangements for the project as a whole

The primary monitoring mechanism will be quarterly and annual reports prepared by the Project Manager and presented to the PSC. These reports will assess achievements against this PIP and overall project progress using the indicators defined in the results framework. As part of the assessment, financial results will be included and discussed. The PIU will be responsible for updating the PIP on an annual basis, taking into account experiences and the strategic focus of the Project. It will also assist the implementing agencies in the collection of relevant data to measure the project’s progress. Consultants will be hired by the PIU to collect baseline data and to carry out impact studies during the course of the project.

The PIU will submit al reports to the World Bank and DFID. Reports include (see Section 3.8.2 and Annex B):

- Applications for withdrawal [Form 1903B]
- Quarterly performance reports
- Quarterly consolidated output monitoring (physical progress) reports
- Sources and uses of funds
- Procurement reports.

GOK and development partners will carry out a mid-term review at the half way point of the Project. At the end of the mission, the review team will report, in an aide-memoire, its areas of focus, objectives, review of any prior actions, findings (including and assessment of overall progress), recommendations and agreements reached between GOK and donors. This output will provide a basis for strengthening the project. The GOK and development partners will prepare an Implementation Completion Report (ICR) after the completion of the project which rates the performance of the project in a number of dimensions (e.g. outcome, sustainability, development impact, GOK's performance etc.), sets out major factors affecting implementation and documents lessons learned.

# 3 Description by component

Throughout this section and others where cost and budget figures are presented, we have used an exchange rate of KShs 80 to the U$.

## 3.1 Component 1: Financial and judicial sector strategy development

### 3.1.1 Description of component

The Project will support the formulation of a financial sector strategy necessary to achieve the policy objectives identified in the ERSWEC. The process will involve broad consultations among stakeholders and will be informed by various recent studies on the financial sector, including the Financial Sector Assessment Programme, the banking sector reform strategy (undertaken for the Government by a joint team of Kenyan and international specialists and funded by DFID) and the study on Development Finance Institutions (DFIs) and rural finance funded by the Financial Sector Reform and Strengthening (FIRST) Initiative.

The type of support to be provided will include: (i) providing technical advisors; (ii) arranging for consultants to carry out studies on specific identified issues; and (iii) arranging workshops for stakeholders to build broad consensus and ownership of the reform process. For example, one of the areas already identified where further study is required is the pension system - where there are high unfunded Government liabilities and coverage is limited to people in formal employment.

The Project will support the Judiciary to develop the Judicial Strategy Action Plan (JSAP) which will include the introduction of performance and service standards, a comprehensive training programme, and the introduction of a credible system for the selection, appointment, and removal/discipline of judges and their staff, including strengthening the Judicial Service Commission. The Project will support the implementation of priorities identified by the Government and key stakeholders, and parts of the plan that will improve the judiciary's responsiveness to the demands of the legal and regulatory framework for the financial and commercial sectors, including alternative dispute resolution mechanisms.

The Project will support implementing agencies in designing a framework for monitoring and evaluating progress in financial and legal/judicial sector development in Kenya. This framework will provide a basis for assessing performance against the higher level policy objectives, including measures such as improved access, stability and efficiency of the financial system and improvements in case management and judicial procedures. The approach taken will need to be consistent with and supportive of monitoring and evaluation efforts under the ERSWEC. This framework will also provide the basis on which this Project progress against its overall development objectives will be monitored. The Project will support the implementing agencies in developing and tracking appropriate indicators. Inputs will include: (i) specialist advice on enhancing existing statistical instruments; (ii) specific pilot and baseline studies; and (iii) consultants to support the development and implementation of the framework.

### 3.1.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.1.1** below sets out the inputs required to achieve the outputs for the three sub-components that fall under component 1. It also assigns responsibility for implementation to: the MOF; Judiciary; sector institutions and stakeholders; and PIU.

**Table 3.1.1: Component 1 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • Financial sector strategy | Technical advisers, consultants, workshops | MOF/Sector Institutions Stakeholders |
| • Judicial strategy action plan | Technical advisors, consultants, workshops | Judiciary |
| • Framework for M&E | Technical advisers, workshops, ICT tools | PIU/Sector institutions |

### 3.1.3 Component cost and financing

The budget for this component has been derived by estimating the cost of inputs required to complete each identified activity. **Table 3.1.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices. The financing required for this component over the duration of the project is KShs 68 million (US$ 0.855 million)

**Table 3.1.2: Component 1 costs in KShs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KSH) | | | | | TOTAL OUPUT COST IN KSHs |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | |
| Financial sector strategy | 40,480,000 | - | - | - | - | 40,480,000 |
| Operational Judicial Sector Strategy | 3,767,500 | - | - | - | - | 3,767,500 |
| Operational Monitoring and Evaluation Framew | 3,080,000 | 7,260,000 | 7,590,000 | - | 6,270,000 | 24,200,000 |
| **Subtotal** | **47,327,500** | **7,260,000** | **7,590,000** | **-** | **6,270,000** | **68,447,500** |
| **Total cost in U$** | **591,594** | **90,750** | **94,875** | **-** | **78,375** | **855,594** |

### 3.1.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.1.1**. In summary the schedule indicates that:

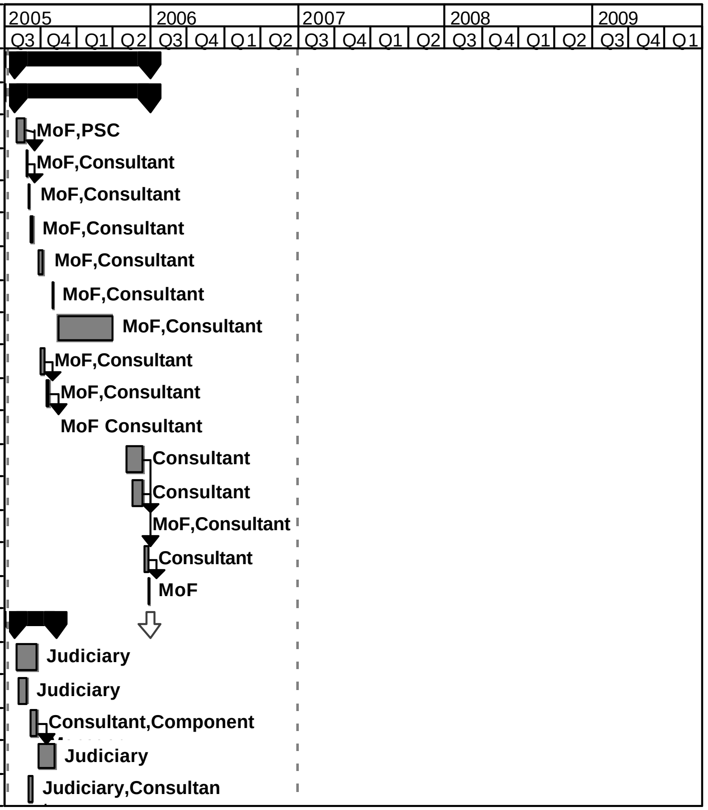
- A draft financial sector strategy will be presented to the stakeholders for validation in the second quarter of 2006
- The judicial sector strategy will be operationalised in 2005
- The Project's Monitoring and Evaluation framework will be operational by the last quarter of 2005.

### 3.1.5 Critical risks

There is a modest risk that entrenched economic and political interests, dominance of the banking sub-sector and limited technical knowledge among some key stakeholders may hamper objective analysis of factors to be considered in development of a sector-wide financial strategy. Overall recovery of the economy will help to reduce protectionist attitudes among institutions. The other factor that will help to loosen entrenched views is the broad based consultative process of the project.

**Figure 3.1.1: Component 1 – implementation schedule**

| ID | Task Name |
|---|---|
| 1 | **COMPONENT 1: FINANCIAL AND JUDICIAL SECTOR DEVELOPMENT STRATEGY** |
| 2 | **SUB-COMPONENT 1: FINANCIAL SECTOR STRATEGY** |
| 3 | Develop a framework for an integrated Financial Sector Strategy |
| 4 | Organise stakeholder forum to agree on a shared vision for Financial Sector Strategy |
| 5 | Develop TORs for a team to develop the strategy in line with agreed vision |
| 6 | Identify task team to guide the preparation of the strategy |
| 7 | Review the studies made in the sector towards reform |
| 8 | Identify additional studies required to inform the strategy (filling knowledge gaps) |
| 9 | Conduct additional studies to inform the strategy development process and content |
| 10 | Draft summary of key reform issues in the sector |
| 11 | Confirm key issues with stakeholders and prepare a presentation |
| 12 | Present Reform Issues Paper to stakeholder and agree on priorities issues |
| 13 | Draft strategy |
| 14 | Cost the interventions |
| 15 | Present draft strategy to stakeholders for validation |
| 16 | Incorporate stakeholders views into draft and finalise draft |
| 17 | Disseminate final version of strategy to sector organisations |
| 18 | **SUB-COMPONENT 2: JUDICIAL SECTOR STRATEGY** |
| 19 | Operationalise the strategy |
| 20 | Prepare a popular version of the strategy for wider circulation |
| 21 | Develop operational plans for each department |
| 22 | Entrench the operational plans into the GJLOS implementation structure |
| 23 | Train reform champions on change management |



## 3.2 Component 2: Restructuring and privatisation of financial institutions

### 3.2.1 Description of component

The banking system has a high level of non-performing loans concentrated in four commercial banks with state ownership. Divesting the Government's stake in these institutions will help strengthen the banking system through mobilising the resources of the private sector to build the operational capacity of these institutions, eliminating direct and indirect subsidies and removing political involvement in credit allocation. This will help significantly to strengthen competition and improve stability, which in turn will result in downward pressure on the currently high interest rate margins and increase the incentives to reach underserved markets. It will also demonstrate the Government's commitment to improving governance and fiscal responsibility.

The Project will support the establishment of a specialist Bank Restructuring and Privatisation Project (BRPP) within the MOF, which will provide the specialist technical resources required to implement the Government's policy. The core BRPP team, comprising international and Kenyan specialists, will guide the privatisation process from the identification of strategic options for divestiture, through short-term preparatory restructuring to preparation and completion of the transactions. This work will be supported by specialist short-term legal and audit advisers.

Other financial institutions where the Government has a particular interest/ responsibility include Co-operative Bank, Kenya Post Office Savings Bank (KPOSB) and the development finance institutions (DFIs). These institutions are afflicted with severe performance problems, including (in all cases except for KPOSB) sizeable non-performing loans. The Project will support the restructuring of these institutions consistent with the Government's market-based policy for financial sector development. The restructuring of the DFIs will be undertaken according to the DFI strategy currently developed with support from FIRST. The Project will support strengthening the role and effectiveness of KPOSB in serving as a safe depositary for small savers and in providing payment services. Finally, the Project will support strengthening Co-op Bank's role as key institution for improving access to financial services.

### 3.2.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.2.1** below sets out the inputs needed to achieve the outputs for the three sub-components that fall under component 2. It also assigns responsibility for implementation to PIU, Department of Government Investments DGIPE and BRPP. The affected institutions and the CBK will key to the restructuring process in providing the required information.

**Table 3.2.1: Component 2 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| Establishment of Specialist Bank Restructuring and Privatisation Project (BRPP) | Project Documents<br>Advisors | MOF/DGIPE |
| Restructuring Development Financial Institutions | Advisors | BRPP/MOF/DGIPE |
| Restructuring of Kenya Post Office Savings Bank and Cooperative Bank | Advisors | BRPP/MOF/DGIPE |
| State influenced Banks restructured and privatised | Advisors | BRPP/MOF/DGIPE |

## 3.2.3 Component cost and financing

The total financing required for this component is KShs 447 million (US$ 5.588 million). **Table 3.2.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices.

**Table 3.2.2: Component 2 costs in KShs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KSH) | | | | | TOTAL OUPUT COST (KSHs) |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | |
| Establishment of Specialist Bank Restructuring and Privatisation Project (BRPP) | 38,280,000 | 31,900,000 | 31,900,000 | 31,900,000 | 31,020,000 | 165,000,000 |
| Restructuring Development Finance Institutions | - | 1,100,000 | 7,040,000 | 26,620,000 | 22,000,000 | 56,760,000 |
| Restructuring of Kenya Post Office Savings Bank and Cooperative Bank | 2,200,000 | 2,035,000 | 11,550,000 | 13,310,000 | 12,320,000 | 41,415,000 |
| State infleunced banks restructured and privatised | 92,664,000 | 54,208,000 | 37,004,000 | - | - | 183,876,000 |
| **Total Cost for Component** | **133,144,000** | **89,243,000** | **87,494,000** | **71,830,000** | **65,340,000** | **447,051,000** |
| **Cost in U$** | **1,664,300** | **1,115,538** | **1,093,675** | **897,875** | **816,750** | **5,588,138** |

## 3.2.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.2.1**.In summary the schedule indicates the following:

- The BRPP will be fully operational by the last quarter of 2005
- Implementation of restructuring plans for financial institutions will commence in the second quarter of 2006 with National Bank of Kenya

(NBK). Restructuring of DFIs is scheduled to start in the second quarter of 2009.

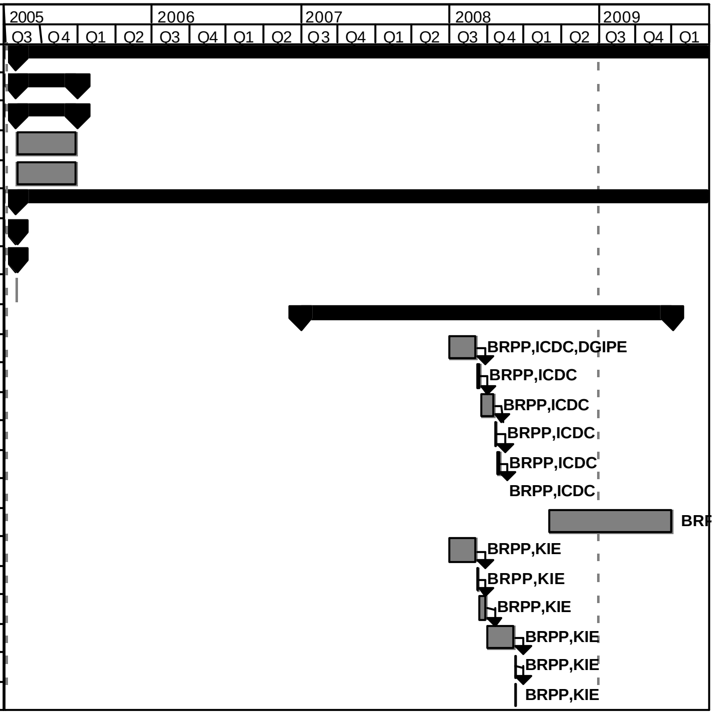
- Implementation of the preferred divestiture option for Kenya Commercial Bank (KCB) is scheduled for the third quarter of 2006.

### 3.2.5 Critical risks

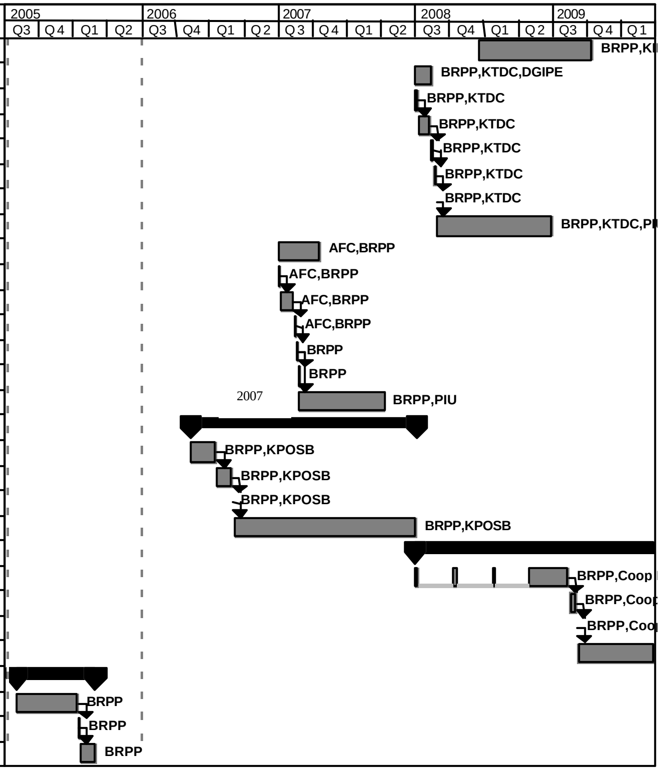
The proposed restructuring and privatisation of the state influenced banks and development finance institutions runs a high risk of failure and delays for a couple of reasons which include: i) vested interest by the management and staff of the affected institutions; ii) lukewarm political will to undertake the surgical reforms needed; iii) inadequate appreciation of the intricate nature of the reform process by key officers in the government and other stakeholders; iv) lack of budgetary resources to recapitalise institutions and settle government related debt, and v) lack of a facilitative legal framework e.g. the Privatisation Bill has stalled while successful restructuring of banks and DFIs require a mechanism or facility for off-loading their NPLs. Moreover there is lack of implementation capacity in government due to the intricate and wide ranging nature of reforms. The planned stakeholder consultations will help to improve ownership of reforms while narrowing and sequencing of the reforms over a longer period could somewhat relieve implementation constraints. However limited budgetary resources, the issue of a legal framework for privatisation of banks and resolution of their NPLs will need further consideration.

## Figure 3.2.1: Component 2 – implementation schedule

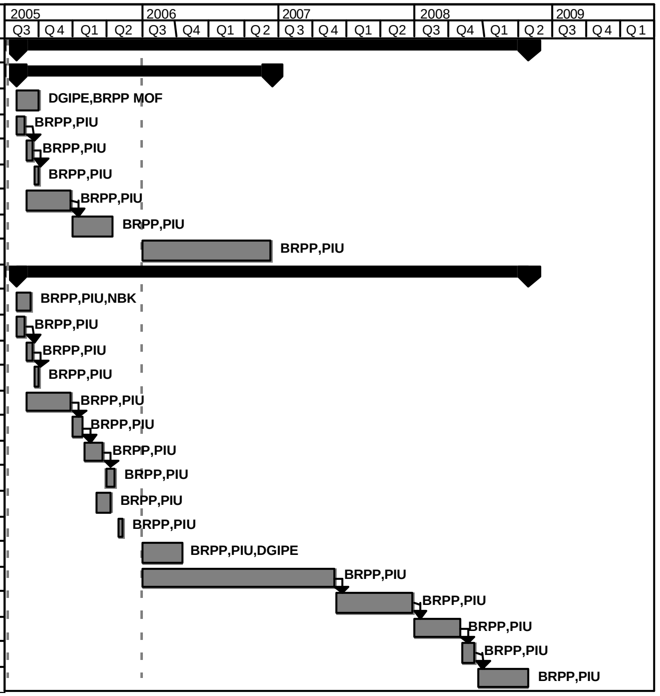
| ID | Task Name |
|---|---|
| 1 | **COMPONENT 2: RESTRUCTURING AND PRIVATIZATION OF FINANCIAL INSTITUTIONS** |
| 2 | **SUB-COMPONENT 1: ESTABLISHMENT OF SPECIALIST BANK RESTRCTURING AND PRIVATISATION PROJECT (BRPP)** |
| 3 | **BRPP fully operational and internal operations established** |
| 4 | Set the legal and institutional framework |
| 5 | Establishment of BRPP operational office |
| 6 | **SUB-COMPONENT 2: RESTRUCTURING AND PRIVATIZATION OF FINANCIAL INSTITUTIONS** |
| 7 | **Priotised financial services and sector** |
| 8 | Determine the priorities for DFIs especially services and target groups |
| 9 | |
| 10 | **Restructured DFIs** |
| 11 | Conduct study for restructuring ICDC- Consultancy |
| 12 | Review studies done on ICDC |
| 13 | Conduct institutional and financial fact finding to confirm issues affecting the effectiveness of ICDC in delivering it mandates |
| 14 | Develop an Action Plan for restructuring of ICDC |
| 15 | Draft action plan for restructuring of ICDC |
| 16 | Validate action plan for restructuring plan |
| 17 | Implement of restructuring plan |
| 18 | Conduct a study on ways and means of restructuring KIE |
| 19 | Review studies done on KIE |
| 20 | Conduct institutional and financial fact finding to confirm issues affecting the effectiveness of KIE in delivering it mandates |
| 21 | Develop an Action Plan for restructuring of KIE |
| 22 | Draft action plan for restructuring of KIE |
| 23 | Validate action plan for restructuring plan |



| ID | Task Name |
|---|---|
| 24 | Implement of restructuring plan |
| 25 | Conduct study for restructuring KTDA- Consultancy |
| 26 | Review studies done on KTDA |
| 27 | Conduct institutional and financial fact finding to confirm issues affecting the effectiveness of KTDA in delivering it mandates |
| 28 | Develop an Action Plan for restructuring of KTDA |
| 29 | Draft action plan for restructuring of KTDA |
| 30 | Validate action plan for restructuring plan |
| 31 | Implement of restructuring plan |
| 32 | Conduct study for restructuring AFC- Consultancy |
| 33 | Review studies done on AFC |
| 34 | Conduct institutional and financial fact finding to confirm issues affecting the effectiveness of AFC in delivering it mandates |
| 35 | Develop an Action Plan for restructuring of AFC |
| 36 | Draft action plan for restructuring of AFC |
| 37 | Validate action plan for restructuring plan |
| 38 | Implement of restructuring plan |
| 39 | **Restructured KPOSB** |
| 40 | Develop an effective structure of KPOSB |
| 41 | Conduct a strategic and operational audit of KPOSB |
| 42 | Present study results to stakeholders |
| 43 | Implement audit recommendations |
| 44 | **Strengthen the Cooperative Bank** |
| 45 | Develop an effective structure for |
| 46 | Conduct a strategic and operational audit of Cooperative Bank |
| 47 | Present study results to stakeholders |
| 48 | Implement audit recommendations |
| 49 | **Improved access to financial services** |
| 50 | Develop a strategy for improving access to financial services |
| 51 | Discuss and validate the strategy |
| 52 | Implement the strategy |



| ID | Task Name |
|---|---|
| 53 | **SUB-COMPONENT 3: RESTRUCTURING AND PRIVATISATION OF STATE INFLUENCED BANKS** |
| 54 | **Kenya Commercial Bank - Divestiture** |
| 55 | Undertake consultancy for KCB divestiture |
| 56 | Prepare TORs for Consultants |
| 57 | Invite tenders for consultancy |
| 58 | Select consultants |
| 59 | Conduct study on options for government divestiture |
| 60 | Review consultants recommendations |
| 61 | Implement KCB divestiture |
| 62 | **National Bank of Kenya - Restructured** |
| 63 | Undertake consultancy for NBK divestiture |
| 64 | Prepare TORs for Consultants |
| 65 | Invite tenders for consultancy |
| 66 | Select consultants |
| 67 | Conduct a diagnostic review of assets |
| 68 | Prepare diagnostic report |
| 69 | Review the diagnostic report |
| 70 | Review consultants recommendations |
| 71 | Invite tenders for restructuring |
| 72 | Select restructuring consultants |
| 73 | Prepare restructuring plan |
| 74 | Implementation of the restructuring plan |
| 75 | Recapitalise NBK |
| 76 | Curve out NPLs |
| 77 | Restructure management |
| 78 | Prepare Government exit strategy |



| ID | Task Name |
|---|---|
| 79 | **Consolidated Bank of Kenya Privatised** |
| 80 | Undertake consultancy for Consolidated Bank assets diagnostic review and valuation |
| 81 | Prepare TORs for Consultants |
| 82 | Invite tenders for consultancy |
| 83 | Select consultants |
| 84 | Conduct a diagnostic review of assets |
| 85 | Review diagnostic report |
| 86 | Implement KCB divestiture |
| 87 | Prepare valuation report |
| 88 | Review the diagnostic report |
| 89 | Prepare NPLs action plan |
| 90 | Complete sale of Consolidated Bank |
| 91 | Invite bids for purchase of bank |
| 92 | Select successful bidders |
| 93 | Transfer of shares/payment |
| 94 | **Industrial Development Bank Divested** |
| 95 | Undertake consultancy for IDB assets diagnostic review and valuation |
| 96 | Review prepared reports |
| 97 | Review prepared reports |
| 98 | Conduct a diagnostic review of assets |
| 99 | Prepare a valuation report |
| 100 | Prepare privatisation strategy |
| 101 | Implementation of the strategy and surrender of banking license |

## 3.3 Component 3: Strengthening financial sector regulators and Deposit Protection Fund

### 3.3.1 Description of component

CBK is responsible for supervision of specified banks and non-bank financial institutions. CBK also provides lender of last resort facilities to the banking system. The Bank Supervision Department (BSD) of the CBK has a well founded off-site and on-site supervision programme, but can benefit from additional capacity building. The Deposit Protection Fund (DPF) Board, formally an independent institution is housed in CBK. DPF is responsible for deposit insurance and liquidation of failed banks. DPF is managed by CBK with the Governor acting as its Chairman. Both the CBK and DPF lack independence in their activities because of weaknesses in their enabling legislation.

The other regulatory and supervisory authorities in the financial sector also suffer from lack of autonomy. The Insurance Commission (IC) is not operationally independent and does not have adequate resources to carry out effective supervision of the insurance sector. The Capital Markets Authority (CMA) was recently brought within the ambit of the State Corporations Act, which requires CMA to consult with the Minister of Finance in exercising its regulation marking powers, The Retirement Benefits Authority (RBA) does not have adequate skills to develop a framework for risk based supervision nor the capacity to implement the framework. There is currently no regulatory authority for Savings and Credit Cooperatives (SACCOs) and Micro Finance Institutions (MFIs).

The Project will support a substantial overhaul of the legislative framework for banking supervision with the purpose of enhancing the autonomy of the CBK in undertaking this function. The most notable areas where action will be taken include: (i) vesting of key powers to deal with problem banks, including removal of officers or directors, appointment of a statutory manager, or revocation of banking licenses with the CBK instead of the Minister of Finance, thus ensuring that the CBK will be held fully accountable for any future failure to deal promptly with identified problem banks; (ii) repealing legal provisions of the Central Bank Amendment Act 2000 and Section 44 of the Banking Act in order to remove uncertainty in the market place about the Government's commitment to market-based financial intermediation; and (iii) revisions in current regulations on loan loss provisioning to adequately reflect the impairment of assets (currently, no specific provisions are required against NPLs classified as substandard, i.e. 91-180 days in arrears, which leads to overstatement of earnings and capital and the current regulations are not harmonised with the requirements of International Financial Reporting Standards). The Project will support the legislative drafting and subsequent implementation and necessary capacity building.

The Project will also support the amendment and drafting of new legislation defining the activities of the DPF so as to (i) make it an autonomous institution, (ii) strengthen its role and effectiveness as a provider of the financial safety net and (iii) make the liquidation process more effective. Special emphasis will be put on the review of the Banking Act and the Companies Act and a possible drafting of DPF-specific legislation. The Project will support legislative drafting and subsequent implementation and necessary capacity building.

Support will also be provided to other financial sector regulators. The Project will support amendment of the relevant laws to make the activities of IC, CMA and RBA autonomous and provide technical assistance in implementation and capacity building. The Project will also assist in the establishment of an effective regulatory and supervisory framework for SACCOs and MFIs that balances the benefits of more transparent and sound intermediation in these sectors with the costs it imposes on the institutions and taxpayers. Specifically, the Project will support necessary legislative and regulatory drafting and provide technical assistance in building the institutional framework to implement the legislation and build capacity in the authorities charged with supervising SACCOs and MFIs.

Additional to the activities related to specific legislative changes, technical advisors will be provided where necessary, staff capacity building activities (training, twinning, attachments) carried out and Management Information Systems (MIS) improvements implemented to increase the effectiveness of all financial sector regulators and supervisors. Finally, the Project will also support the setting up of a mechanism for information sharing and coordination of activities among the financial sector regulators.

### 3.3.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.3.1** below sets out the inputs needed to achieve the outputs for the seven sub-components that fall under component 3. It also assigns responsibility for implementation to MOF, CBK, DPF, Office of the Auditor General (OAG), Parliament and Institute of Certified Public Accountants of Kenya (ICPAK).

**Table 3.3.1: Component 3 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • CBK autonomy enhanced | Technical Advisor | MOF, CBK, OAG, CBK |
| • Banking sector guidelines reviewed | Technical Advisor | MOF, CBK, OAG, CBK |

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • Capacity of FISD enhanced | TA, Funds | CBK |
| • Banking Act amended | Consultant and Workshops | CBK, MOF, OAG |
| • DPF Act enacted | Consultant and Workshops | CBK, MOF, OAG |
| • Autonomous DPF established | Consultant and Workshops | CBK, MOF, OAG |
| • MIS established | Consultancy | CBK, MOF, OAG |
| • Capacity built | Advisor | CBK |
| • MIS established | Advisor | CBK |
| • Autonomous Insurance Commission | Advisor | MOF, IC, OAG |
| • Insurance Act Overhauled | Consultants | MOF, IC, OAG |
| • IRDA Act enacted | Consultants | MOF, IC, OAG |
| • IAIS Standards Adopted | Consultants | MOF, IC, OAG |
| • Member of IAIS | Consultants | MOF, IC, OAG |
| • Public information | Consultant | IC |
| • Legislation amended | TA | IC, Parliament |
| • MIS developed and implemented | TA | IC, Parliament |
| • Increased capacity for risk based supervision | TA and Funds | IC, |
| • RBA Legislative Framework overhaul process | TA and Funds | OAG, RBA |
| • MFI Regulatory Authority established | Consultancy Legal Assist. In Drafting<br>Workshops | CBK, MoF |
| • SACCO's Regulatory authority established | Consultancy Legal Assist. In Drafting<br>Workshops | CBK, MoF |

### 3.3.3 Component cost and financing

The financing needed for this component is KShs 294 million (US$ 3.7 million). **Table 3.3.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices.

**Table 3.3.2: Component 3 costs in KShs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KSH) | | | | | TOTAL OUPUT COST (KSHs) |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | |
| Enhanced CBK Autonomy | 3,300,000 | 4,422,000 | - | - | - | 7,722,000 |
| Banking sector guidelines reviewed | 5,940,000 | 2,640,000 | 1,127,500 | 907,500 | 907,500 | 11,522,500 |
| Enhanced FISD capacity | 5,654,000 | 15,862,000 | 3,960,000 | 1,210,000 | 110,000 | 26,796,000 |
| Banking Act amended | 2,200,000 | 220,000 | 330,000 | 330,000 | 110,000 | 3,190,000 |
| DPF Act enacted | 1,980,000 | 605,000 | 165,000 | 165,000 | 165,000 | 3,080,000 |
| Autonomous DPF established | 1,320,000 | 1,430,000 | 8,250,000 | 6,393,200 | 770,000 | 18,163,200 |
| MIS established | 1,705,000 | 13,750,000 | 13,420,000 | 220,000 | 220,000 | 29,315,000 |
| Capacity Built | 1,870,000 | 1,980,000 | 1,980,000 | 1,870,000 | 1,870,000 | 9,570,000 |
| Capacity building | 1,606,000 | 6,556,000 | 2,376,000 | 2,376,000 | 2,376,000 | 15,290,000 |
| MIS established | 220,000 | 13,420,000 | 220,000 | 220,000 | 220,000 | 14,300,000 |
| Autonomous Insurance Commission | - | 23,320,000 | 165,000 | - | - | 23,485,000 |
| Insurance Act Overhauled | - | - | 275,000 | 55,000 | 55,000 | 385,000 |
| IRDA Act enacted | - | 1,320,000 | 1,265,000 | 165,000 | 165,000 | 2,915,000 |
| IAIS Standards Adopted | - | - | 1,100,000 | 1,870,000 | 1,650,000 | 4,620,000 |
| Member of IAIS | - | - | - | - | - | - |
| Public information | - | 1,320,000 | 2,200,000 | 660,000 | 660,000 | 4,840,000 |
| Amended legislation | 15,620,000 | 220,000 | 330,000 | 330,000 | 110,000 | 16,610,000 |
| MIS developed and implemented | 7,786,428 | 7,566,428 | 4,093,571 | 3,150,714 | 2,207,857 | 24,804,998 |
| Increased capacity for risk based supervision | 3,627,800 | 1,782,000 | 1,782,000 | 1,782,000 | 1,782,000 | 10,755,800 |
| RBA legislative framework overhaul process | 7,898,000 | - | 13,200,000 | - | - | 21,098,000 |
| MFI Regulatory Authority established | 1,485,000 | 1,100,000 | 6,765,000 | 165,000 | 165,000 | 9,680,000 |
| Regulatory authority established | 21,681,000 | 5,434,000 | 3,619,000 | 2,519,000 | 2,519,000 | 35,772,000 |
| **Total** | **83,893,228** | **102,947,428** | **66,623,071** | **24,388,414** | **16,062,357** | **293,914,498** |
| **Cost in U$** | **1,048,665** | **1,286,843** | **832,788** | **304,855** | **200,779** | **3,673,931** |

## 3.3.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.3.1**. The key features of the schedule are as follows:

- The amended Banking and CBK Acts will both be passed in the third quarter of 2006
- Revised banking and risk based management guidelines will be published by the end of 2005 and 2006 respectively
- Various capacity building initiatives are planned for DPF from the first quarter of 2006 to the end of the project
- The new Insurance Commission and Capital Markets Authority Acts will both be implemented in the second quarter of 2006

- RBA staff will be trained in Risk Based Supervision from the first quarter of 2006 to the second quarter of 2007

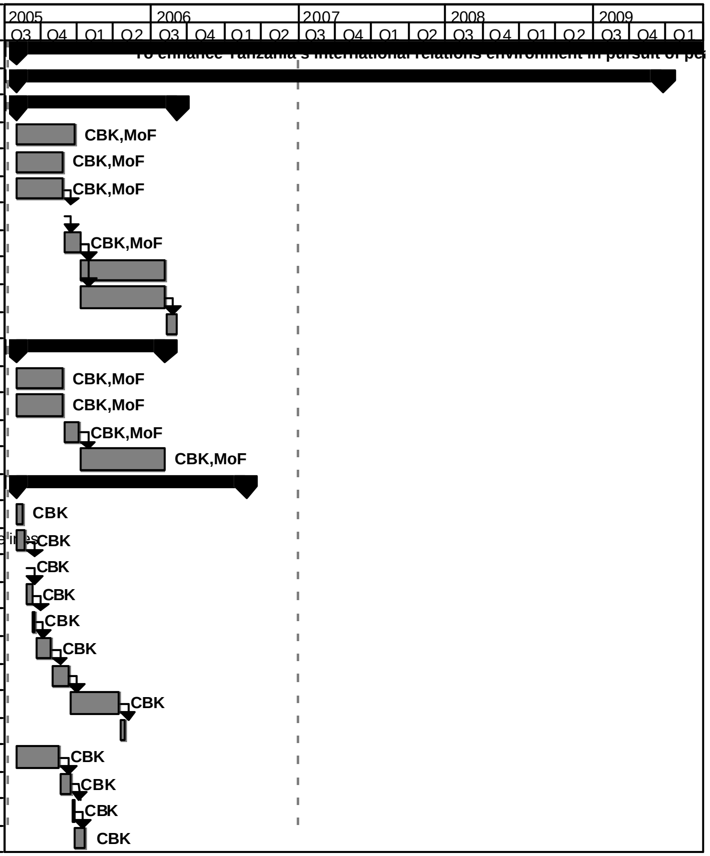
- New MFI and SACCO legislation will be in place in 2006.

### 3.3.5 Critical risks

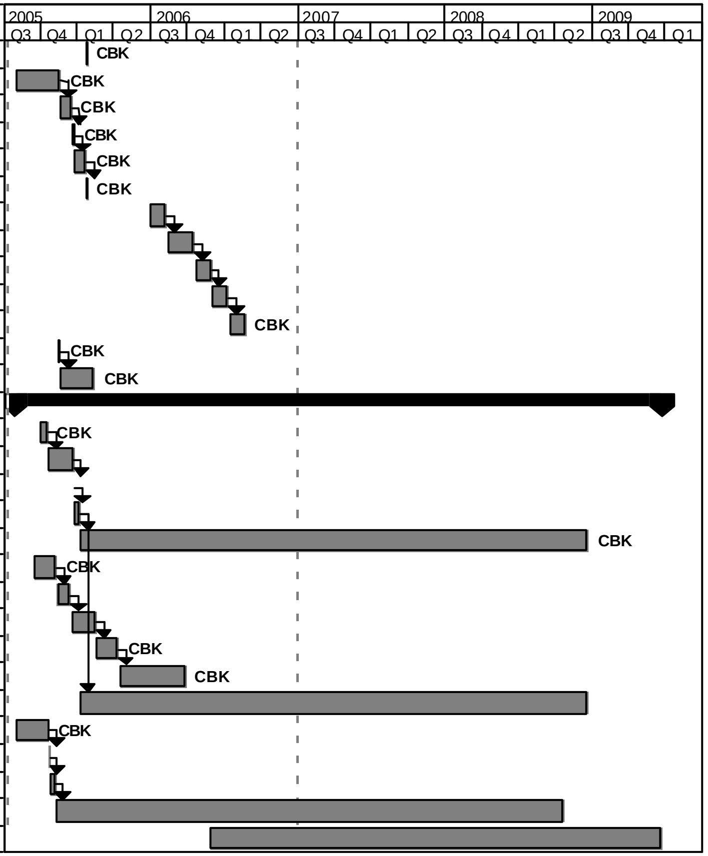
The main risk to the proposed reforms for strengthening of the financial sector regulators is the low capacity of Parliament to pass legislation. There is a large backlog of pending Bills awaiting deliberation by Parliament. Whereas the House Business Committee could be persuaded to fast track the financial sector Bills, there is still a high risk of failure for two main reasons: first, due to the current political polarisation in the country, it is difficult to get sufficient support in Parliament to enact critical legislation which is perceived as enhancing Government performance; second, lack of commitment and poor understanding of the reform process by key officers in the government who perceive the independence and strengthening of the regulators as a reduction in their importance. Although not a major concern, autonomy for some of the regulators will require allocation of extra budgetary resources in order to support their elevated positions and also to make them effective – especially in attracting and retaining qualified staff. The financial constraint could be mitigated by allowing some of the regulators such as Insurance Commission, RBA, DPF, CMA and SSRA to levy fees on the institutions that they regulate. The other significant risk to the reforms is lack of implementation capacity in government due to competing needs and pressure for reforms. Finally, the project design would seem to encourage independent growth of the regulators, whereas the trend of financial products convergence suggests the need for some uniformity and coordination of regulation at least to reduce compliance costs. The planned establishment of a mechanism for coordinating and sharing information among the regulators will help to mitigate this risk.

**Figure 3.3.1: Component 3 – implementation schedule**

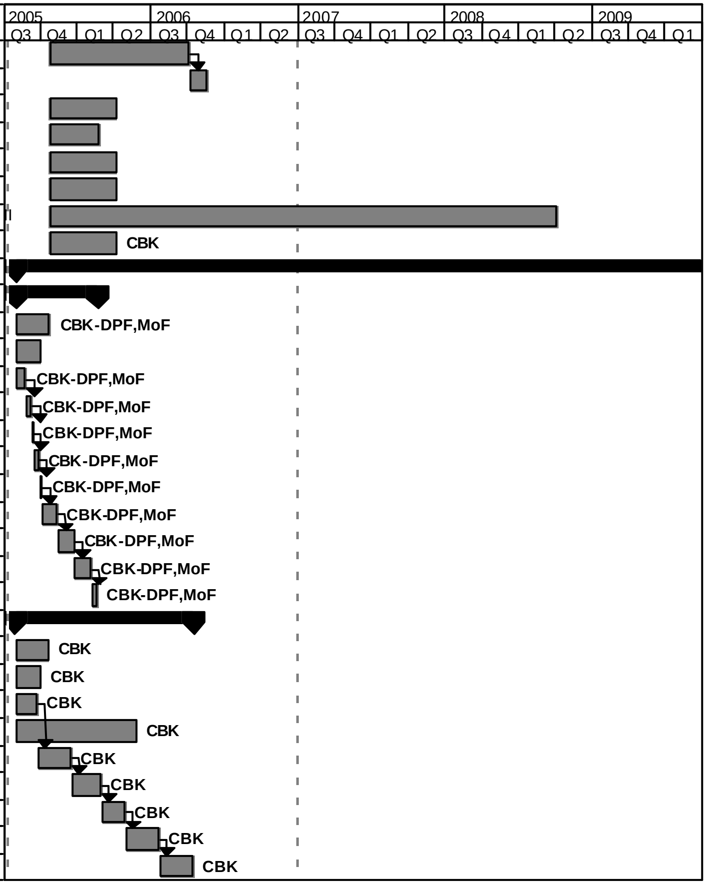
| ID | Task Name |
|---|---|
| 1 | **COMPONENT 3: STRENGTHENING FINANCIAL SECTOR REGULATORS AND THE DEPOSIT PROTECTION FUND** |
| 2 | **SUB-COMPONENT 3.1: Strengthening of banking sector legal and regulatory regime** |
| 3 | **Enhanced CBK Autonomy** |
| 4 | Amend the Banking Act to vest all supervisory, licensing and interventions with CBK |
| 5 | Identify required aspects of the Banking Act to achieve desired objectives |
| 6 | Consolidate all necessary amendments to be done on the Banking Act |
| 7 | Present the consolidated proposal to stakeholders |
| 8 | Draft Banking Act amendments taking into account stakeholder suggestions/recommendations |
| 9 | Present proposed amendments to Cabinet for approval |
| 10 | Publish Banking Act amendment Bill and follow debate in Parliament |
| 11 | Obtain Presidential Assent to amended Act |
| 12 | **Amend CBK Act to enhance the CBK autonomy** |
| 13 | Review the current CBK Act |
| 14 | Identify and consolidate all necessary amendments to be done on the Banking Act |
| 15 | Draft Banking Act amendments and revise regulations for subsequent submission to parliament. |
| 16 | Passing of the amended CBK Act by parliament and subsequent presidential assent |
| 17 | **Banking sector guidelines revised** |
| 18 | Identify aspects of the guidelines for review |
| 19 | Conduct (to include stakeholder consultations) a study on the appropriateness of the current baniking sector guidelines |
| 20 | Present study results to stakeholder |
| 21 | Draft revised banking sector guidelines taking into accounts study findings and stakeholder views |
| 22 | Approve new guidelines for the banking sector |
| 23 | Enforce implementation of IAS |
| 24 | Start IAS implementation process |
| 25 | Monitor IAS implementation |
| 26 | Publish IAS implementation reports |
| 27 | Develop a comprehensive AML/CFT guidelines |
| 28 | Review of the developed guidelines by stakeholders |
| 29 | Revise AML/CFT guidelines |
| 30 | Publish and distribute developed AML/CFT guidelines. |



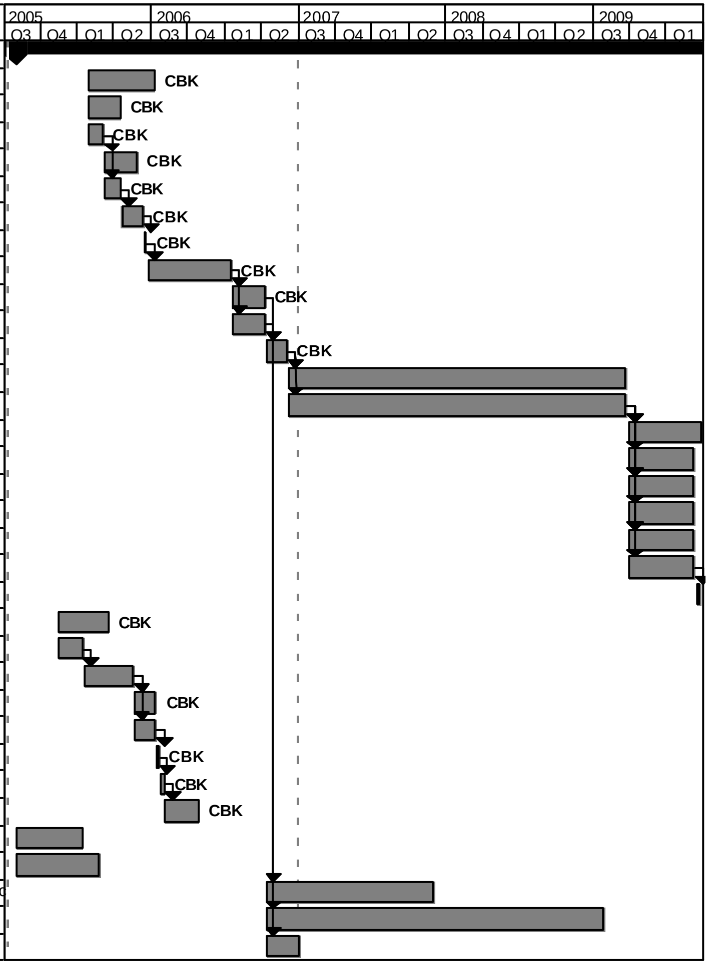
| ID | Task Name |
|---|---|
| 31 | Sensitise stakeholders on the developed AML/CFT guidelines |
| 32 | Formulate Risk Based Management guidelines |
| 33 | Review the formulated guideline |
| 34 | Revise the guidelines |
| 35 | Publish and distribute the revised guidelines |
| 36 | Stakeholders sensitisation of the formulated and published risk based management guidelines |
| 37 | Adopt a more robust loan provisioning criteria in accordance with Core principles 5, 11-14, 18, 20 and 23. |
| 38 | Review of the existing loan provisioning criteria |
| 39 | Publish the reviewed loan provisioning criteria |
| 40 | Implementation of the reviewed criteria |
| 41 | Adopt RBS inspection guidelines |
| 42 | RBS inspection guidelines implementation. |
| 43 | Monitor and evaluate RBS inspection guidelines process |
| 44 | **Enhanced FISD capacity** |
| 45 | Determine FISD staff capacity requirements |
| 46 | Conduct staff capacity needs study |
| 47 | Present staff capacity needs requirements to CBK |
| 48 | Develop an action plan for implementing the recommendations of the study |
| 49 | Implement action plan for staff capacity building |
| 50 | Acquire relevant hardware and software to improve information processing, dissemination and decision making |
| 51 | Conduct study on software requirements |
| 52 | Hardware and software procurement |
| 53 | Install the acquired equipment |
| 54 | Staff training on the new system |
| 55 | Train staff - in other operational areas |
| 56 | Conduct training needs assessment |
| 57 | Presents study results to CBK management |
| 58 | Develop a training action plan to implement study findings |
| 59 | Implement action plan |
| 60 | Monitor the training process |



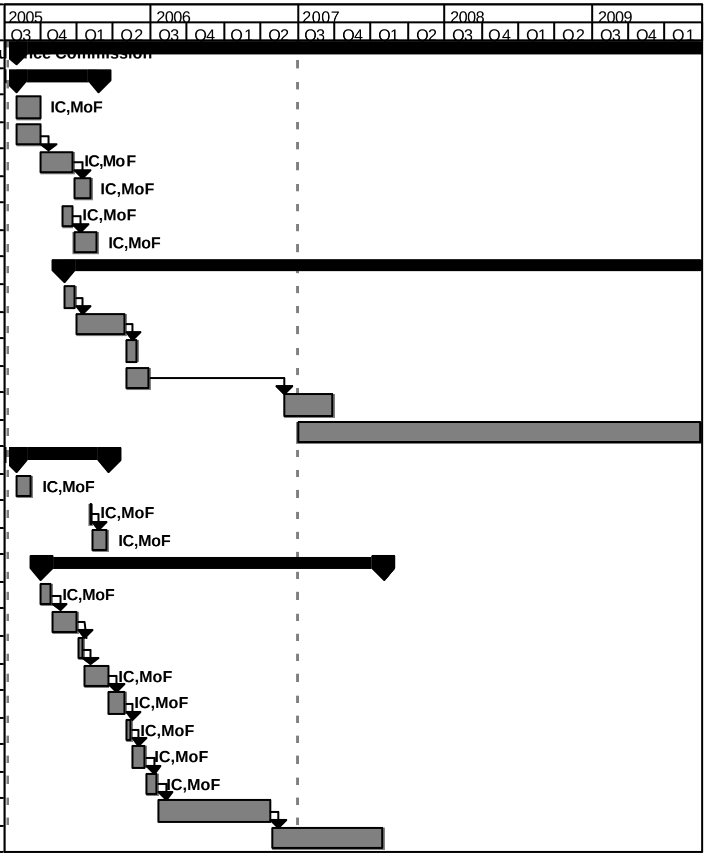
| ID | Task Name |
|---|---|
| 61 | Conduct Staff on-job training |
| 62 | Identify and second staff to jurisdictions that have fully implemented Risk Based Supervision |
| 63 | Training of FISD staff on risk identification, measurement and control |
| 64 | Train staff on computer assisted audit techniques (in-house) |
| 65 | Train supervisors on electronic working papers (on site) |
| 66 | Train FISD Staff on the BASEL II Accord (in house) |
| 67 | Second staff to jurisdictions in Europe / North America that are at an advanced stage of implementation of BASEL I |
| 68 | Train FISD staff on AML / CFT |
| 69 | **SUB-COMPONENT 3.2: Strengthening the Depositors Protection Fund** |
| 70 | **DPF Act Enacted** |
| 71 | Draft new DPF legislation |
| 72 | Review the current DPF Act |
| 73 | Identify and consolidate all necessary DPF legislation contents |
| 74 | Draft DPF Legislation for discussion with stakeholders. |
| 75 | Conduct stakeholder consultations |
| 76 | Revise PDF legislation for subsequent submission to parliament. |
| 77 | Finalise DPF draft legislation for subsequent submission to parliament |
| 78 | Parliamentary approval and implementation |
| 79 | Passing of the DPF Act by parliament and subsequent presidential assent |
| 80 | Implement DPF legislation |
| 81 | Monitor and evaluate implementation process |
| 82 | **Banking Act amended** |
| 83 | Stakeholder consultations |
| 84 | Conduct a total review of the Banking Act |
| 85 | Identify and consolidate all necessary amendments to be done on the banking act |
| 86 | Amendment of Banking Act |
| 87 | Draft Banking Act amendments and revise regulations for subsequent submission to parliament. |
| 88 | Parliamentary approval |
| 89 | Passing of the amended Banking act by parliament and subsequent presidential assent |
| 90 | Implement the amended Banking Act |
| 91 | Monitor and evaluate implementation process |



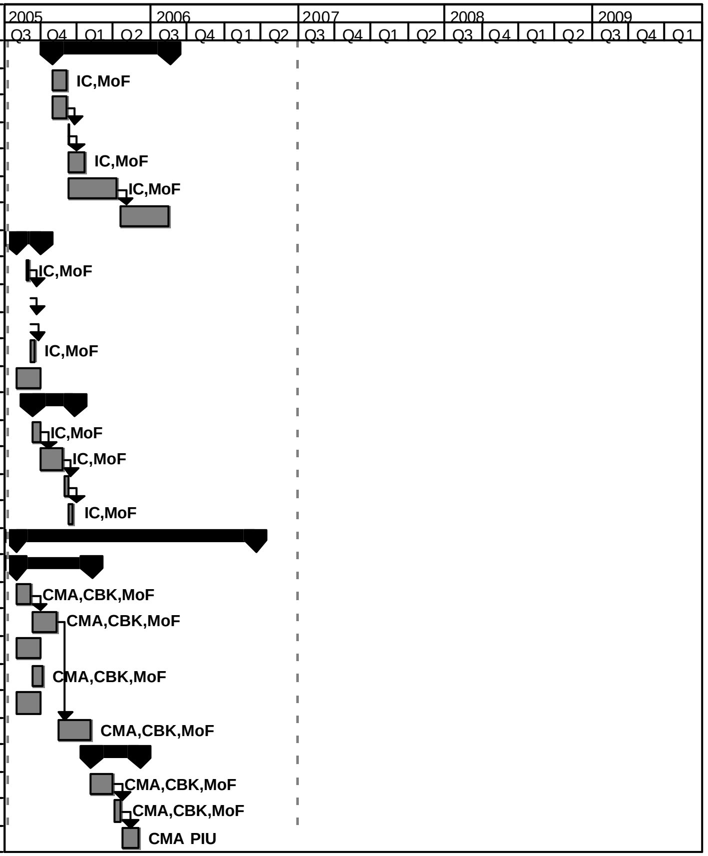
| ID | Task Name |
|---|---|
| 92 | **Autonomous DPF established** |
| 93 | Recruitment of CEO |
| 94 | Conduct search and selection for the DPF CEO |
| 95 | An independent DPF Board appointed |
| 96 | Assess staff requirements |
| 97 | Perform staff requirement analysis |
| 98 | Design an appropriate staff strategy to meet staff requirements |
| 99 | Approve the staffing plan |
| 100 | Implement and monitor implementation |
| 101 | Assess training needs |
| 102 | Undertake training needs analysis |
| 103 | Design an appropriate training programme and strategy |
| 104 | Implement and monitor implementation |
| 105 | Staff training in various specialised areas |
| 106 | Train staff on procurement of consulting and professional services |
| 107 | Train staff on Legislative drafting |
| 108 | Train staff in International commercial Arbitration |
| 109 | Train staff in professional ethics and lawyering skills workshop |
| 110 | Train managers on relevant legal matters |
| 111 | Training DPF staff on risk management |
| 112 | MIS established |
| 113 | Develop a data base and MIS reporting |
| 114 | Procure appropriate hardware and software. |
| 115 | Implement data base and MIS reporting system implementation. |
| 116 | Develop MOU for information sharing with other regulators |
| 117 | Draft MOU for information sharing |
| 118 | Present draft MOU to stakeholders |
| 119 | Approval of the MoU |
| 120 | MOU Implementation |
| 121 | Staff training (Other) |
| 122 | Capacity built in area of examination |
| 123 | Training staff in receivership, liquidation law, alternative dispute resolutions mechanism, statutory management etc |
| 124 | Attachment of Key staff to well established Deposit Insurance institutions |
| 125 | Recruitment of additional staff in areas of liquidation and receivership |



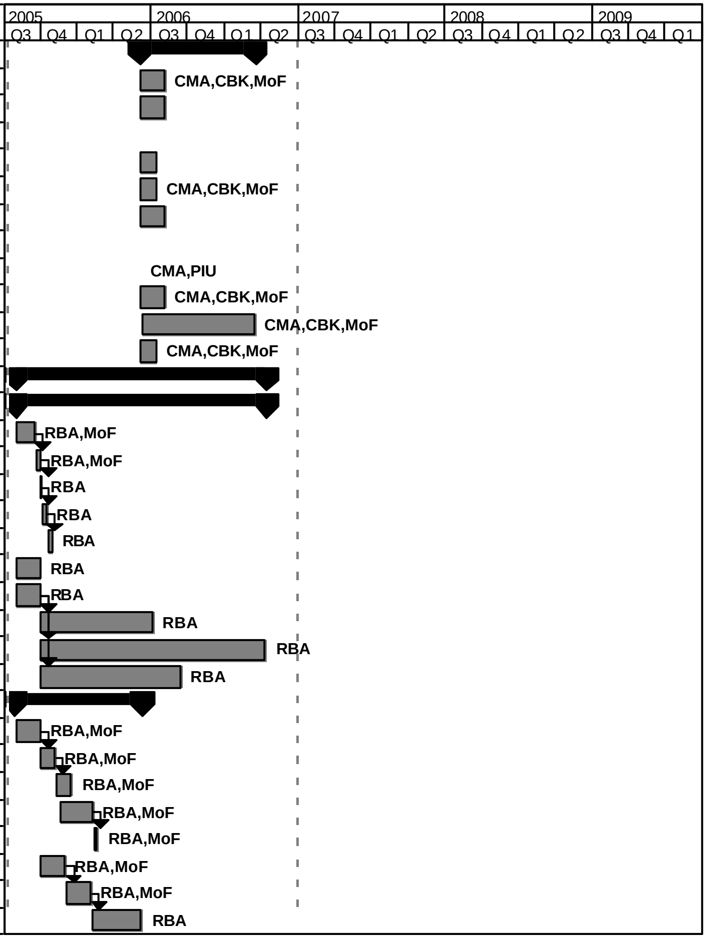
| ID | Task Name |
|---|---|
| 126 | **SUB-COMPONENT 3.3: Strengthening of insurance sector legal and regulatory regime and capacity building of Insurance Commission** |
| 127 | **Enhanced capacity for the Insurance Commission staff** |
| 128 | Review of the organisation structure and staff needs |
| 129 | Commission and manage consultants to review the organisation structure and assess staff needs |
| 130 | Structure implementation |
| 131 | Identify training needs-commission consultants to identify training needs |
| 132 | Design training programmes to meet IC and career development needs. |
| 133 | Implement the training programmes |
| 134 | **Staff recruitment** |
| 135 | Carry out a staff survey to determine optimum staffing |
| 136 | Develop a recruitment strategy |
| 137 | Approve the recruitment strategy |
| 138 | Advertise for the vacant posts |
| 139 | Conduct interview and hire staff as per recruitment strategy |
| 140 | Staff training for recruits and current staff |
| 141 | **Autonomous Insurance Commission** |
| 142 | Conduct stakeholder consultation |
| 143 | Sensitisatising stakeholders of the new IC Act |
| 144 | Implementation of the amended IC Act |
| 145 | **IRDA Act enacted** |
| 146 | Draft new IRDA legislation |
| 147 | Review the IRDA Act |
| 148 | Identify and consolidate all necessary IRDA legislation contents |
| 149 | Draft IRDA Legislation for discussion with stakeholders. |
| 150 | Revise IRDA legislation for subsequent submission to parliament. |
| 151 | Finalise IRDA draft legislation for subsequent submission to parliament |
| 152 | Parliamentary approval |
| 153 | Passing of the IRDA act by parliament and subsequent presidential assent |
| 154 | Implement IRDA legislation |
| 155 | Monitor and evaluate implementation process |



| ID | Task Name |
|---|---|
| 156 | **IAIS Standards Adopted** |
| 157 | Study Implications of IAIS Standards |
| 158 | Conduct study on the implications of the IAIS Standards |
| 159 | Report on the findings |
| 160 | Adopt IAIS Standards |
| 161 | Train staff on IAIS standards |
| 162 | Monitor and evaluate IAIS implementation process |
| 163 | **Member of IAIS** |
| 164 | Subscribe to IAAS |
| 165 | Subscription fee |
| 166 | Annual renewal |
| 167 | Public information |
| 168 | Website developed |
| 169 | **Develop a strategy for positioning the website.** |
| 170 | Identify the key stakeholders to be addressed through the website |
| 171 | Develop website contents to be uploaded |
| 172 | Establish mechanisms and identify responsibilities for regular updating of the website |
| 173 | Launch the website |
| 174 | **SUB-COMPONENT 3.4: Strengthening of Capital Market regulation and capacity building of CMA** |
| 175 | **Amended legislation** |
| 176 | Stakeholder consultations |
| 177 | Hire CMA Advisor |
| 178 | Conduct study on areas of the CMA Act that need review |
| 179 | Consolidate all necessary amendments to be done on the CMA Act |
| 180 | Amendment of CMA Act |
| 181 | Draft CMA Act amendments and revise regulations for subsequent submission to parliament. |
| 182 | **Parliamentary approval** |
| 183 | Passing of the amended CMA Act by parliament and subsequent presidential assent |
| 184 | Implement the amended CMA Act |
| 185 | Monitor and evaluate implementation process |

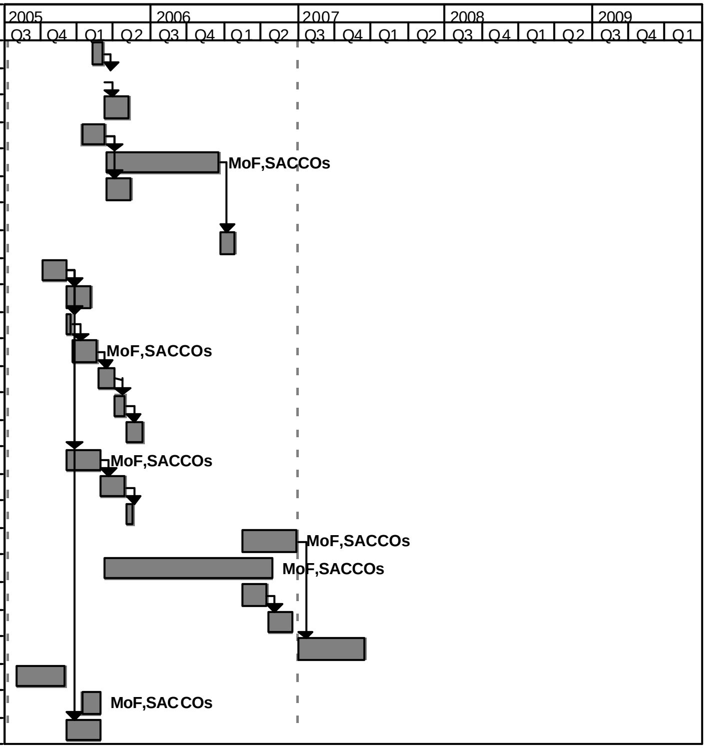


| ID | Task Name |
|---|---|
| 186 | **MIS developed and implemented** |
| 187 | Assess staff requirements |
| 188 | Perform staff requirement analysis |
| 189 | Approve the designed strategy |
| 190 | Implement and monitor implementation |
| 191 | Assess training needs |
| 192 | Design an appropriate training programme and strategy |
| 193 | Approve the designed strategy |
| 194 | Implement and monitor implementation |
| 195 | Develop a data base and MIS reporting |
| 196 | Build capacity by training staff in various courses |
| 197 | Develop MOU for information sharing with other regulators |
| 198 | **SUB-COMPONENT 3.5: Strengthening of Retirement Benefits Authority and capacity building** |
| 199 | **Increased capacity for risk based supervision** |
| 200 | Develop a detailed specification of capacity building requirements for RBA |
| 201 | TORs for Technical Assistance |
| 202 | Submission and discussion of the proposed training manual with stakeholders. |
| 203 | Revision and subsequent approval of the training manual. |
| 204 | Distribute the approved training manual to all departments. |
| 205 | Staff selection |
| 206 | Individual staff to identify their training requirements |
| 207 | Implementation of the training manual |
| 208 | Train staff according to their training requirements |
| 209 | Monitor and evaluate expected training results. (Internal) |
| 210 | **RBA legislative framework overhaul process** |
| 211 | Amend the Retirement Benefits Act to provide for a definition of umbrella schemes. |
| 212 | Publish the Amended Act for introduction into the National Assembly and follow debate on the amended act. |
| 213 | Prepare vellum copies for assent |
| 214 | Publish the act |
| 215 | Mobilise stakeholders |
| 216 | Develop a data base and MIS reporting system in coordination with RBA |
| 217 | Procure appropriate hardware and software. |
| 218 | Data base and MIS reporting system implementation. |



| ID | Task Name |
|---|---|
| 219 | **SUB-COMPONENT 3.6: Development and implementation of MFI regulatory framework** |
| 220 | **MFI Regulatory framework established** |
| 221 | Comprehensively revise and finalise the MFI Strategy |
| 222 | Stakeholder consultations |
| 223 | Enact the MFI Act |
| 224 | Identify and consolidate all necessary MFI legislation contents |
| 225 | Draft MFI Legislation for discussion with stakeholders. |
| 226 | Revise MFI legislation for subsequent submission to parliament. |
| 227 | Pass the MFI Act by parliament and subsequent presidential assent |
| 228 | Implement MFI legislation |
| 229 | Support AMFI (Association of MicroFinance Institutions) to develop self regulation |
| 230 | Support to develop a code of conduct for non-deposit taking MFIs |
| 231 | Monitor and evaluate implementation process |
| 232 | **SUB-COMPONENT 3.7:Development and implementation of SACCOs' regulatory framework** |
| 233 | **Regulatory authority established** |
| 234 | Develop SACCOs strategy |
| 235 | Advise on SACCO regulation |
| 236 | Comprehensively revise SACCOs strategy |
| 237 | Facilitate stakeholders discussions |
| 238 | Incorporate stakeholders views in the strategy |
| 239 | Communicate new strategy to stakeholders |
| 240 | Draft SACCOs Regulatory Authority Act |
| 241 | Identify and consolidate all necessary SACCOs legislation contents |
| 242 | Draft SACCOs Legislation for discussion with stakeholders. |
| 243 | Revise SACCOs legislation for subsequent submission to parliament. |
| 244 | Finalise SACCOs draft legislation for subsequent submission to parliament |
| 245 | Passing of the SACCOs Act by parliament and subsequent presidential assent |
| 246 | Implement SACCOs legislation |
| 247 | Monitor and evaluate implementation process |
| 248 | Assess staff requirements |
| 249 | Perform staff requirement analysis |

| ID | Task Name |
|---|---|
| 250 | Design an appropriate staff strategy to meet staff requirements |
| 251 | Approve the designed strategy |
| 252 | Implement and monitor implementation |
| 253 | Assessment of Training needs |
| 254 | Undertake Capacity building for regulator and the industry |
| 255 | Design an appropriate training programme and strategy |
| 256 | Approve the designed strategy |
| 257 | Implement and monitor implementation |
| 258 | Infrastructure assessment |
| 259 | Staff recruitment |
| 260 | Carry out staff survey and extra staff requirement |
| 261 | Establish a recruitment strategy |
| 262 | Approve the recruitment strategy |
| 263 | Advertise for the vacant posts |
| 264 | Conduct interview and hire staff as per recruitment strategy |
| 265 | Develop Data base for SACCOs management and MIS reporting |
| 266 | Data base and MIS reporting system implementation. |
| 267 | Procurement of appropriate software. |
| 268 | Train – Audit and inspection |
| 269 | Hire consultant to review present audit and inspection manual |
| 270 | Review the existing audit and inspection manual |
| 271 | Consultant's recommendation approved |
| 272 | Develop training material on audit and inspection best practices and contemporary techniques. |
| 273 | Train staff on audit and inspection best practices and contemporary techniques |
| 274 | Establish a programme for continuous professional development. |
| 275 | Establish and maintain training records for all personnel |



## 3.4 Component 4: Strengthening debt management and debt markets

### 3.4.1 Description of component

Kenya is participating in the joint World Ban/IMF Programme on Central Government Debt Management and Domestic Debt Market Development. Under the Programme, a diagnostic of Kenya's central government debt management and debt securities market was carried out and the authorities agreed to the need to design a programme of reforms and capacity building.

Central government borrowing is divided between the MoF and the CBK. The MoF, through its External Resources Department, borrows from foreign sources and the CBK borrows on behalf of government in the domestic market but there is little coordination or consolidation of these functions. There are no formal debt management objectives and no written procedures for formulation and approval of a debt management strategy. To the extent that there has been an explicit strategy for debt management, this seems to have developed gradually out of existing practices, rather than being founded on cost/risk considerations. In order to strengthen central government debt management, the decision has been taken to set up a Debt Management Office (DMO) within the MoF.

The Project will provide technical support for setting up a unified and sustainable DMO, including review of relevant legislation. The DMO, among other things, will be responsible for a consolidated debt database and the basic cost/risk analyses of the total debt. This will involve training the relevant staff in the use of the Commonwealth Debt Recording System (the CS-DRMS), a new version of which is under installation (version *2000+),* and in the use of risk models. Upgrading of the debt recording system will be the first order of priority.

Activities under strengthening of debt management will include:

i. ***Setting up a Comprehensive debt database and debt recording system,*** including: a) assistance with the reconciliation process of present data; b) recommendations on new hardware and providing assistance with it s installation; *c)* the installation of **CS-DMS** 2000+ and providing training of staff in its use; d) assisting in linking the CS-DMS 2000+ with the CBK’s database for the domestic debt; and e) preparation of a procedures manual, and recommendations on how to set up an organisation for future front office debt data enters and back office controls.

ii. ***Preparing a report on the required staff capacity,*** including: a) needed skill and staffing levels; b) possible means to attract and retain skilled staff, both in short and medium terms; and c) alternative training programmes.

iii. ***Drafting a new Public Debt Management Law,*** including: a) debt management objectives; b) requirement to determine a debt management strategy, with yearly revisions; and **c)** reporting and evaluation procedures.

iv. ***Creating the DMO and developing internal processes,*** including: a) establishment of a separate back office to be responsible for the CS-DMS 2000+; b) drafting of an agreement between the MOF and the CBK clarifying the role of the CBK as fiscal and paying agent for the central government, and regulating the warranted coordination between these two institutions; *c)* evaluation of needed support functions to the DMO, e.g., legal, human resources management and IT; d) establishment of a middle office to analyse the risks in the debt portfolio, prepare proposals for debt management strategies, control that the debt is within prescribed cost and risk limits, and to give inputs in debt sustainability analyses; e) drafting of organisational guidelines clarifying the responsibilities of the separate units of the DMO and determining the decision making power within the DMO; f) institutionalisation of the process for formulating debt management strategies, and the approval and evaluation of these strategies; and g) development of a procedure for coordination of debt management policy with fiscal policy.

Previous efforts to establish improved debt management practices in Kenya have floundered due to weaknesses in the supporting institutional infrastructure. The Project will therefore not only support increased capacity in form of training, but also build up institutions by providing an appropriate legal and organisational framework. The ability of the MoF to attract and retain skilled staff is crucial for the sustainability of the DMO.

Development of debt markets is crucial to the development of long-term securities and capital markets in general. The Project will support a number of technical improvements with a view to enhancing the operations of the primary and secondary government securities markets. In order for these technical improvements to be effective, it will be necessary for the CMA to revise current rules so as to allow an OTC market for professional wholesale investors outside the Nairobi Stock Exchange (NSE). Without this policy change, the benefits of pursuing the following domestic debt market reforms would be severely compromised. Activities for strengthening debt markets will focus on:

i. ***Restructuring the primary market for government securities,*** by (a) preparing an institutional survey of demand for government securities and analysis of government cash flows to serve as a basis for formulating a revised domestic borrowing programme of benchmark bonds; and (b) recommendations on how to phase in the new benchmark bond programme.

ii. ***Restructuring the secondary market for government securities*** by (a) drafting and implementing rules and regulations to facilitate OTC trading in government securities; (b) drafting a proposal for a primary dealer system which includes a securities lending facility as well as oversight and prudential issues; and (c) conducting a workshop on primary dealer operations, regulatory compliance and other issues related to the primary dealership, provide training for central bank staff and an internal operations manual for the primary dealership.

iii. ***Support for money market development*** by providing assistance on how to establish a money market index which includes contribution parameters and dissemination procedures.

### 3.4.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.4.1** below sets out the inputs needed to achieve the outputs for the two sub-components that fall under component 4. It also assigns responsibility for implementation to 8 Government institutions, namely: the MoF, CBK, AD, DMD, DGIPE, ERD, AG, and CMA DMD, DGIPE, ACG and CBK.

**Table 3.4.1: Component 4 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • Debt Management Office (DMO) fully operational and internal processes fully developed. | Advisor | DMD, AD, ERD, CBK, DGIPE |
| • Debt management legislation enacted | Consultant | MOF, CBK, AG |
| • Primary market for government securities restructured | Consultant | MOF, CBK |
| • Secondary Market for government securities restructured | Advisor | CMA, CBK |
| • Established money market | Consultant | CBK |

### 3.4.3 Component cost and financing

The financing needed for this component is KShs 99 million (US$ 1.2 million). **Table 3.4.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices.

**Table 3.4.2: Component 4 costs in KShs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KSH) | | | | | TOTAL OUTPUT COST (KSH) |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | |
| Debt Management Office (DMO) fully operational and internal processes fully developed. | 34,188,000 | 13,134,000 | 4,730,000 | 2,530,000 | 1,870,000 | 56,452,000 |
| Debt management legislation enActed | - | 1,100,000 | 1,375,000 | 165,000 | 165,000 | 2,805,000 |
| Primary market for government securities restructured | 5,038,000 | 11,880,000 | 4,972,000 | - | - | 21,890,000 |
| Secondary Market for government securities restructured | 5,500,000 | 3,080,000 | 4,125,000 | 165,000 | 165,000 | 13,035,000 |
| Established money market | 44,000 | 4,510,000 | - | - | - | 4,554,000 |
| **Total** | **44,770,000** | **33,704,000** | **15,202,000** | **2,860,000** | **2,200,000** | **98,736,000** |
| **Cost in U$** | **559,625** | **421,300** | **190,025** | **35,750** | **27,500** | **1,234,200** |

### 3.4.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.4.1**. The key features of the schedule are as follows:

- A back office responsible for operating the CS-DMS 2000 will be in place by the second quarter of 2006. Further, debt management policy procedures will have been disseminated to personnel in the DMO by the third quarter of 2006; and new legislation passed by the third quarter of 2007

- The primary market for government securities will be restructured over a two-year period commencing in the third quarter of 2005. It is expected that a new benchmark bond programme will have been adopted by the fourth quarter of 2006

- OTC trading rules and regulations will be introduced in the third quarter of 2007

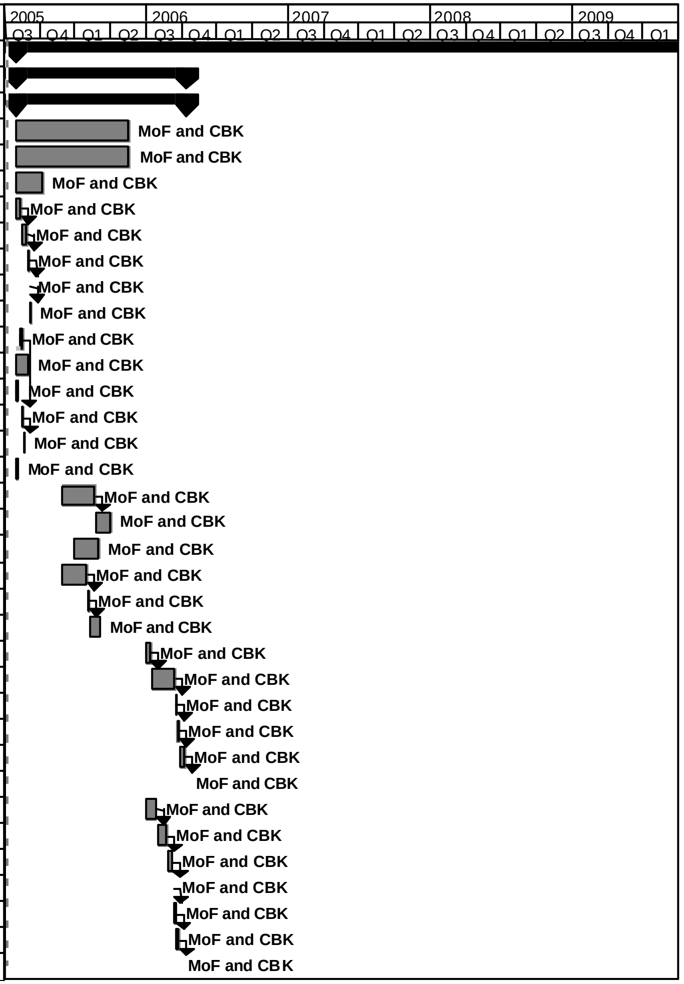
- A money market index will be developed by the third quarter of 2006.

### 3.4.5 Critical risks

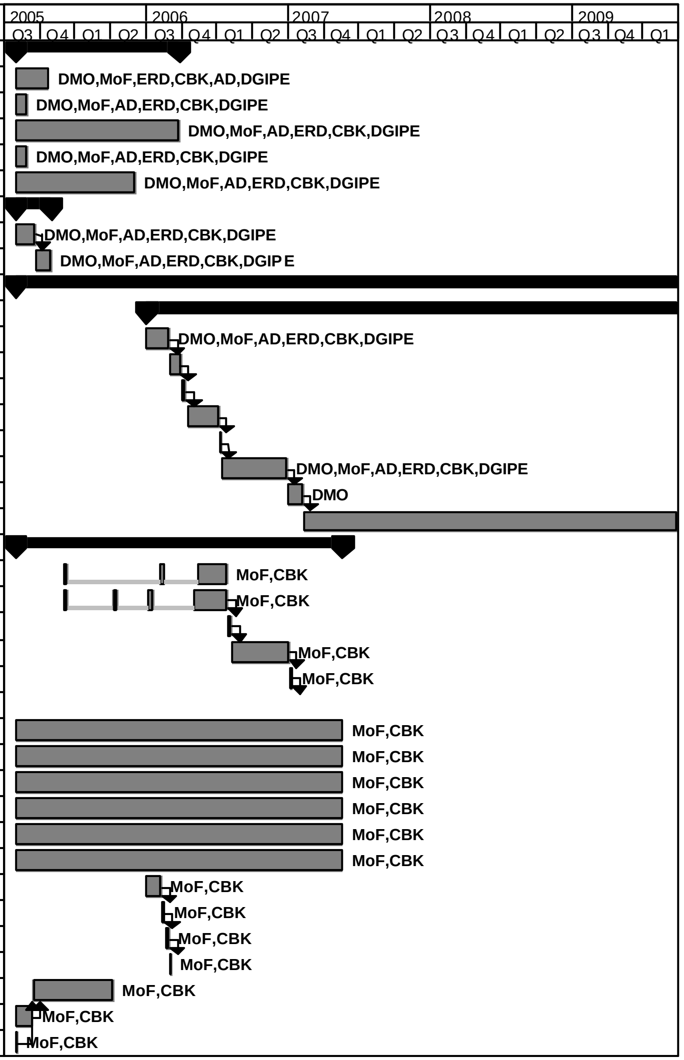
The main risk to the reforms proposed to strengthen debt management and debt markets relates to the inability to get the needed legal and regulatory framework on time due to the slow pace of passing legislation in Kenya's Parliament. The other risk, though minor, revolves around the possibility of a misunderstanding and rivalries between the many Government departments involved. The planned consultations between the stakeholders and the establishment of the debt task force are the main means of mitigating the potential risk.

## Figure 3.4.1: Component 4 – implementation schedule

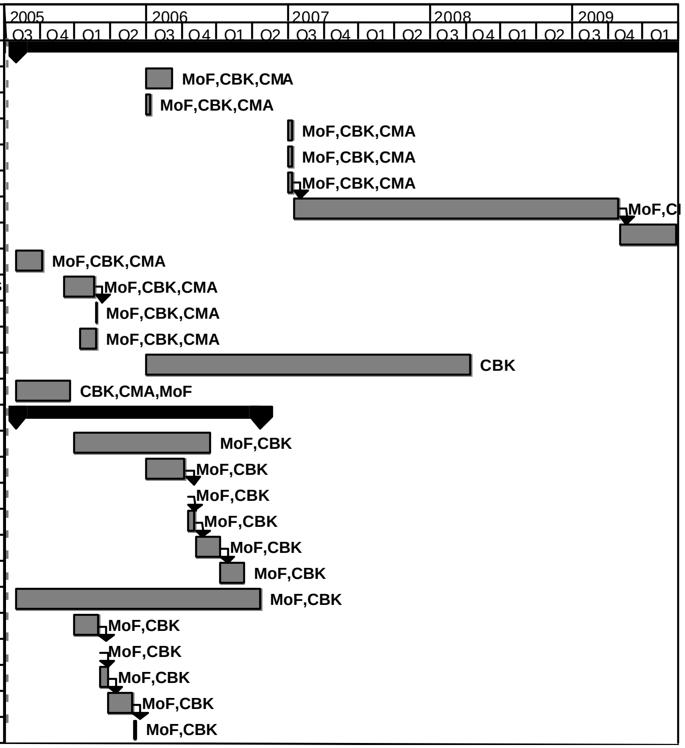
| ID | Task Name |
|---|---|
| 1 | **COMPONENT 4: STRENGTHENING DEBT MANAGEMENT AND DEBT MARKETS** |
| 2 | **SUB-COMPONENT 4.1: Establish unified and sustainable Debt Office** |
| 3 | **Debt Management Office (DMO) fully operational** |
| 4 | Establish back office responsible for the CS-2000+ |
| 5 | Purchase equipment (Furniture and others) |
| 6 | Draft an agreement between MoF and CBK clarifying role of CBK and GoK |
| 7 | Draft an agreement |
| 8 | Discuss the contents of the agreements with CBK and MoF, revise and prepare final agreement |
| 9 | Prepare and present the draft agreement |
| 10 | Discuss the draft agreement with CBK and MoF officials |
| 11 | Revise and approve the final agreement |
| 12 | Evaluate needed support functions to the DMO (e.g. Legal, HRM, and |
| 13 | Review the functions of the DMO |
| 14 | Evaluate support functions to the DMO |
| 15 | Discuss draft report with stakeholders |
| 16 | Revise and approve of the final report |
| 17 | Draft organisational guidelines clarifying the responsibilities of the separate units of the DMO |
| 18 | Conduct a diagnostic review of the institutional arrangements for the |
| 19 | Prepare a draft report on the DMO organisational guidelines |
| 20 | Dicuss the report with stakeholders |
| 21 | Revise the draft report on the DMO organisational guidelines incorporating stakeholders inputs |
| 22 | Present and approve final report |
| 23 | Distribute report to various DMO units |
| 24 | Institutionalise the process for formulating debt management strategies |
| 25 | Draft debt management strategies |
| 26 | Discuss the draft debt management strategies with stakeholders for evaluation purposes |
| 27 | Revise the debt management strategies |
| 28 | Present and approve the final debt management strategies |
| 29 | Distribute the debt management strategies to DMO units |
| 30 | Develop a procedure for coordinating debt management policy. |
| 31 | Review existing policy for debt management to identify gaps and bottlenecks |
| 32 | Develop draft procedures for coordination debt management policy |
| 33 | Discuss the draft procedures with stakeholders |
| 34 | Revise the debt management policy procedures |
| 35 | Present and approve of the final debt management policy procedures. |
| 36 | Disseminate the debt management policy procedures to DMO units |



| ID | Task Name |
|---|---|
| 37 | **Set up a comprehensive debt database and debt recording system** |
| 38 | Reconcile the existing data |
| 39 | Recommended and purchase hardware and software for CS- |
| 40 | Set up Debt recording for DMO and link it with CBK database for the domestic debt |
| 41 | Design a training programme on the use of the database |
| 42 | Train staff of DMO and others on database management and debt recording |
| 43 | **Report on the required staff capacity** |
| 44 | Assess and approve staff requirements |
| 45 | Implement assessed staff requirements |
| 46 | **SUB-COMPONENT 4.2: Strengthening of Debt Markets** |
| 47 | **Debt management legislation enacted** |
| 48 | Draft a new Public Debt Management Law |
| 49 | Identify and consolidate all necessary Public Debt Management legislation contents |
| 50 | Draft Public Debt Management Legislation for discussion with stakeholders. |
| 51 | Revise Public Debt Management legislation for subsequent submission to parliament. |
| 52 | Finalise Public Debt Management draft legislation for subsequent submission to parliament |
| 53 | Pass the Public Debt Management Act by parliament and subsequent presidential assent |
| 54 | Implement Public Debt Management legislation |
| 55 | Monitor and evaluate the implementation process |
| 56 | **Primary market for government securities restructured** |
| 57 | Prepare institutional survey of demand for Government Securities |
| 58 | Commission and manage consultant in carrying out institutional survey of demand for government securities |
| 59 | Draft report submitted to the stakeholders for discussion |
| 60 | Revise survey report incorporating stakeholders' views |
| 61 | Survey report submitted and approved |
| 62 | Distribute the report to various stakeholders |
| 63 | Analyse Government cash flows |
| 64 | Commission and manage consultant in analysing government cash |
| 65 | Draft report submitted to the stakeholders for discussion |
| 66 | Revise survey report incorporating stakeholders' views |
| 67 | Submit and approve Government cash flow analysis report |
| 68 | Distribute the report to various stakeholders |
| 69 | Develop and adopt new benchmark bond programme |
| 70 | Discuss draft report with stakeholders |
| 71 | Revise the new benchmark bond programme |
| 72 | Approve and adopt the new bond programme |
| 73 | Strengthen Auction rules and disseminate information provided to the market leaders |
| 74 | Develop procedures for strengthening Auction rules |
| 75 | Disseminate the developed procedures to market leaders |



| ID | Task Name |
|---|---|
| 76 | **Secondary Market for government securities restructured** |
| 77 | Draft and implement rules and regulations for OTC Trading in Government securities |
| 78 | Identify and consolidate all necessary rules and regulations for OTC trading in Government securities |
| 79 | Draft rules and regulations for OTC trading in Government securities |
| 80 | Revise rules and regulations for OTC trading in Government securities |
| 81 | Finalise rules and regulations for OTC trading in Government securities |
| 82 | Implement rules and regulations for OTC trading in Government securities |
| 83 | Monitor and evaluate implementation process |
| 84 | Diagnostic study of options for government securities |
| 85 | Draft proposal for primary dealer system, including securities lending facility as well as oversight and prudential issues |
| 86 | Conduct workshop on private dealer operations |
| 87 | Prepare operations manual for primary dealership |
| 88 | Train CBK Staff |
| 89 | Conduct a study to explore formalities for linking NSE-CDS with the proposed CBK-CDS for Government securities |
| 90 | **Established money market** |
| 91 | Develop and adopt money market index, Nairobi Inter-bank Borrowing rate |
| 92 | Develop money market index |
| 93 | Discuss developed index with stakeholders |
| 94 | Revise the money market index |
| 95 | Approve and adopt the money market index |
| 96 | Disseminate information to the shareholders |
| 97 | Introduce and adopt Master Repurchase agreements |
| 98 | Develop master repurchase agreements |
| 99 | Discuss developed master repurchase agreement with stakeholders |
| 100 | Revise master repurchase agreement |
| 101 | Approve and adopt master repurchase agreement |
| 102 | Disseminate information to the shareholders |



## 3.5 Component 5: Modernising the National Payments System

### 3.5.1 Description of component

*Modernising the National Payments System*

Payments in Kenya are largely paper-based and manually processed. Cash is the most common form of payment. Cheques have traditionally dominated non-cash payments, accounting for about 95 percent of non-cash payments as of June 2003. In the absence of an electronic large value transfer system, large payments are made by check, correspondent account transactions pursuant to Society for Worldwide InterBank Financial Telecommunications (SWIFT) messages, or through direct transactions in the settlement accounts maintained by commercial banks at the CBK. Retail payments systems comprising proprietary and shared ATM networks, and electronic funds transfer at point of sale (EFTPOS), are in place but growing relatively slowly.

A growing number of InterBank payments in Kenya are conducted through correspondent account transactions on the basis of instructions transmitted through SWIFT. While banks chose this option because it is fast and secure, the use of correspondent accounts in a commercial bank network can contribute to systemic risk. The nine Kenya banks that are not SWIFT members use messenger and courier services to deliver payment instructions to the CBK. The CBK is encouraging broader participation by banks in the SWIFT system or use of secured SWIFT-derivative (bureau) facilities by connecting through the African Exchange Bureau domiciled in South Africa or Kenya Commerce Exchange Service Bureau, which is locally owned.

The risk and efficiency weaknesses stemming from the current arrangements can be addressed through implementing a modern Real Time Gross Settlement (RTGS) system.

*Government Securities Transactions*

The National Debt Office (NDO) in the CBK is the registrar of Government securities and operates an in-house developed electronic registry. The settlement rules for Treasury bonds are laid out in the NSE Trading and Settlement Rules as T+3. For transactions of Ksh 5 million or less, the buyer has the option to make payment by either InterBank transfer, or by check. InterBank transfers are required for all transactions over Ksh 5 million. The buyer in these larger transactions must supply evidence of payment to the NSE by 3.00 pm on T+3, in the form of an InterBank money transfer slip or a letter giving instructions for the InterBank payment. The seller must first deliver the sale and transfer confirmation to the NSE for approval and then send it to the NDO by 12.00 pm on T+1 for registration. Cash payment and ownership transfer should be completed by close of business on T+3.

The main weakness in the current system is that there is no coordination within the Banking Department which transfers InterBank funds, in the case of settlement banks. As a result, there is no link between the transfer of funds, and the transfer of title greatly increases settlement risks. Market participants reduce settlement risk by settling directly with each other, rather than through a broker and require the name of the counter party before delivering securities. If the counter party does not have an InterBank limit, he will be required to complete his leg of the transaction first.

Due to recent securities fraud, added security measures have been established and the seller may be required to appear in person to confirm payment or settlement instructions. This creates delays and the transfer of securities leg of the transaction can take anywhere between 5 and 14 days to complete. Therefore settlement is not T+3 but closer to T+5. The buyer will first transfer funds on T+5**,** hoping to receive his securities on the same day. However, this is not always the case as each transaction requires the CBK to process the settlement instructions which must include broker confirmation, trade confirmation and settlement instruction from both buyer and seller. The uncertainty of the settlement period adds to costs by increasing settlement risk and therefore discourages secondary market trading and prevents the use of Treasury bonds for liquidity management purposes.

The current weaknesses in the government securities clearing and settlement systems can be reduced by acquiring a modern Scripless Securities Settlement System and an associated Central Depository System with appropriate linkages to a suitable RTGS system.

*Regional integration*

Kenya is a member of the East African Payments Systems Committee (EAPSCH), charged with the development and harmonisation of payment systems in the three member countries (Kenya, Uganda and Tanzania). The following developments have been achieved though the work of the committee:

- Automation of the three countries' clearing houses;
- Development of guidelines for licensing and regulating E-money schemes and products;
- Harmonisation of definition of payment systems and terminology;
- Development of guidelines on risk management measures.

Uganda and Tanzania have already taken steps to acquire a modern RTGS system. The Kenyan system will be designed to support the required future linkages. Despite the use of different currencies in the three countries a linkage solution based on a Payment versus Payment (PvP) approach could be implemented using a forex confirmation matching system similar in concept to that used by the well known CLS system. The key underlying requirement is that all three domestic RTGS systems use SWIFT as the message carrier. Implementation of such a system would only be feasible when all RTGS systems are successfully operational; thus this requirement is not included in this initiative.

The Kenyan authorities already recognise the existing deficiencies in the clearing and settlement mechanisms and a task force has produced a framework and strategy paper for the modernisation of the national payments system which has recommended, among other things, introduction of RTGS. The CBK has already earmarked funds for the setting up of a stand alone RTGS.

The Project will provide appropriate technical assistance and funding to acquire a Scripless Securities Settlement System (SSSS) / Central Depository System (CDS) to facilitate the safe, secure and efficient clearance and settlement of funds and securities transfers (both primary and secondary market transfers) in a manner consistent with best international practice as outlined in the Bank for International Settlements (BIS) issued Core Principles for Systemically Important Payment Systems (January 2001) and Recommendations for Securities Settlement Systems issued by the BIS and the Technical Committee of IOSCO (November 2001). This will tie in with the already initiated comprehensive reform of the national payments system, including the review and development of an appropriate policy, legal and regulatory framework by which the CBK will effectively fulfil its oversight role. In addition, the Project will provide funding for training of CBK staff and the necessary technical and legal expertise to assist and mentor CBK staff in the complex technical, organisational and operational issues involved in payments and securities system reform.

Reform efforts for low value payments mechanisms are underway but the solutions adopted could be improved upon by using new technology. The Project will fund a diagnostic study to identify the needs for improvements in the mechanisms for low value payments transfers.

Specifically, the FLSTAC will support the following:

i. ***New Scripless Securities Settlement and Central Depository System (SSSS/CDS)***. The proposed loan will build upon the work already accomplished in this area and assist CBK and other appropriate institutions acquire a modern *SSSICDS* system to provide a safe, secure and efficient repository of records of ownership of all government securities as well as an efficient mechanism for supporting all facets of the primary and secondary markets. This system will be linked with the RTGS system to remove risks via a suitable Delivery versus Payment mechanism (DvP) and a PvP mechanism for foreign exchange trading.

ii. ***Establishment of an Appropriate Legal Framework and Oversight Function***. Modern safe and efficient payments and securities systems requires not only implementation of new operational systems but also requires two additional essential elements; an adequate legal and regulatory framework and establishment of a payments system oversight function within the Central Bank. The FLSTAC will provide appropriate opportunities to review and develop an appropriate policy, legal and regulatory framework included as well as a set of mechanisms by which the CBK will effectively fulfil its oversight rote. A diagnostic study to identify the needs for improvements in the mechanisms for low value payments transfers will also be carried out.

iii. ***Payments System Expert Advice for the Project Team***. Payments and securities system reforms are quite complex and involve policy, technical, organisational and operational issues. Successful initiatives have benefited from the support of well-qualified, experienced and motivated experts. Payments system experts are likely to be needed to advise CBK in regard to several pre-procurement design, procurement phase activities, and possibly as well during the installation phase. The FLSTAC will provide funding for such advisors.

iv. ***Training for Staff of the National Payments System Division (CBK)***. The Project will provide funding for training of about 15 staff of the Division on relevant critical and highly technical matters of the payments system such as oversight, and securities trading and settlement. At the end of the Project, large value and time critical payment transactions will be processed electronically in a RTGS environment that has the required legal and regulatory underpinning, efficient linkages with other systems including a SSSSICDS, central bank general ledger system, and low value retail funds transfer systems operating on a deferred net settlement basis, appropriate central bank oversight, and with functionality to be linked with counterpart RTGS systems in Uganda and Tanzania.

## 3.5.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.5.1** below sets out the inputs needed to achieve the outputs for the three sub-components that fall under component 5. It also assigns responsibility for implementation to three Government institutions, namely: the CBK, CMA, and NSE.

**Table 3.5.1: Component 5 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • Implementation of Scripless Securities Settlement and Central Depository System | Technical Advisor<br>Funds | MOF, CBK, AG,<br>CBK |
| • Establishment of an Appropriate Legal Framework and Oversight | TA | CBK |
| • Payments System device for the Project Team | Advisor /Funds | CBK |
| • Training for Staff of the National Payments Division (CBK) | Advisor<br>Funds<br>Consultants | CBK |

## 3.5.3 Component cost and financing

The financing needed for this component is KShs 247 million (US$ 3.1million). **Table 3.5.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices.

**Table 3.5.2: Component 5 costs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KSH) | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | OUTPUT COST (KSH) |
| Implementation of Scripless Securities Settlement and Central Depository System | 129,536,000 | 10,824,000 | 11,704,000 | 11,264,000 | 10,824,000 | 174,152,000 |
| Establishment of an Appropriate Legal Framework and Oversight | 6,600,000 | 7,865,000 | 6,490,000 | 5,280,000 | 5,280,000 | 31,515,000 |
| Payments System device for the Project Team | 7,260,000 | 7,040,000 | 7,040,000 | 7,040,000 | 7,040,000 | 35,420,000 |
| Training for Staff of the National Payments Division (CBK) | 2,640,000 | 880,000 | 880,000 | 880,000 | 880,000 | 6,160,000 |
| **Total Cost for Component** | **146,036,000** | **26,609,000** | **26,114,000** | **24,464,000** | **24,024,000** | **247,247,000** |
| **Cost in U$** | 1,825,450 | 332,613 | 326,425 | 305,800 | 300,300 | 3,090,588 |

### 3.5.4 Component implementation schedule

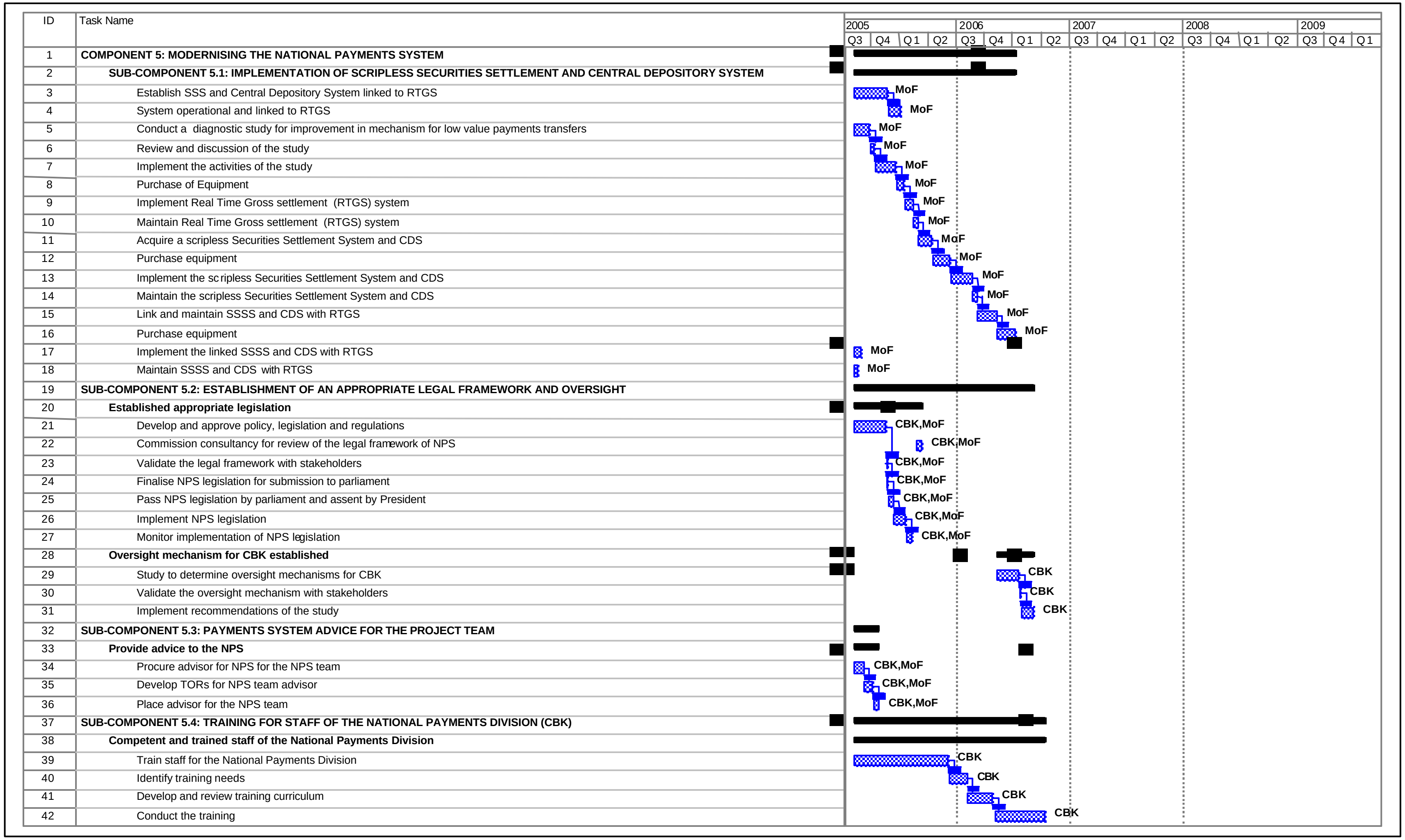
The implementation schedule for this component is presented in **Figure 3.5.1**. The key features of the schedule are as follows:

- The RTGS and SSSS/CDS will be operational at MOF by the first and third quarter of 2006 respectively. The systems will be interfaced by the end of the fourth quarter of 2006
- The National Payments System legislation will have been enacted by the last quarter of 2005
- Training of staff in the National Payments Division at CBK is scheduled to run over the first two quarters of 2007.

### 3.5.5 Critical risks

The need for an efficient National Payments System is well understood. The main risk to the proposed reforms is obtaining the necessary legal and regulatory framework as a basis for their implementation due to the slow and uncertain pace of enacting legislation. The other risk although minor in nature is fear of technology among the major players due to complexity of NPS processes, past incidents of fraud and a culture of default in the financial sector. Stakeholder sensitisation may help to fast track the legal and regulatory framework, but the mistrust of technology can only be overcome with experience supplemented with appropriate training of both regulators and beneficiaries.

## Figure 3.5.1: Component 5 – implementation schedule



| ID | Task Name |
|---|---|
| 1 | **COMPONENT 5: MODERNISING THE NATIONAL PAYMENTS SYSTEM** |
| 2 | **SUB-COMPONENT 5.1: IMPLEMENTATION OF SCRIPLESS SECURITIES SETTLEMENT AND CENTRAL DEPOSITORY SYSTEM** |
| 3 | Establish SSS and Central Depository System linked to RTGS |
| 4 | System operational and linked to RTGS |
| 5 | Conduct a diagnostic study for improvement in mechanism for low value payments transfers |
| 6 | Review and discussion of the study |
| 7 | Implement the activities of the study |
| 8 | Purchase of Equipment |
| 9 | Implement Real Time Gross settlement (RTGS) system |
| 10 | Maintain Real Time Gross settlement (RTGS) system |
| 11 | Acquire a scripless Securities Settlement System and CDS |
| 12 | Purchase equipment |
| 13 | Implement the scripless Securities Settlement System and CDS |
| 14 | Maintain the scripless Securities Settlement System and CDS |
| 15 | Link and maintain SSSS and CDS with RTGS |
| 16 | Purchase equipment |
| 17 | Implement the linked SSSS and CDS with RTGS |
| 18 | Maintain SSSS and CDS with RTGS |
| 19 | **SUB-COMPONENT 5.2: ESTABLISHMENT OF AN APPROPRIATE LEGAL FRAMEWORK AND OVERSIGHT** |
| 20 | **Established appropriate legislation** |
| 21 | Develop and approve policy, legislation and regulations |
| 22 | Commission consultancy for review of the legal framework of NPS |
| 23 | Validate the legal framework with stakeholders |
| 24 | Finalise NPS legislation for submission to parliament |
| 25 | Pass NPS legislation by parliament and assent by President |
| 26 | Implement NPS legislation |
| 27 | Monitor implementation of NPS legislation |
| 28 | **Oversight mechanism for CBK established** |
| 29 | Study to determine oversight mechanisms for CBK |
| 30 | Validate the oversight mechanism with stakeholders |
| 31 | Implement recommendations of the study |
| 32 | **SUB-COMPONENT 5.3: PAYMENTS SYSTEM ADVICE FOR THE PROJECT TEAM** |
| 33 | **Provide advice to the NPS** |
| 34 | Procure advisor for NPS for the NPS team |
| 35 | Develop TORs for NPS team advisor |
| 36 | Place advisor for the NPS team |
| 37 | **SUB-COMPONENT 5.4: TRAINING FOR STAFF OF THE NATIONAL PAYMENTS DIVISION (CBK)** |
| 38 | **Competent and trained staff of the National Payments Division** |
| 39 | Train staff for the National Payments Division |
| 40 | Identify training needs |
| 41 | Develop and review training curriculum |
| 42 | Conduct the training |

## 3.6 Component 6: Improving the lending environment

### 3.6.1 Description of component

One of the major impediments to growth in Kenya is insufficient access to financial services by large segments of the Kenyan population and enterprises, especially the small and medium sized ones. While there are many reasons for lack of access to credit, weaknesses in the creditor rights framework and institutional infrastructure (notably the Companies and Land Registries), the overly debtor-friendly enforcement mechanisms and the pervasive lack of credit information on potential borrowers are among major contributing factors. The resulting adverse lending environment increases the cost of lending and contributes to the lack of competition in the provision of credit.

The Project will support improvements in the legal and institutional framework required to improve the environment in which banks, other financial institutions and supply and trade creditors extend credit. The activities supported by the Project will include:

i. ***Improvements in the Operations of the Department of the Registrar General***.

Assistance to the Department (which includes the Companies Register) will include: (a) assistance to the Companies Register to enable the Registry clear the backlog in filing and allow for speedy and accurate information sharing of corporate information and data; and the development of amendments to the necessary laws, such as the Companies Act; assistance will also be extended to other registers in the Department, such as the business names and receivers registers; and (b) combining of the Charges Register and the Chattel Transfer Register into one and moving the combined separate register (notification system) for charged pledges over movable assets out of the Companies Register; and developing a new Personal Property Securities Act *(i.e.* secured transactions framework) in line with international best practices.

ii. ***Improvements in the Land Registration System***.

This assistance to the Ministry of Lands will allow the transformation of the current manual system of land records into a digital format which will enable much speedier searches as well as establishment and enforcement of security interests over land and other real estate.

iii. ***Establishment of a Legal and Regulatory Framework for the Operation of Private Credit Reference Bureaus***.

Private credit registry will facilitate the much needed information flow among the credit granting institutions. This assistance will concentrate on the laws and regulations necessary for the optimal functioning of such an information system, including issues of data and consumer protection.

iv. ***Development of Rules for the Taxation of Leasing***.

The Project will support necessary changes to the taxation of leasing activities. The current tax regime is internally inconsistent and does measure up to international best practice. This impedes the growth of leasing, especially financial leases. The Project will support consultations of Kenya Revenue Authority (KRA) with all major stakeholders, assistance in drafting of new taxation rules and implementation of the new rules.

Under (i), a thorough functional review and assessment of the various existing registers and their business processes will be conducted. Areas already identified as in need of urgent upgrading are internal processes and procedures, simplification of the registration requirements, automation, human resource development and appropriate skills mix in the Department, and training. The functional review will also take into account the plans for the decentralisation of the registration process and the creation of a "one-stop-shop" for companies, support for which is envisioned under the MSME project. On the basis of the functional review (audit), recommendations setting out the content and sequencing of institutional changes and reforms that will be required to upgrade and modernise the various registers in the Department of the Registrar General will be adopted. This will require well-qualified organisational management consultants with expertise in reforming similar institutions. The consulting team needs to have personnel qualified in change management, MIS, IT and law. The first phase of the reform, the functional audit is envisioned to be financed by FIRST. Assistance to the Department of the Registrar General will build on earlier assistance provided by UNDP.

The Companies Register will be transformed into an institution capable of providing accurate and reliable information and service on companies to the credit and capital markets and the interested public. The Project will also support the development of any legislation necessary for the reform of the Department and simplification of various registration procedures (including amendments to the Companies Act).

The registration of charges/pledges is particularly fragmented and ineffective under the current system. Individuals, sole proprietorships, partnerships and other non-incorporated entrepreneurs register their charges in the Chattel Transfer Register. Companies, on the other hand, register their charges in the Companies Register. In addition, mortgages and charges on land have to be registered in the various Land Registers (there are several registration systems in Kenya) where they are noted on the title documentation. Such a fragmented system leads to inefficiencies and impedes access to credit, as it does not provide a clear and predictable framework in which creditors are able to easily and accurately ascertain the validity and priority of charges taken over their debtor's property.

The Project will provide support for combining the Charges Registry and the Chattel Transfer Register into one register and the establishment of a single unified notification system (register) of all security interests (charges, pledges, debentures, etc.) over all movable assets and given by all legal and natural persons. The first phase of this assistance, namely the preparation of detailed recommendations for the reform (its legislative and institutional aspects) is envisioned to be financed by FIRST. The intention is eventually to move this single notification system out of the Companies Register and establish the combined register on a commercial basis. Support will be given for the drafting of a new legislation (Personal Property Securities Act) to allow for a unified system of security interests based on international best practices (including Article IX in the US or similar legislation in Canada and New Zealand).

Under (ii), the Project will support the digitising of the land records. There are currently over 3.5 million land records in Kenya and all of these are manual records. It is very difficult to effectively establish and enforce security over land, as searches in the various registries are difficult to undertake, with files often misplaced or missing. The Ministry of Lands has agreed on a reform programme which will include the development of a Land Policy; review of illegally obtained titles; simplification of the registers; and necessary changes in the legislation to make the various registration systems consistent with each other. The development of a comprehensive Land Policy is supported by several donor agencies. This Project will assist in a discrete part of the Ministry's reform programme, namely the transfer of land records from a manual to a digital system by financing consultants and IT equipment.

Under (iii), the Project will assist the CBK, MOJCA and the Office of the Attorney General in the development of any necessary laws and regulations for the operation of a private credit registry through which financial and non-financial institutions granting credit will be able to ascertain the credit history of individuals and small firms. It is the intention that this system will cover both positive and negative information. Assistance will encompass such issues as appropriate consumer and data protection.

### 3.6.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.6.1** below sets out the inputs needed to achieve the outputs for the four sub-components that fall under component 6. It also assigns responsibility for implementation to four Government institutions, namely: the MOF, MOJCA, Ministry of Lands and Settlement and Judiciary.

**Table 3.6.1: Component 6 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| Improved operations at the Registrar General Department | Technical Assistance and funds | Judiciary/OAG/Consultant |
| Improved land registration system | Technical Assistance and Funds | Ministry of Land and Settlement |
| Improved operation of credit reference bureaus | Technical Assistance and Funds | MOF, MOJCA |
| New/revised rules for taxation leasing | Technical Assistance and Funds | MOF, MOJCA |

## 3.6.3 Component cost and financing

The financing needed for this component is KShs 213 million (US$ 2.7 million). **Table 3.6.2** presents an analysis of component costs by output for each year of the project at 2005 constant prices.

**Table 3.6.2: Component 6 costs in KShs by output**

| PLANNED OUTPUT | YEAR BUDGET COST (KHS) | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | OUTPUT COST (KSH) |
| Improved operations at the Registrar General Department | 63,745,000 | 37,455,000 | 9,735,000 | 3,135,000 | 3,135,000 | **117,205,000** |
| Improved land registration system | 22,110,000 | 15,840,000 | 9,130,000 | 6,930,000 | 4,730,000 | **58,740,000** |
| Improved operation of credit reference bureaus | 5,445,000 | 5,720,000 | 4,895,000 | 2,750,000 | 2,750,000 | **21,560,000** |
| New/revised rules for taxation leasing | 4,400,000 | 1,650,000 | 3,520,000 | 3,080,000 | 2,640,000 | **15,290,000** |
| **Total Cost for Component** | **95,700,000** | **60,665,000** | **27,280,000** | **15,895,000** | **13,255,000** | **212,795,000** |
| **Cost in U$** | **1196250** | **758312.5** | **341000** | **198687.5** | **165687.5** | **2,659,938** |

### 3.6.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.6.1**. The key features of the schedule are as follows:

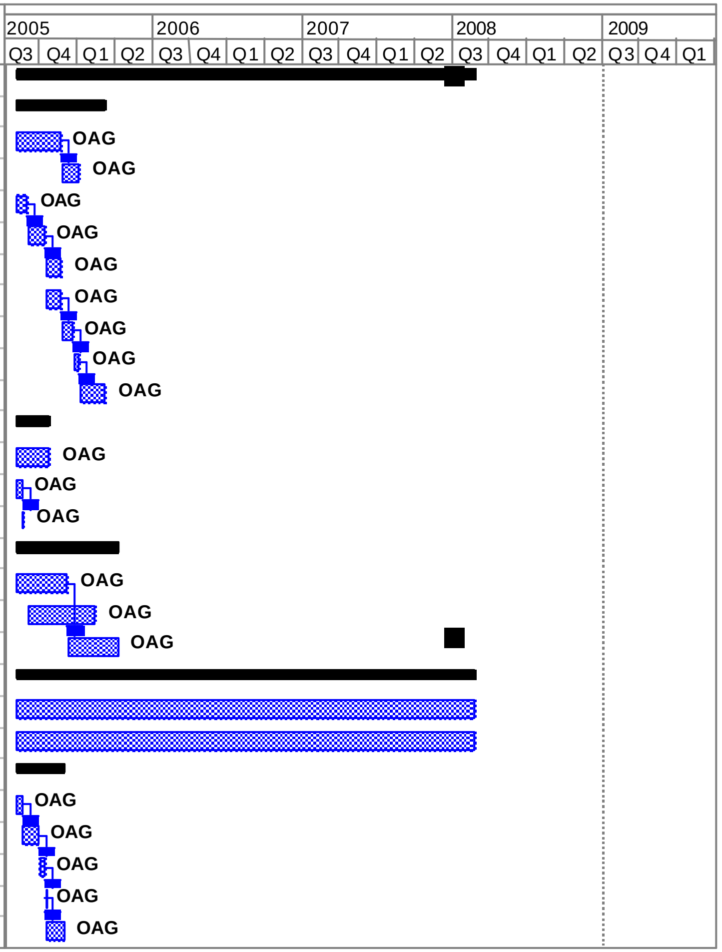
- The Registrar General Department's Registries will be computerised and staff trained by the end of the first quarter of 2006
- Business laws will be amended over the period from 2005 to 2008
- The Charges and Chattel Transfer Registries will be consolidated by the end of 2005
- An implementation plan for a digital system for the management of land records will be ready by the first quarter of 2006
- Legislation for private credit reference bureaus and taxation of leasing will have been amended by early 2007.

### 3.6.5 Critical risks

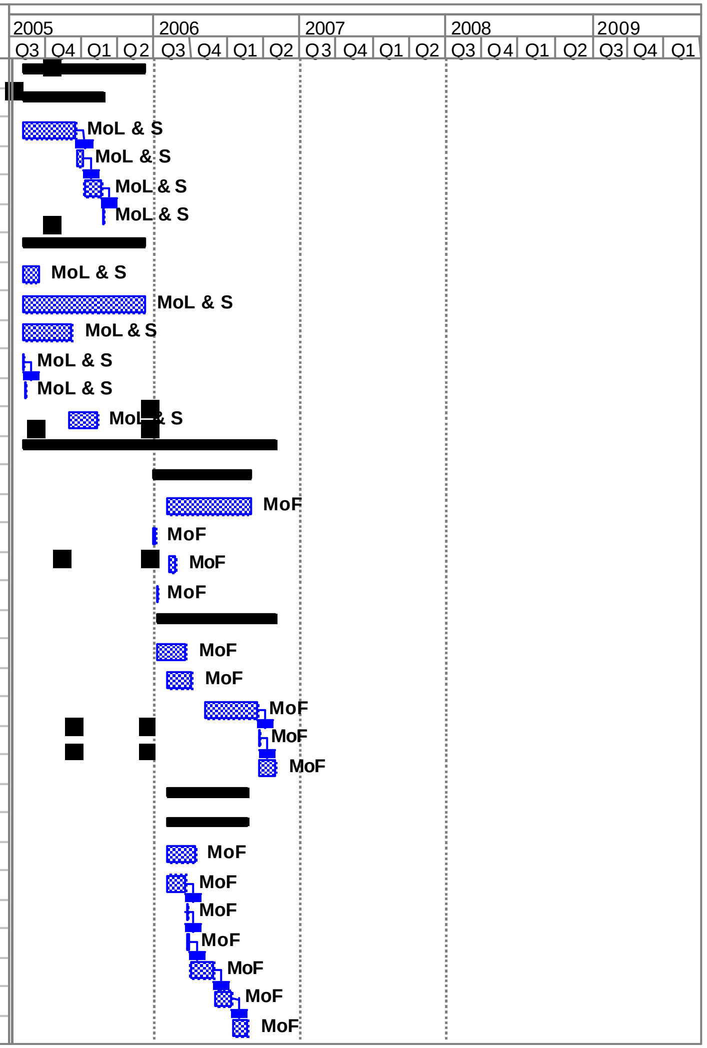
Low capacity and the absence of incentives in the Department of the Registrar General may result in delays in clearing the backlog in filing. To ameliorate this risk current staff will need to work overtime. As overtime payment is not provided for in the Government Regulations, the proposal is to provide general support. The department will determine the best use of the funds in the interest of clearing the backlog.

**Figure 3.6.1: Component 6 – implementation schedule**

| ID | Task Name |
|---|---|
| 1 | **COMPONENT 6: IMPROVING THE LENDING ENVIRONMENT** |
| 2 | **SUB-COMPONENT 6.1: IMPROVED OPERATIONS AT THE DEPARTMENT OF THE REGISTRAR GENERAL** |
| 3 | Computerise Registries at the Registrars General Department |
| 4 | Conduct computing needs assessment |
| 5 | Define data specifications |
| 6 | Purchase Computers |
| 7 | Purchase scanners |
| 8 | Purchase servers |
| 9 | Purchase software for registries |
| 10 | Install and operationalise the scanners |
| 11 | Train staff on the operations of the software |
| 12 | **Improvement in operations of the Company's Registry** |
| 13 | Conduct operational audit of Company's Registry |
| 14 | Develop TORs for operational audit |
| 15 | Procure consultant for operational audit of Company Registry |
| 16 | **Filing backlog cleared** |
| 17 | Clear backlog files |
| 18 | Hire a firm for data entry |
| 19 | Provide support for clearance of backlog |
| 20 | **Legislation amended and enacted** |
| 21 | Participation in the Review of Business Laws undertaken by the Law Reform through preparation of memoranda |
| 22 | Membership to the Task Force on Business Laws coordinated by the Kenya Law Reform Commission. |
| 23 | **Operational review of Charge's Registry** |
| 24 | Develop TORs for operational review |
| 25 | Procure consultant for review of Charges Registry |
| 26 | Consolidate the Charges and Chattel Transfer Registries |
| 27 | Hold a workshop for the Companies Registry, Ministry of Lands and other Stakeholders |
| 28 | Draft amendments to the existing legislation- Ministry of Lands and draft new relevant legislation. |



| ID | Task Name |
|---|---|
| 29 | **SUB-COMPONENT 6.2: IMPROVEMENTS IN THE LAND REGISTRATION SYSTEM** |
| 30 | **Improved land registration system** |
| 31 | Operational review on Land Registry |
| 32 | Develop TORs for operational review |
| 33 | Procure consultant for review of Land Registry |
| 34 | Validate consultants report |
| 35 | **Digital system for the management of land records** |
| 36 | Implement digital system for the management of land records |
| 37 | Update the of Files |
| 38 | Hire of data entry clerks |
| 39 | Identify suitable system to bridge the gap through study Tours |
| 40 | Identify suitable system to bridge the gap through stakeholder Forums |
| 41 | Plan for the Implementation of the new system |
| 42 | **SUB-COMPONENT 6.3: ESTABLISHMENT OF A LEGAL AND REGULATORY FRAMEWORK** |
| 47 | **Improved operation of credit reference bureaus** |
| 48 | Operational review of Credit Registry |
| 49 | Develop TORs for operational review |
| 50 | Procure consultant for review of Credit Registry |
| 51 | Validate consultants' work |
| 52 | **Legal and regulatory framework for the operation of private credit reference bureaus** |
| 53 | Develop laws and regulations for credit reference system |
| 54 | Review existing laws |
| 55 | Amend the laws |
| 56 | Validate the amended laws |
| 57 | Implement new laws |
| 58 | **SUB-COMPONENT 6.4: DEVELOPMENT OF RULES FOR THE TAXATION OF LEASING** |
| 59 | **New/revised rules for taxation leasing** |
| 60 | New/revised rules for taxation leasing developed |
| 61 | Consultancy for review of the legal framework taxation and leasing |
| 62 | Validate the legal framework with stakeholders |
| 63 | Finalise leasing legislation for submission to parliament |
| 64 | Passing of leasing legislation by parliament and assent by President |
| 65 | Implement leasing legislation |
| 66 | Monitor implementation of taxation of leasing legislation |



## 3.7 Component 7: Legal and judicial reform

### 3.7.1 Description of component

*The Judiciary*

The Government has commenced an ambitious reform strategy for the Judiciary, including the removal of corrupt and incompetent judicial staff. The Project will build on the measures taken by the Government through the Bank's previous assistance which initiated the computerisation of the Judiciary and the MOJCA and support them in carrying out their respective mandates and to move to the next stage of reform. The Project addresses the need for a coherent strategy for the judiciary to confront institutional issues such as weak capacity, corruption, and poor enforcement.

The Judicial Reform sub-component will support the implementation of the following activities in Key Results Area No. 3 of the GJLOS:

i. ***Court Case Management and Records Management System***.

The objective is to enhance the efficiency, transparency and effectiveness of the court system. The Project will support the automation of court case management and the review, analysis, and introduction of procedures such as small claims procedures, summary procedures for uncontested debt, and alternative dispute resolution procedures, and the relevant training and application. Data entry for court case management systems will commence with the commercial courts. Activities to support this result area include electronically integrating the various processes of the courts initially in selected pilot areas, including receipt, recording, and tracking of cases, and generating statistics to enable analysis of cases and case management performance of courts. The proposed system will make possible the inter-court tracking of cases (transfer and appeals) and the generation of micro and macro statistical reports useful in evaluating performance at various levels and in formulating policies and introducing systems for continuing case management systems.

ii. ***Computerisation of Court Registries***.

The objective is to reduce the incidence of lost files, increase the speed of retrieval of files and reduce opportunities for graft. The Project will support the review of existing data in the registries and the installation of computer hardware and software to adequately capture, store and manage this data.

iii. ***Judicial Education Programme***.

The objective is to develop the capacity of the judiciary to adequately support commercial activity and dispute resolution mechanisms. The Project will support the review of the policy and institutional framework for judicial education, and the design of a comprehensive judicial education programme that can enhance the efficiency, accountability and competence of judicial staff, and improve capacity in subject areas consistent with the scope of the FLSTAC, and priority needs determined by the Government. The Project will also support the implementation of the judicial education programme on financial and commercial law subjects.

iv. ***Reformed Civil Procedure Rules***.

Civil cases in the High Court and Magistrates' Courts are governed by the Civil Procedure Rules, which determine the progress of a case from filing to enforcement of judgment. The rules date substantially from 1953 (although there have been some useful recent reforms which have streamlined the system) and are outdated. The civil procedure rules will be updated to make civil litigation faster, cheaper, and more efficient and accessible.

v. ***Promote the Use of Alternative Dispute Resolution***.

Alternative Dispute Resolution (ADR) refers to informal processes of resolving disputes. Forms of ADR include mediation, negotiation, early neutral evaluation, conciliation, adjudication, and expert determination. In addition, there is a well-established formal statute-based system for arbitration in Kenya. The interventions in this area are aimed at raising awareness amongst the Judiciary, litigants and the legal profession about the advantages that ADR can bring to all three, and to integrate ADR within the judicial system. At the local level, ADR will be implemented by adoption of mediation initially in selected pilot areas through a strengthened paralegal network and training of local community leaders.

vi. ***Use of Small Claims Procedures***.

The intention is to investigate and develop initially on a pilot basis the use of Small Claims Procedures in Magistrates' Courts in Kenya. The intention is not to set up a new system of Small Claims Courts, but to build on the existing system of Magistrates' Courts, and to introduce small claims procedures into this existing and well-developed system.

vii. ***Strengthened Enforcement of Judgments***.

Enforcement is the final part of the Court process. It is the means by which a judgment creditor realises the effect of judgment in his favour. Enforcement of judgment differs significantly between countries. In the richest quartile of countries it takes on average 64 days to enforce a judgment on a small debt collection once the judge has produced an opinion. The countries in the poorest quartile fare worse. On average it takes 192 days – a long time, particularly for small businesses with little access to credit - to collect debts once judgment is rendered.

The most common modes of enforcement or execution are: attachment of assets (e.g. money or movable property); statutory sale of property; and detention in jail of judgment debtors. It is clear that there are a number of problems with the way the system of enforcement is currently operating. The commercial sector in particular has felt the burdens of the current mode of enforcement. Execution proceedings have in certain cases taken years to accomplish, frustrating calculations and projections of business enterprises. These problems will be tackled by measures including strengthening the Civil Procedure Rules; considering the regulation of auctioneers who are often responsible for the execution of judgment debts; and considering the whole enforcement regime, including the efficacy of the system of jailing civil debtors.

A close examination of the activities that need to be carried out under reform of Civil Procedure Rules, Alternative Dispute Resolution, Small Claims and Enforcement Mechanism show that these can be integrated into the reform of the Civil Procedure Act and Rules. This is the approach adopted in developing the outputs, activities and costing in this subcomponent.

### *Law Reform*

The objective of this sub-component is to strengthen the law reform process and increase accessibility to legal information.

The Law Reform sub-component will support the following activities in Key Results Area No. 6 of the GJLOS:

i. ***Capacity Building of the Law Reform Commission, Office of the Parliamentary Counsel at the OAG, and the Parliamentary Service Commission***.

A coordinating mechanism for law reform is needed to facilitate a more rational approach to the review, harmonisation and amendment of the laws of Kenya. The Project will support a workshop bringing together the three organisations and the Law Society of Kenya and professional development of staff in all thee institutions will be undertaken, including a core in-house training programme in legal drafting and legal research.

ii. ***Drafting of Priority Bills Essential for the Reform of Financial and Commercial Sectors***.

The Project will support technical assistance for the drafting of priority bills, and the development of a sustainable, participatory approach to law reform. The Project will support the drafting of amendments to laws, including the Companies Act; Insolvency Act; Bankruptcy Act; Business Names Registration Act; Banking Act; Central Bank of Kenya; Insurance Act; Capital Markets Authority Act; Kenya Postal Office Savings Bank Act; and Retirement Benefits Authority Act. The Project will also support the preparation of new legislation, including bills on the Deposit Protection Fund, Personal Property Securities (secured transactions), and Data and Consumer Protection. Further, it will support the implementation of laws currently under preparation, including the SACCOs Bill and Microfinance Institutions Bill.

iii. ***Law Library Development, Update of Laws and Legal Information Dissemination***.

The Project will finance the assessments of law library needs of the Law Reform Commission, MOJCA and the Office of the Attorney General, and the Parliamentary Service Commission. It will also finance revision and updates of the Laws of Kenya, National Law Reports and development of publicly accessible legal information. The other activities under this intervention will aim at collection, processing and keeping information in a manner that facilitates access and use. The first activity will be the automation of recording of court proceedings. The second activity will be to streamline court registries to eliminate cases of “lost files” as well as to decongest the registries for ease of reference. The third activity is to improve access to legal information by completing pending law reports and putting in place a mechanism for continuous law reporting.

iv. ***Legal Sector to Become Employer of Choice for Critical Mass of Smart Lawyers***.

In the 60s and 70s**,** the public sector legal institutions used to be the preferred choice for lawyers beginning their careers. This is not the case today. The working environment hardly allows individual lawyers to give their best, and compensation compared to alternative employment is meagre, Consequently, those who join the institutions only do so as a last alternative and the services offered by these institutions have deteriorated significantly, The proposed interventions include improving the terms and conditions of the officers and their work environment. Efforts, which are crucial to the success of the reforms, are under way to harmonise term s and conditions of service so that they are at par with those of officers serving in the Judiciary.

v. ***Improved Legal Training Facilities at Kenya School of Law***.

The objective is to enhance the capacity of the School of Law to provide quality legal education. The Kenya School of law intends to develop a curriculum for the different levels of legal professionals to ensure they have the skills and knowledge to cope with their profession in a fast changing environment. Though generally professionals can update their knowledge in informal ways, there is need to have a formalised and systematic method through which the required skills and knowledge are impacted. The management of the school also intents to expand the market for the school to target the East African Region in the drive to make the school number one choice for post university legal training.

Although there is clearly scope for strengthening the provision of legal education across the board, the decision has been taken to focus in the first instance on commercial law education. This is both because of the priority that the Government has put on private sector development, and also because this is a curriculum area that needs particular attention. The aim is to involve the private sector in developing these activities so that the new curriculum reflects real business issues.

vi. ***The Law Reform Function Strengthened***.

The Kenya Law Reform Commission was formed in 1982. However, its impact in leading the agenda in law reform has been negligible. With the coming of the new Government, the need for an active law reform commission has been revived. In the short run the Commission proposes to build capacity to lead in law reform. To this end, a workshop bringing together the office of the Attorney General and the Law Society of Kenya, as well as the professional development of staff is planned to support a specialised capacity building programme on legal drafting and legal research.

vii. ***Legal Drafting Strengthened***.

The most urgent pending bills will be identified and priority legal drafting needs will be met, by contracting-out if necessary. Legal drafting capacity in the OAG and ministries will be developed through recruitment and training.

### *Legal Education*

The sustainability of the reforms supported under the judicial and law reform subcomponents will depend heavily on building adequate capacity in the legal profession and the judiciary. A comprehensive approach and plan of action is required to repair a legal and judicial educational system which currently suffers from unclear institutional mandates, low university admission and graduation standards, a lack of basic training materials in key commercial and financial sector fields, poor physical infrastructures, limited advanced educational opportunities for teaching professionals, outdated libraries and an absence of basic IT infrastructure and computer research facilities.

The Legal Education sub-component would support:

i. ***Improved Legal Profession***.

The Project will support the strengthening of legal education programmes including continuing legal education for lawyers, judges and magistrates. It will also support the revision of admission, graduation and bar membership standards.

ii. ***Curriculum Development and Capacity Building of the Law Faculty***.

Technical assistance will be provided to the Faculty of Law and to the Council of Legal Education to review the curricula of the respective national institutions to facilitate standardisation in key subject areas. The Project will also support the development of specialised courses in financial and commercial law and legal drafting and the professional development of law faculties of all three legal teaching institutions.

iii. ***Commercial Law Libraries***.

All law school libraries will be stocked with basic texts and periodicals in law particularly in financial and commercial law subjects. The Project will also finance the publication of teaching materials.

### 3.7.2 Component matrix of outputs, inputs and institutional responsibility

**Table 3.7.1** below sets out the inputs needed to achieve the outputs for the five sub-components that fall under component 7. It also assigns responsibility for implementation to 8 Government institutions, namely: the Judiciary, Council of Legal Education, Kenya Law Reform Commission, Parliamentary Service Commission, Office Attorney General, Ministry of Justice and Constitutional Affairs, Public University, and Kenya School of Law.

**Table 3.7.1: Component 7 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| • Integrated Court Case Management and Records Management System | Technical advisers<br>Computer hard and soft ware<br>Training | Judiciary |
| • Judicial education programme designed and implemented | Technical advise<br>Curriculum development materials | Judiciary<br>Council of Legal Education |
| • Modern Civil Procedure Rules (to include provisions for ADR, Small Claims and improved enforcement mechanisms | Technical advisers<br>Workshops | Judiciary/stakeholders |
| • Capacity built in Law Reform Commission, Office of Parliamentary Counsel and Parliamentary Service Commission | Technical advisers<br>Stakeholder consultation | Kenya Law Reform<br>Parliamentary Service Commission |
| • Priority Financial and Commercial Laws enacted or amended | Technical adviser<br>Consultancy | KLRC, OAG, Parliament |
| • Improved law library and legal information at Kenya Law Reform Commission | Technical advisers<br>Funds | KLRC, PSC, OAG |
| • Lawyers' terms and conditions harmonised with judiciary scheme | Technical advisers<br>Stakeholder consultations | OAG/MOJ&CA |
| • Improve capacity of Parliamentary Service Commission staff | Technical advisers<br>Stakeholder consultations | OAG/MOJ&CA |
| • Reduce legal drafting backlog | Technical advisers<br>Stakeholder consultations | OAG/MOJ&CA |
| • Revised and up to date laws | Technical advisers<br>Stakeholder consultations | OAG/MOJ&CA |
| • Bulletin for law updates | Technical advisers<br>Stakeholder consultations | OAG/MOJ&CA |
| • Capacity for law reporting enhanced | Technical advisers<br>Training input | OAG |
| • Capacity for law reporting enhanced | Technical advisers<br>Training input | OAG |

| **Output** | **Inputs** | **Responsible institution & department** |
|---|---|---|
| • Financial and commercial law curricula developed and implemented - Public Universities | Technical advisers | Public Universities<br>Stakeholders |
| • Specialised capacity building programme on legal drafting and research developed and implemented at Kenya School of Law. | Technical advisers<br>Teaching materials | Kenya Law School |
| • Financial and commercial law training for lawyers and judges enhanced at Kenya School Law | Text books<br>Technical advisers | Kenya Law School<br>Kenya Law Reform Commission |

### 3.7.3 Component cost and financing

The financing needed for this component is KShs 609 million (US$ 7.6million). **Table 3.7.2** presents an analysis of component costs by output for each year of the project at 2005 constant prices.

**Table 3.7.2: Component 7 costs in KShs by output**

| **PLANNED OUTPUT** | **YEAR BUDGET COST (KSH)** | | | | | **TOTAL** |
|---|---|---|---|---|---|---|
| | **Year 2005** | **Year 2006** | **Year 2007** | **Year 2008** | **Year 2009** | **OUTPUT COST (KSH)** |
| Integrated Court Case Management and Records Management System | 56,320,000 | 66,000,000 | 33,000,000 | - | - | **155,320,000** |
| Judicial education programme designed and implemented | 11,847,000 | 1,100,000 | 5,500,000 | 5,500,000 | 5,500,000 | **29,447,000** |
| Modern Civil Procedure Rules (to include provisions for ADR, Small Claims and impoved enforcement mechanisms | 9,608,500 | - | - | - | - | **9,608,500** |
| Prioritised strategy for law reform in Kenya | 12,881,000 | 11,000,000 | 11,000,000 | 11,000,000 | 11,000,000 | **56,881,000** |
| Capacity built at Kenya Law Reform Commission | 1,650,000 | 7,150,000 | 9,350,000 | 9,350,000 | 9,350,000 | **36,850,000** |
| Priority Financial and Commercial Laws enacted or amended | 10,565,500 | 10,010,000 | 10,010,000 | 1,100,000 | 1,100,000 | **32,785,500** |
| Improved law library and legal information at Kenya Law Reform Commission | 5,500,000 | 5,500,000 | 5,500,000 | 5,500,000 | 5,500,000 | **27,500,000** |
| Lawyers' terms and conditions harmonised with judiciary scheme | 1,017,500 | - | - | - | - | **1,017,500** |
| Improve capacity of Parliamentary Service Commission staff | 440,000 | 990,000 | 990,000 | 990,000 | - | **3,410,000** |
| Reduce legal drafting backlog | 20,735,000 | 1,100,000 | 990,000 | 1,320,000 | - | **24,145,000** |
| Revised and up to date laws | 16,720,000 | 39,930,000 | 17,930,000 | 6,930,000 | 6,930,000 | **88,440,000** |
| Bulletin for law updates | 1,210,000 | 990,000 | 990,000 | 990,000 | 990,000 | **5,170,000** |
| Capaity for law reporting enhanced | 2,200,000 | 3,300,000 | - | - | - | **5,500,000** |
| Financial and commercial law curricula developed and implemented - Public Universities | 13,772,000 | 13,750,000 | 9,350,000 | 21,450,000 | 15,950,000 | **74,272,000** |
| Specialised capacity building programme on legal drafting and research developed and implemented at Kenya Law School | 8,525,000 | 5,170,000 | 6,050,000 | 5,500,000 | 5,500,000 | **30,745,000** |
| Financial and commercial law training for lawyers and judges enhanced at Kenya School Law | 8,525,000 | 8,470,000 | 3,850,000 | 3,300,000 | 3,300,000 | **27,445,000** |
| **Subtotal** | **181,516,500** | **174,460,000** | **114,510,000** | **72,930,000** | **65,120,000** | **608,536,500** |
| **Cost in U$** | **2,268,956** | **2,180,750** | **1,431,375** | **911,625** | **814,000** | **7,606,706** |

### 3.7.4 Component implementation schedule

The implementation schedule for this component is presented in **Figure 3.7.1**. The key features of the schedule are as follows:

- By the first quarter of 2006, an integrated court case and records management system will have been piloted at Milimani Commercial Courts and the Court of Appeal

- A new judicial education programme will have been designed by the end of the year

- Modern civil procedure rules will be gazetted by the second quarter of 2006

- Law reform commission staff will receive extensive training in legislative drafting, research and reporting over a three-year period from 2005. During the same period a training programme will also be delivered to Parliamentary Service Commission Staff

- New financial and commercial laws will be enacted by the third quarter of 2006

- In the fourth quarter of 2007 law facilities at public universities will offer financial and commercial law courses. In addition, the Kenya School of Law will run a course on legal drafting and research from the third quarter of 2006.

### 3.7.5 Critical risks

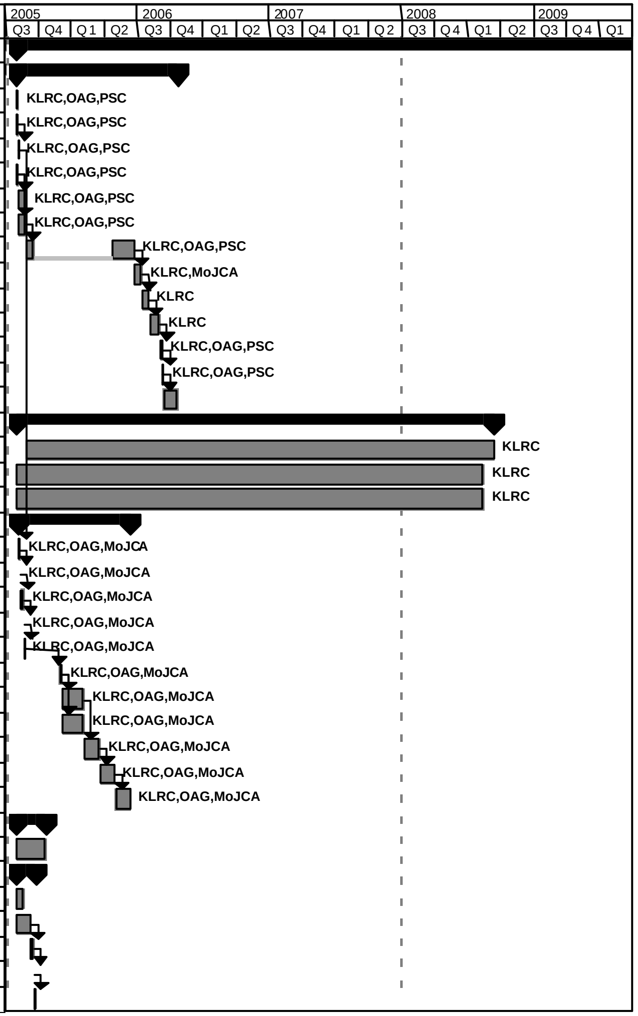
The only critical risks identified under this component are as follows: The success of the Judicial Education Programme depends on the Judiciary’s support of the same. It is therefore critical that the programme is institutionalised. The implementation of harmonisation of terms and conditions of service for the Lawyers is fully dependant on the Government supporting an increased wage bill at a time when the Government is seeking to reduce its wage bill.

## Figure 3.7.1: Component 7 – implementation schedule

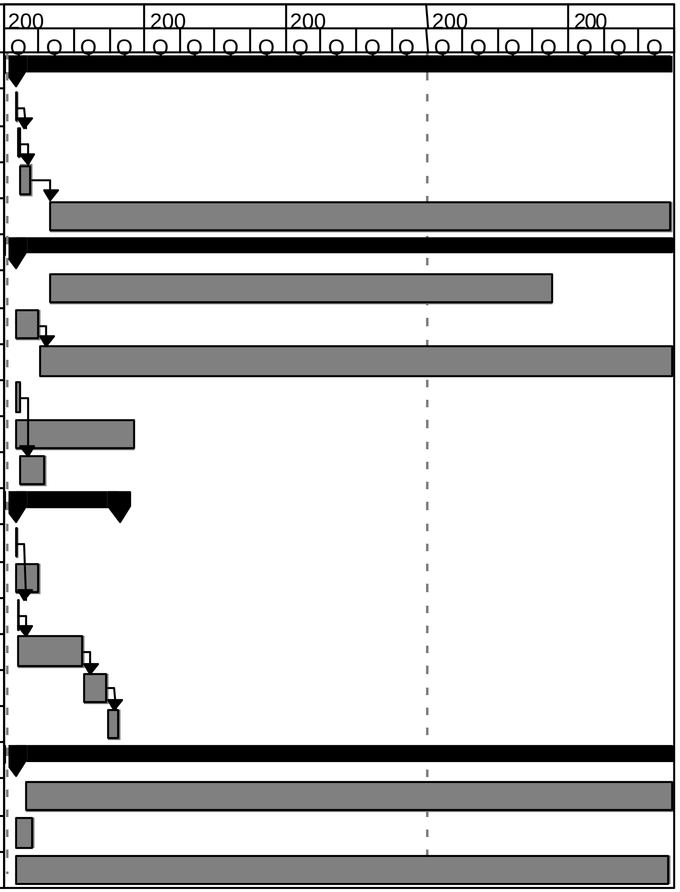
| ID | Task Name |
|---|---|
| 1 | **COMPONENT 7: LEGAL AND JUDICIAL REFORM** |
| 2 | **SUB- COMPENENT 1: REFORM OF THE JUDICIARY** |
| 3 | **Integrated Court Case Management and Records Management System** |
| 4 | Establish the requirement for a modern filling system and court case management system |
| 5 | Conduct a needs assessment (software, equipment, infrastructure, tender documents for procurement of the systems) |
| 6 | Procure and install system for Court Case and Record Management (Software) |
| 7 | Purchase infrastructure - LAN/WAN, hardware and Software etc. To include capacity building to operate the system |
| 8 | Operationalise the system |
| 9 | Customise and pilot system at Milimani Commercial Courts and Court of Appeal |
| 10 | **Judicial education programme designed and implemented** |
| 11 | Design a comprehensive judicial education programme |
| 12 | Develop objectives for Judicial Education in Kenya Review |
| 13 | Conduct needs assessment to identify skills gap (including review of the current curriculum) |
| 14 | Present the findings to stakeholders and agree on prioritised areas of intervention |
| 15 | Develop a plan to address gaps |
| 16 | Present findings to stakeholders |
| 17 | Agree on way forward |
| 18 | Review similar curriculum among Commonwealth nations (desk work) |
| 19 | Draft curriculum to achieve the set objectives taking into account best practice from Commonwealth |
| 20 | Review draft curriculum |
| 21 | Approve new curriculum |
| 22 | Publish curriculum and training materials |
| 23 | Train a selected number of judges and magistrates in the commercial courts |
| 24 | Implement new curriculum |
| 25 | **Modern Civil Procedure Rules developed to include provisions for ADR, Small Claims etc** |
| 26 | Set up and equip Rules Committee Secretariat |
| 27 | Appoint members of the Secretariat |
| 28 | Develop objectives for New Civil Procedures and Rules |
| 29 | Review studies that have faulted the existing Civil Procedures and Rules |
| 30 | Identify areas of improvement and draft required changes |
| 31 | Review Civil Procedure Act in line with the proposed changes |
| 32 | Draft new rules and procedures |
| 33 | Receive final comments from stakeholders |
| 34 | Present Amendments to Cabinet for approval |
| 35 | Publish Bill for introduction to the National Assembly and follow debate the amendments |
| 36 | Draft accompanying regulations |
| 37 | Gazette amendments and accompanying regulations |
| 38 | Organise a retreat to induct implementers to the new rules to create awareness |

Government of Kenya
Ministry of Finance

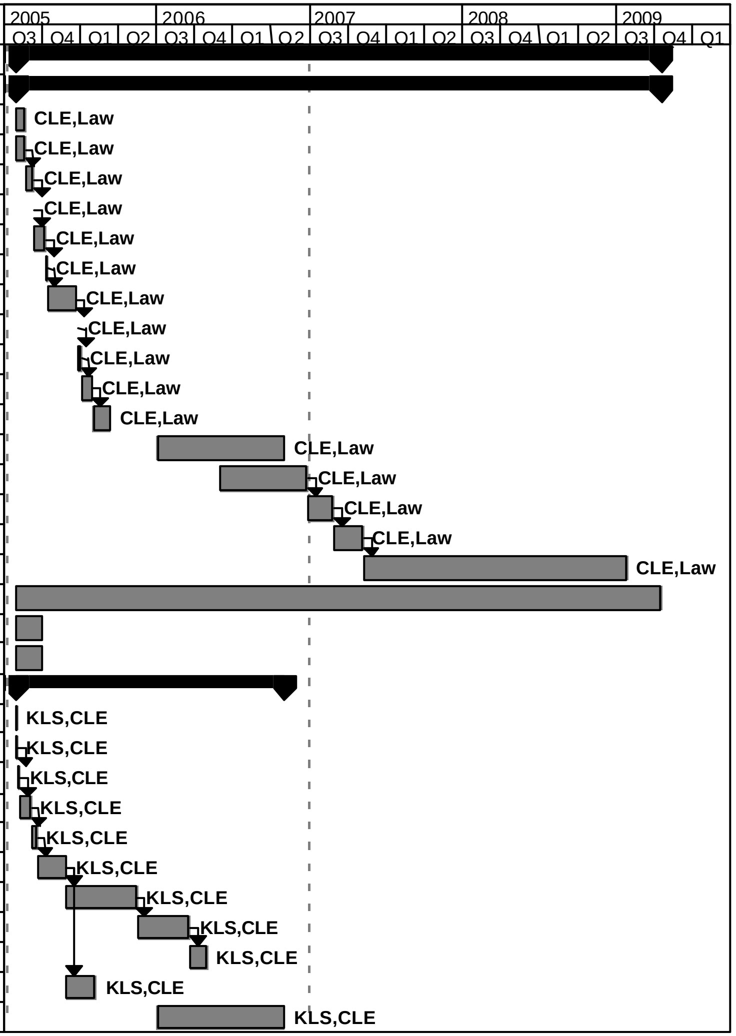
| ID | Task Name |
|---|---|
| 39 | **SUB- COMPENENT 2: LAW REFORM** |
| 40 | **Prioritised strategy for law reform in Kenya** |
| 41 | Streamline the process and responsibilities for law reform |
| 42 | Develop a shared vision for law reform |
| 43 | Hold a forum to share the vision and agree responsibilities |
| 44 | Develop a prioritised work plan for realising the vision |
| 45 | Amend the laws that may hinder the relisation of the shared vision |
| 46 | Review all the laws that provide responsibilities for law reform and identify areas of amendment |
| 47 | Draft the necessary amendments |
| 48 | Cabinet approval of the amendments |
| 49 | Publish the amedments for debate by Parliament |
| 50 | Follow up Parliamentary debate |
| 51 | Incorporate agreed amendments |
| 52 | Gatzette amended Bills |
| 53 | Implement the work plan for realisation of the strategy and shared vision (includes TA support) |
| 54 | **Capacity built at Kenya Law Reform Commission** |
| 55 | Provide supplementary support to the ongoing capacity building efforts |
| 56 | Train staff in legislative drafting, research and report writing |
| 57 | Attach staff and organise for study visits to various institutions for lesson learning |
| 58 | **Priority Financial and Commercial Laws enacted or amended** |
| 59 | Prioritise financial and commercial laws for amendment/enactment |
| 60 | Organise a stakeholder forum to agree on priority financial and commercial laws for amendment/enactment |
| 61 | Define responsibilities for review of the laws |
| 62 | Develop an action plan for review and enactment of the priority laws |
| 63 | Present proritised action plan to stakeholders |
| 64 | Incorporate stakeholder suggestions in the prioritised action plan |
| 65 | Draft the required amendments/new laws |
| 66 | Process the required amendments/new laws |
| 67 | Get Cabinet approval |
| 68 | Debate Bills in Parliament |
| 69 | Make necessary amendments and publish |
| 70 | **Improved law library and legal information at Kenya Law Reform Commission** |
| 71 | Supplement the EU initiative for library service (provide additional resources) |
| 72 | **Lawyers' terms and conditions harmonised with Judiciary Scheme** |
| 73 | Review proposal forwarded to PSC |
| 74 | Select team to review the proposal and review proposal |
| 75 | Make any adjustments given recent developments in the sector and Government Employees compensation initiatives |
| 76 | Present recommendations to stakeholders |
| 77 | Present revised proposal to PSC/DPM |



| ID | Task |
|---|---|
| 78 | **Capacity built for Parliamentary** |
| 79 | Establish the training needs |
| 80 | Develop the TOR for training needs |
| 81 | Carryout training needs |
| 82 | Train selected number of officers per year (10 |
| 83 | **Reduce legal drafting backlog at Legislative** |
| 84 | Improve legal drafting capacity of |
| 85 | Conduct training need |
| 86 | Train staff in identified areas of legal |
| 87 | Identify and prioritise drafting backlog |
| 88 | Reduce drafting |
| 89 | Hire additional staff (consultancy basis) |
| 90 | **Revised and** |
| 91 | Avail updated laws electronically |
| 92 | Hire legal firm to assist in revising and |
| 93 | Obtain revised |
| 94 | Process the agreed revisions |
| 95 | Proof read and update the |
| 96 | Publish the Book in |
| 97 | **Bulletin for law** |
| 98 | Publish bi-monthly |
| 99 | Engage consultant to design |
| 10 | Capacity for law reporting enhanced by |



| ID | Task Name |
|---|---|
| 101 | **SUB- COMPENENT 3: STRENGTHENING OF LEGAL EDUCATION** |
| 102 | **Financial and commercial law curricula developed and implemented at Law Faculties in public** |
| 103 | Develop curriculum for enhancement of financial and commercial law at public |
| 104 | Develop objectives for financial and commercial law curriculum in public |
| 105 | Assess training needs for capacity in financial and commercial law to meet the stated |
| 106 | Present findings to |
| 107 | Develop curriculum outline for review - to meet the identified |
| 108 | Agree on curriculum |
| 109 | Develop the full |
| 110 | Organise stakeholder forum for comments on |
| 111 | Incorporate stakeholder views into |
| 112 | Approve |
| 113 | Produce teaching |
| 114 | Train trainers of the curriculum (5 |
| 115 | Pilot the new curriculum at the public |
| 116 | Review curriculum to incorporate lessons |
| 117 | Produce teaching |
| 118 | Rollout the curriculum to the teaching load at Public |
| 119 | Supplement support to Public Universities by supporting 3 candidates to do |
| 120 | Computerise faculty for student |
| 121 | Introduce cyber based law in at least one |
| 122 | **Specialised capacity building programme on legal drafting and research developed and implemented at KLS** |
| 123 | Develop curriculum for post graduate legal drafting and research at Kenya Law |
| 124 | Develop objectives for |
| 125 | Agree objectives between |
| 126 | Draft curriculum to meet objectives for legal drafting and |
| 127 | Agree on draft |
| 128 | Develop teaching modules for |
| 129 | Develop teaching materials to deliver the |
| 130 | Test pilot the |
| 131 | Revise curriculum taking into account lessons learned for test |
| 132 | Develop or purchase teaching materials/aids including any electronic |
| 133 | Full rollout the |



## 3.8 Component 8: Project management

### 3.8.1 Component description

The FLSTAP project design provides for a discrete unit to coordinate implementation of the project through the five-year period. In the long and short run, the unit would require to put in place systems, build capacity and acquire equipment to fulfil its mandate. The following paragraphs present some of the PIU's requirements.

The first set of activities are aimed at operationalising the PIU. A limited number of specialised project management staff will be recruited to enable the effective implementation of the FLSTAP. This will be done through a competitive process on the basis of qualifications for the assignment. Set-up activities also include securing and/or procuring office accommodation, tools of work such as computers and facilitative equipment such as cars.

Among other things, the PIU will be responsible for financial management of the FLSTAP. To perform the financial management tasks, the PIU requires an appropriate Financial Management System (FMS). To this end, provision has been made to acquire a package and train PIU staff in its use.

Though project personnel and the component managers are expected to be competent, the project has its own unique attributes and as a result there may be need for orientation of the PIU staff to the objectives of the project and the environment within which they have to deliver. Against this rational, an induction and various skills enhancement courses, with a focus on project management skills, have been planned for under this component. An Information, Education and Communication (IEC) programme has been provided for whose aims are to continuously inform, educate and involve stakeholders in the assessment of FLSTAP's performance. The IEC programme will help to galvanise energies and efforts towards a consistent and focused drive towards implementation of the project activities. The IEC outputs include a communications strategy, periodic newsletters widely distributed to stakeholders and a project website which offers electronic media on FLSTAP's implementation progress.

Though the PIU is not responsible for implementation of the FLSTAP activities, it is responsible for monitoring and evaluation of project implementation. It is also responsible for quarterly reporting to the PSC, IDA and DFID. These activities require a database for storage of reports from implementing institutions.

### 3.8.2 Component matrix, inputs and institutional responsibility

**Table 3.8.1** below sets out the activities to be undertaken to achieve the outputs for the subcomponents in this component. Also presented are resources requirements to achieve the outputs and institutional responsibility for delivery of the output.

**Table 3.8.1: Component 8 matrix of outputs, inputs and institutional responsibility**

| Output | Inputs | Responsible institution & department |
|---|---|---|
| Operational Project Implementation Unit (PIU) | Equipment, Advisers, staff cost, ICT tools, cars | PIU/MOF |
| Financial Management System for PIU | FMS system, Advisers | PIU/MOF |
| PIU staff and FLSTAP component managers capacity enhanced | Advisers | PIU/MOF |
| An effective IEC Programme | Advisers, ICT tools | PIU/MOF |
| Effective Database at PIU | ICT tools, Advisers | PIU/MOF |
| A performance based appraisal system for PIU | ICT tools, Advisers | PIU/MOF |

### 3.8.3 Component cost and financing

The financing needed for this component is KShs 206 million (US$ 2.6 million). **Table 3.8.2** presents an analysis of component costs by output for each year of the project at constant 2005 prices.

**Table 3.8.2: Component costs by output**

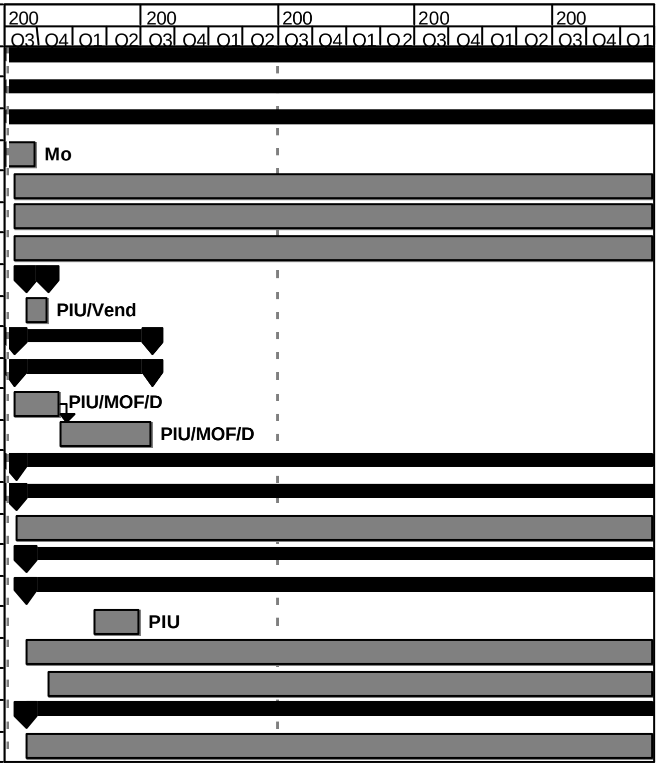
| PLANNED OUTPUT | YEAR BUDGET COST (KHS) | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | Year 2005 | Year 2006 | Year 2007 | Year 2008 | Year 2009 | OUTPUT COST (KSH) |
| Operational Project Implementation Unit (PIU) | 48,433,000 | 21,923,000 | 21,923,000 | 23,298,000 | 21,923,000 | 137,500,000 |
| Financial Management System for PIU | 11,968,000 | 5,500,000 | 5,500,000 | 5,500,000 | 5,500,000 | 33,968,000 |
| PIU staff and FLSTAP component managers capacity enhanced | 2,090,000 | - | 2,090,000 | - | - | 4,180,000 |
| An effective IEC Programme | 3,410,000 | 1,650,000 | 1,650,000 | 1,650,000 | 1,650,000 | 10,010,000 |
| Effective Database at PIU | 7,700,000 | 2,156,000 | 2,156,000 | 2,156,000 | 2,156,000 | 16,324,000 |
| A performance based appraisal system for PIU | 3,520,000 | - | - | - | - | 3,520,000 |
| **Subtotal** | **77,121,000** | **31,229,000** | **33,319,000** | **32,604,000** | **31,229,000** | **205,502,000** |
| **Cost in U$** | **964,013** | **390,363** | **416,488** | **407,550** | **390,363** | **2,568,775** |

### 3.8.4 Component completion schedule

The component implementation schedule for this component is presented in Figure **3.8.1**.

## Figure 3.8.1: Component 8 – Implementation schedule

| ID | Task |
|---|---|
| 1 | **COMPONENT 8: PROJECT MANAGEMENT** |
| 2 | **SUB-COMPONENT 1: OPERATIONAL PROJECT IMPLMENTATION UNIT** |
| 3 | **Operational PIU** |
| 4 | Staff PIU |
| 5 | Meet cost of staff |
| 6 | Lease and equip PIU offices |
| 7 | Develop work plan for PIU |
| 8 | **Financial Management System for PIU** |
| 9 | Purchase an appropriate financial management package (e.g. Great Plains Dynamics) |
| 10 | **SUB-COMPONENT2: BUILD CAPACITY OF THE PIU STAFF AND COMPONENT MANAGERS** |
| 11 | **PIU staff capacity enhanced** |
| 12 | Conduct staff induction course |
| 13 | Conduct skills enhancement course |
| 14 | **SUB-COMPONENT 3: INFORMATION EDUCATION AND COMMUNICATION PROGRAMME** |
| 15 | **An effective IEC programme** |
| 16 | Design and implement an appropriate IEC programme for FLSTAP |
| 17 | **SUB-COMPONENT 3: INFORMATION EDUCATION AND COMMUNICATION PROGRAMME** |
| 18 | **Effective database at PIU** |
| 19 | Establish the needs for database |
| 20 | Maintain database |
| 21 | Support preparation of quarterly report |
| 22 | **A performance based appraisal system for PIU** |
| 23 | Operationalise the performance based appraisal system |



## 3.9 Administration

### 3.9.1 Procurement management and plan

All procurement will be undertaken by the PIU in accordance with the World Bank's "Guidelines: Procurement Under IBRD Loans and IDA Credits" (May 2004); "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" (May 2004); and the FLSTAP Development Credit Agreement (DCA). Table **3.9.1** sets out the categories of items to be financed by the project. It is the responsibility of the PIU's Procurement Officer to schedule planned expenditure on these items in a procurement plan which will be updated annually.

Detailed costing of the FLSTAP has resulted in some differences between the amounts allocated to the various categories of expenditure shown below and those contained in the project appraisal document. These differences will need to be realigned in time. This may entail revising the DCA during mid-term review of the FLSTAP's implementation.

**Table 3.9.1 Categories of items to be financed by the project**

| Category | Amount (KShs) | Amount US$ | Percentage of total |
|---|---|---|---|
| Goods and equipment | 330,593,998 | 4,132,425 | 14 |
| Consultants services including audits | 825,099,000 | 10,313,738 | 34 |
| Training and workshops | 345,501,200 | 4,318,765 | 14 |
| Operating costs | 680,925,300 | 8,511,566 | 28 |
| Refunding of project preparation advance | 58,400,000 | 730,000 | 2 |
| Unallocated | 159,480,480 | 1,993,506 | 7 |
| **Total** | 2,399,999,978 | 30,000,000 | **100** |

In accordance with World Bank regulations, procurement of:

- Goods and equipment valued over US$ 150,000 will be awarded following International Competitive Bidding procedures. For contracts of less than US$ 150,000, other procurement methods can be used subject to agreement by the project's financiers, including: Limited International Bidding; National Competitive Bidding; Shopping and Direct Contracting. All procurement of goods and equipment will be subject to a prior review by the World Bank

- Consultants will be informed by Terms of Reference approved by the PSC and financiers, and selected on the basis of the following four main contracting methods: Quality and Cost Based Selection; Quality Based Selection; Consultants' Qualifications; Individual Consultants. The following contracts will require the financiers' prior review each contract for consultants' services provided by: an individual estimated to cost the equivalent of US$ 50,000 or more; a firm estimated to cost the equivalent of US$ 100,000 or more. All other contracts shall be subject to a post review by the financier.

### 3.9.2 Financial management

The Project will adopt Government's budgeting and accounting procedures which are set out in Treasury Circulars No. 8/2001 and No. 3/2000 respectively. In brief:

- Expenditure estimates for the FLSTAP will form part of MoF's development expenditure. These estimates will be prepared on a three-year rolling basis

- Once the budget has been appropriated by Parliament, the PIU's Accountant will initiate the disbursement process by preparing a Special Exchequer Request.

The PIU's Accountant will maintain two accounts as follows. First, a special account that will receive dollar deposits from the Project's main credit account. Second, a local currency FLSTAP account to form the primary source of finance for project activities. Funds flow arrangements for the project shall be as follows:

- The World Bank and DFID will make an initial advance disbursement from the proceeds of the Credit/Grant by depositing into the GOK's-operated Special Account.

- Actual expenditure will be reimbursed though submission of Withdrawal Applications and against Financial Monitoring Reports.

- GOK counterpart funds and transfers from the Special Accounts (for payment of transactions in local currency) will be deposited in the project account in accordance with exchequer control and funding arrangements. Counterpart funds will be allocated through the normal central government budgetary process.

The PIU's Accountant will prepare and furnish the PSC and the project's financiers with a quarterly Financial Management Report (FMR) which:

- Presents sources and uses of funds for the FLSTAP, for the period and cumulatively, with explanations for any variances between actual and budgeted uses of such funds.

- Specifies physical progress in project implementation, for the quarter as well as cumulatively, gives reasons for any departures from planned project implementation.

- Reports the status of procurement under the project.

The first FMR will be furnished to the PSC and project's financiers not later than 45 days after the end of the first quarter after FLSTAP's effective date, covering the period from the incurrence of the first expenditure under the project to the end of the quarter; thereafter, each FMR will be submitted to the PSC and project's financiers no later than 45 days after each quarter end.

The annual project financial statements will be audited in accordance with International Standards of Auditing or other standards as promulgated by the International Organisation of Supreme Audit Institutions. The audit will be carried out by an independent auditing firm whose qualifications and experience as well as terms of reference are acceptable to the PSC and the FLSTAP's financiers. The World Bank's Financial Reporting and Auditing Handbook (FARAH) will be used by the auditors in accordance with the Bank's auditing guidelines. Audit reports will be furnished to the Bank within six months after the close of the Project's financial year.

### 3.9.3 Training and technical assistance

The PIU will be a new establishment without experience in World Bank- financed projects. This will be mitigated by the Bank conducting training and capacity building workshops for the project's key management and accounting personnel. It is further proposed that close involvement of the Bank project management and Country team members will centre on regularly supervising performance.

# 4 Implementation and disbursement schedules for the project as a whole

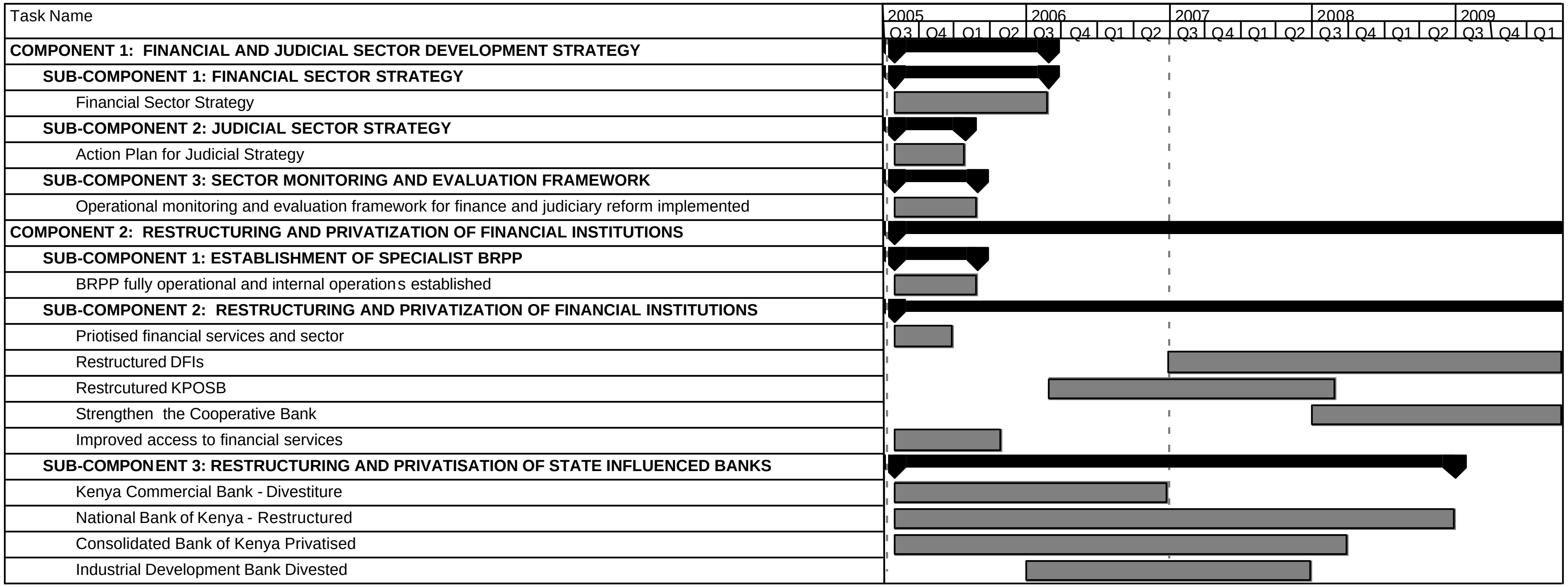
## 4.1 Summary time bound implementation schedule combining all components

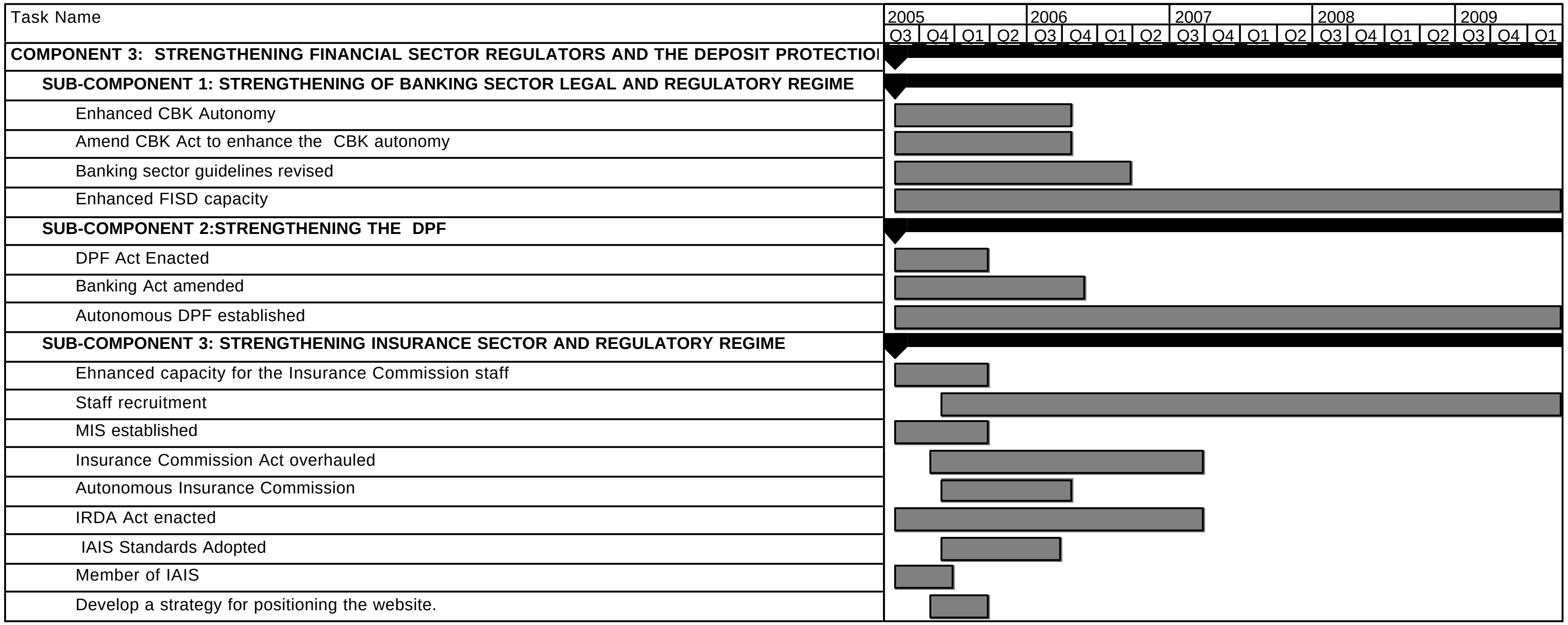
**Figure 4.1.1** overleaf summarises the FLSTAP's implementation schedule in a Gantt Chart for all eight components. The sequencing of FLSTAP outputs and activities is based on the following considerations:

- The need to adapt the pace of implementation to the absorptive capacity of the beneficiary institutions

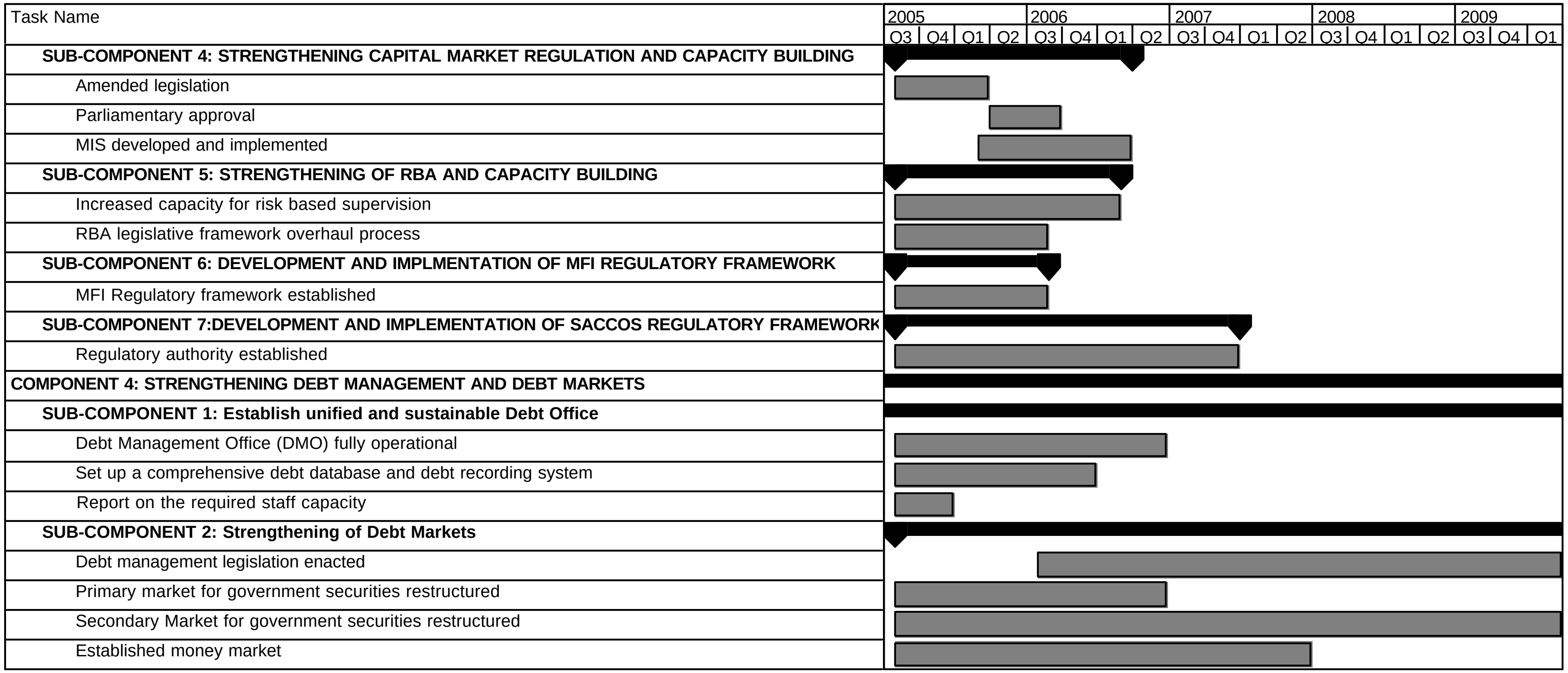
- The need to take into account interdependencies between activities. For example, it schedules factors in the earliest time such that activities can start after allowing preceding activities to finish.

**Figure 4.1.1: FLSTAP summary implementation schedule – all components**

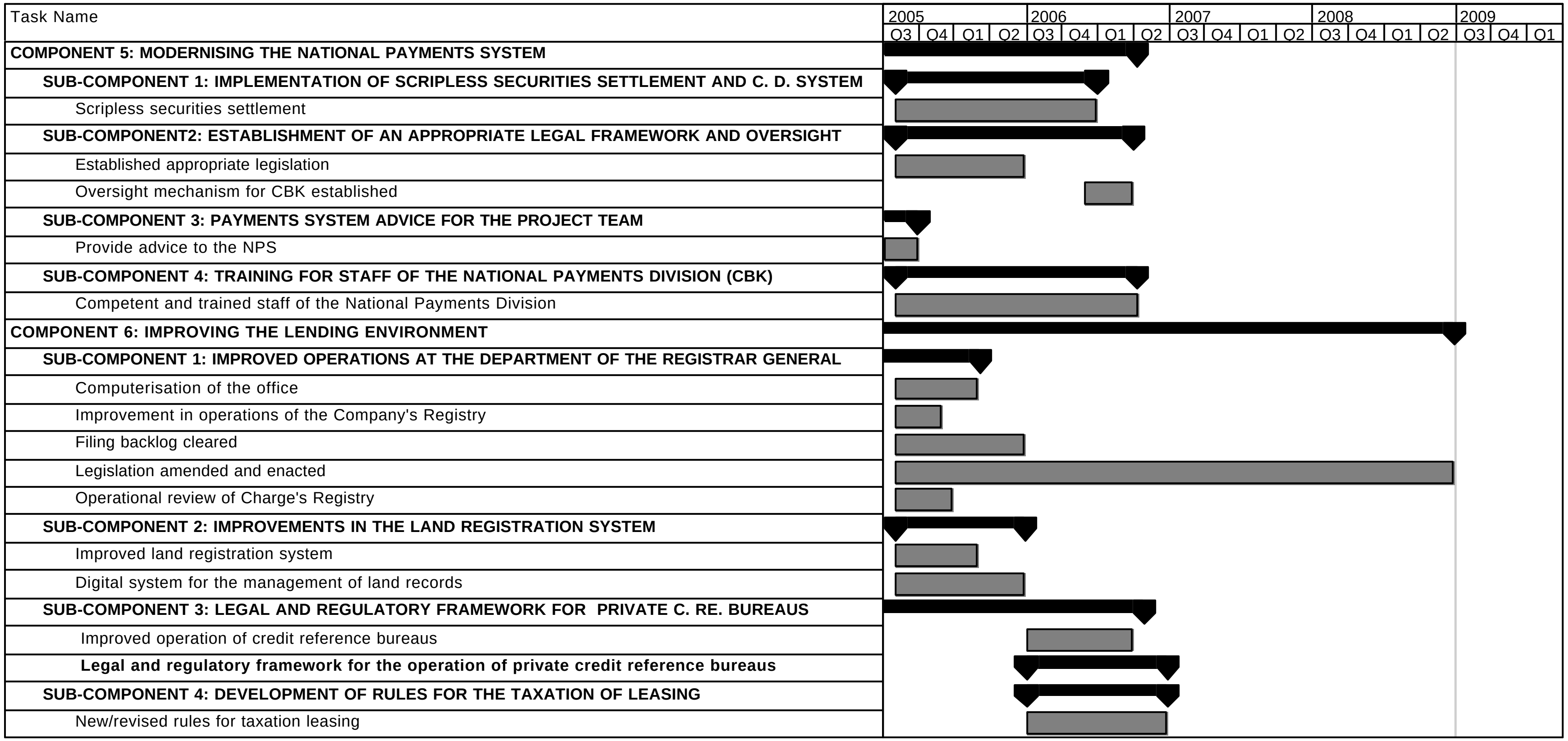




| Task Name |
|---|
| **COMPONENT 3:  STRENGTHENING FINANCIAL SECTOR REGULATORS AND THE DEPOSIT PROTECTIOI** |
| **SUB-COMPONENT 1: STRENGTHENING OF BANKING SECTOR LEGAL AND REGULATORY REGIME** |
| Enhanced CBK Autonomy |
| Amend CBK Act to enhance the  CBK autonomy |
| Banking sector guidelines revised |
| Enhanced FISD capacity |
| **SUB-COMPONENT 2:STRENGTHENING THE  DPF** |
| DPF Act Enacted |
| Banking Act amended |
| Autonomous DPF established |
| **SUB-COMPONENT 3: STRENGTHENING INSURANCE SECTOR AND REGULATORY REGIME** |
| Ehnanced capacity for the Insurance Commission staff |
| Staff recruitment |
| MIS established |
| Insurance Commission Act overhauled |
| Autonomous Insurance Commission |
| IRDA Act enacted |
| IAIS Standards Adopted |
| Member of IAIS |
| Develop a strategy for positioning the website. |

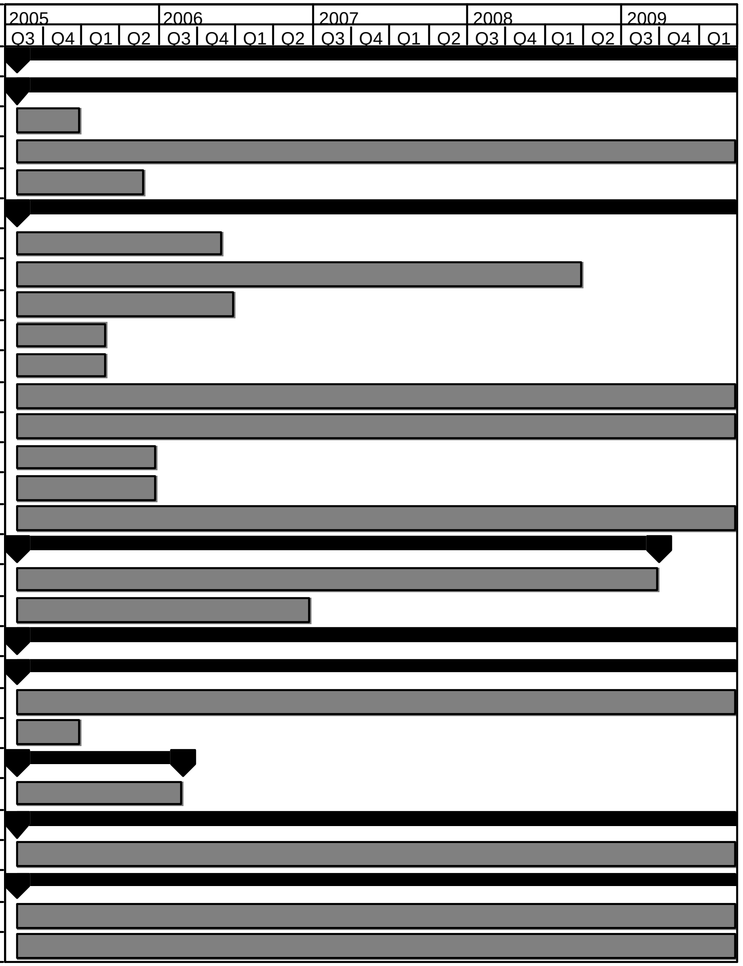


| Task Name |
|---|
| **SUB-COMPONENT 4: STRENGTHENING CAPITAL MARKET REGULATION AND CAPACITY BUILDING** |
| Amended legislation |
| Parliamentary approval |
| MIS developed and implemented |
| **SUB-COMPONENT 5: STRENGTHENING OF RBA AND CAPACITY BUILDING** |
| Increased capacity for risk based supervision |
| RBA legislative framework overhaul process |
| **SUB-COMPONENT 6: DEVELOPMENT AND IMPLMENTATION OF MFI REGULATORY FRAMEWORK** |
| MFI Regulatory framework established |
| **SUB-COMPONENT 7:DEVELOPMENT AND IMPLEMENTATION OF SACCOS REGULATORY FRAMEWORK** |
| Regulatory authority established |
| **COMPONENT 4: STRENGTHENING DEBT MANAGEMENT AND DEBT MARKETS** |
| **SUB-COMPONENT 1: Establish unified and sustainable Debt Office** |
| Debt Management Office (DMO) fully operational |
| Set up a comprehensive debt database and debt recording system |
| Report on the required staff capacity |
| **SUB-COMPONENT 2: Strengthening of Debt Markets** |
| Debt management legislation enacted |
| Primary market for government securities restructured |
| Secondary Market for government securities restructured |
| Established money market |



| Task Name |
|---|
| **COMPONENT 5: MODERNISING THE NATIONAL PAYMENTS SYSTEM** |
| **SUB-COMPONENT 1: IMPLEMENTATION OF SCRIPLESS SECURITIES SETTLEMENT AND C. D. SYSTEM** |
| Scripless securities settlement |
| **SUB-COMPONENT2: ESTABLISHMENT OF AN APPROPRIATE LEGAL FRAMEWORK AND OVERSIGHT** |
| Established appropriate legislation |
| Oversight mechanism for CBK established |
| **SUB-COMPONENT 3: PAYMENTS SYSTEM ADVICE FOR THE PROJECT TEAM** |
| Provide advice to the NPS |
| **SUB-COMPONENT 4: TRAINING FOR STAFF OF THE NATIONAL PAYMENTS DIVISION (CBK)** |
| Competent and trained staff of the National Payments Division |
| **COMPONENT 6: IMPROVING THE LENDING ENVIRONMENT** |
| **SUB-COMPONENT 1: IMPROVED OPERATIONS AT THE DEPARTMENT OF THE REGISTRAR GENERAL** |
| Computerisation of the office |
| Improvement in operations of the Company's Registry |
| Filing backlog cleared |
| Legislation amended and enacted |
| Operational review of Charge's Registry |
| **SUB-COMPONENT 2: IMPROVEMENTS IN THE LAND REGISTRATION SYSTEM** |
| Improved land registration system |
| Digital system for the management of land records |
| **SUB-COMPONENT 3: LEGAL AND REGULATORY FRAMEWORK FOR PRIVATE C. RE. BUREAUS** |
| Improved operation of credit reference bureaus |
| **Legal and regulatory framework for the operation of private credit reference bureaus** |
| **SUB-COMPONENT 4: DEVELOPMENT OF RULES FOR THE TAXATION OF LEASING** |
| New/revised rules for taxation leasing |

| Task Name |
|---|
| **COMPONENT 7: LEGAL AND JUDICIAL REFORM** |
| **SUB- COMPENENT 1: REFORM OF THE JUDICIARY** |
| Integrated Court Case Management and Records Management System |
| Judicial education programme designed and implemented |
| Modern Civil Procedure Rules developed to include provisions for ADR, Small Claims |
| **SUB- COMPENENT 2: LAW REFORM** |
| Prioritised strategy for law reform in Kenya |
| Prioritised strategy for law reform in Kenya |
| Capacity built at Kenya Law Reform Commission |
| Prority Financial and Commercial Laws enacted or amended |
| Improved law library and legal information at Kenya Law Reform Commission |
| Lawyers' terms and conditions harmonised with Judiciary Scheme |
| Capacity built for Parliametary Service Commission |
| Reduce legal drafting backlog at Legislative Drafting Department |
| Revised and updated laws |
| Bulletin for law updates |
| **SUB- COMPENENT 3: STRENGTHENING OF LEGAL EDUCATION** |
| Financial and commercial law curricula developed and implemented at Law Faculties in public universitie |
| Specialised capacity building programme on legal drafting and research developed and implemented at |
| **COMPONENT 8: PROJECT MANAGEMENT** |
| **SUB-COMPONENT 1: OPERATIONAL PROJECT IMPLMENTATION UNIT** |
| Operational PIU |
| Financial Management System for PIU |
| **SUB-COMPONENT2: BUILD CAPACITY OF THE PIU STAFF AND COMPONENT MANAGERS** |
| PIU staff capacity enhanced |
| **SUB-COMPONENT 3: INFORMATION EDUCATION AND COMMUNICATION PROGRAMME** |
| An effective IEC programme |
| **SUB-COMPONENT 3: INFORMATION EDUCATION AND COMMUNICATION PROGRAMME** |
| Effective database at PIU |
| A performance based appraisal system for PIU |



Government of Kenya
Ministry of Finance

## 4.2 Summary financing and disbursement schedule

The principal guide for estimating costs were the component cost ceilings as provided in the PAD. The activities on which the costs are based are derived from outputs specified in the PAD and the proposals put forward by the implementing institutions. The detailed activities and their costs are presented in Annex A of this PIP.

### 4.2.1 Disbursement schedule

**Table 4.2.1** sets out the disbursement schedule for the GOK, the IDA and DFID against the various project expenditure categories. The contributions differ slightly from the proposed distribution in the PAD. The differences arise from the information as given by the potential implementing agencies and what they feel are priorities in their reform agenda.

**Table 4.2.1: Disbursement schedule by financing partner on an expenditure category basis**

| Category | IDA Contribution | DFID Contribution | Government Contribution | Total Per Category |
|---|---|---|---|---|
| | **US$** | **US$** | **US$** | **US$** |
| Goods and equipment | 3,500,000 | 527,021 | 105,404 | **4,132,425** |
| Consulting services | 7,706,494 | 2,172,703 | 434,541 | **10,313,738** |
| Training | 3,560,000 | 632,304 | 126,461 | **4,318,765** |
| Operating Costs | 530,000 | 6,667,972 | 1,333,594 | **8,511,566** |
| Refunding the PPF | 730,000 | 0 | 0 | **730,000** |
| Unallocated | 1,993,506 | 0 | 0 | **1,993,506** |
| **Total in US$** | **18,000,000** | **10,000,000** | **2,000,000** | **30,000,000** |
| **Total in percentage terms** | **60%** | **33.33%** | **6.67%** | **100%** |

**Table 4.2.2** presents the project's financing needs on an annual basis over the life-time of the project. It is worth drawing the reader's attention to the fact that refunding of the PPF has been excluded from the cash flow. In addition, the unallocated amount of US$ 1.99 million does not feature in the Table.

**Table 4.2.2: Estimated annual disbursements**

| US$ | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|---|---|---|---|---|---|---|
| Total cash flow requirement | **10,118,853** | **6,576,468** | **4,726,651** | **3,062,143** | **2,793,754** | **27,277,869** |
| Available financing: | | | | | | |
| IDA | 4,000,000 | 6,000,000 | 4,000,000 | 2,000,000 | 1,000,000 | 17,000,000 |
| DFID | 5,718,853 | 176,468 | 326,651 | 662,143 | 1,393,754 | 8,277,869 |
| GOK | 400,000 | 400,000 | 400,000 | 400,000 | 400,000 | 2,000,000 |
| Total cash inflows | **10,118,853** | **6,576,468** | **4,726,651** | **3,062,143** | **2,793,754** | **27,277,869** |

### 4.2.2 Financing schedule

**Table 4.2.3** below presents the financing schedule by partner on a component basis.

**Table 4.2.3: Financing schedule**

| **Component** | **Local Financing** | **Foreign financing** | **Total in U$** |
|---|---|---|---|
| 1. Financial and Judicial Sector Development Strategies | 213,898 | 641,695 | 855,594 |
| 2. Restructuring and privatisation of State- influenced FIs | 558,814 | 5,029,324 | 5,588,138 |
| 3. Strengthening Financial Sector Regulators and the DPF | 183,628 | 3,488,928 | 3,672,556 |
| 4. Strengtheining Debt Management and Debt Markets | 0 | 1,234,200 | 1,234,200 |
| 5. Modernising the Natinal Payments System | 0 | 3,090,588 | 3,090,588 |
| 6. Improving the Lending Environment | 0 | 2,659,938 | 2,659,938 |
| 7. Legal and Judiciary Reform | 532,469 | 7,074,237 | 7,606,706 |
| 8. Project management | 449,536 | 2,119,239 | 2,568,775 |
| Total Base Cost | 1,938,345 | 25,338,149 | 27,276,494 |
| Unallocated | 61,655 | 2,661,851 | 2,723,506 |
| **Total Project Cost** | **2,000,000** | **28,000,000** | **30,000,000** |

# 5 Monitoring and evaluation for the project as a whole

## 5.1 Performance indicators

Monitoring &Evaluation (M&E) of the FLSTAP will be the responsibility of the relevant implementing/ beneficiary institutions with assistance from the PIU, and other stakeholders as appropriate. Monitoring of the Project will take place at two levels. At one level, each implementing institution in collaboration with personnel in the PIU, will monitor: utilisation of inputs against budget; and timeliness of implementation activities and delivery of outputs scheduled in component Gantt charts (see Sections 3 and 4). At another level, the same teams will periodically monitor the programme's implementation progress relative to specified outputs, outcomes and associated Key Performance Indicators (KPIs).

**Table 5.1.1** lists seven indicators that form the basis for monitoring progress towards the achievement of FLSTAP's project development objective/outcome. The PIU will communicate the outcome indicators to a wide range of stakeholders as a basis for maintaining dialogue.

The table also specifies a target for each indicator. Targets will provide a basis for assessing improvement trends during the life of FLSTAP. To inform this assessment, it will be necessary for beneficiary agencies to collect baseline data. For indicators 2-6, this data should be relatively easy to obtain from routine administrative records maintained by the CBK, MOF and Judiciary. However, it is likely that surveys/studies will be needed to establish baselines for indicators 1 and 7.

**Table 5.1.1 – Project development objective indicators and targets**

| Project Development Objective/Outcome | Indicator | Target |
|---|---|---|
| The overall development objective of the project is to create a sound financial system and strengthened legal framework and judicial capacity that will ensure broad access to financial and related legal services | 1. Percentage of population with access to appropriate financial services | 20 percent increase |
| | 2. Percentage increase in private credit provision relative to GDP | 30 percent increase |
| | 3. Ratio of non-performing loans to the total loan portfolio of the banking system | 10 percent reduction |
| | 4. Spread between average deposit rate and lending rate for prime customers | 30 percent reduction |
| | 5. Percentage reduction in backlog in commercial cases | 25 percent reduction |
| | 6. Number of key commercial sector laws amended and/or passed | 100 percent adopted |
| | 7. Percentage of businesses who are satisfied by the justice system | 23 percent increase |

**Table 5.1.2** sets out the KPIs that will be used to measure progress in achieving intermediate outcomes. It is noteworthy that, as above, KPIs are specified for each intermediate outcome. As part of the implementation of FLSTAP's component 1, it will be necessary to collect baseline data for each KPI, and thereafter set time bound performance targets that can be used to assess progress over time.

**Table 5.1.2 – Key performance indicators for intermediate outcomes**

| Component | Intermediate outcome | KPI |
|---|---|---|
| 1: Financial and Judicial Sector Development Strategy | Financial and judicial sector strategies necessary to achieve the Government's policy objectives have been adopted | • Proportion of components of the financial sector strategy that have been completed in percentage terms<br>• Percentage of financial/judicial sector stakeholders aware of strategies<br>• Number of strategies completed and approved |
| 2: Restructuring and privatisation of financial institutions | Government-owned financial institutions restructured and privatised | • Percentage of bank's (e.g. NBK's) asset size restructured<br>• Percentage reduction in GOK stakes in banks<br>• Proportion of board positions in banks held by GOK representatives |
| 3: Strengthening financial sector regulators and Deposit Protection Fund Board | Increased soundness of the financial system through greater effectiveness of financial sector regulators | • Number of financial sector regulators operating under new/revised legislative/regulatory framework |
| 4: Strengthening debt management and debt markets | Well developed primary market and secondary market for government securities and the money market | • Percentage increase in the auction size of GOK securities<br>• Percentage reduction in GOK borrowing costs |
| 5: Modernising the National Payment System | Reduced transaction costs for financial transfers as a result of increased stability and soundness of money transmission systems | • Percentage reduction in the number of paper based instruments<br>• Percentage of large value and time critical transfers completed within a day |
| 6: Improving the lending environment | Improved access to credit as a result of a better lending environment | • Percentage of MSMEs who report improved access to credit<br>• Percentage increase in volume of leasing finance |
| 7: Legal and judicial reform | Strengthened capacity in the law and justice sector that supports financial and commercial sector development | • Percentage reduction in the number of complaints regarding the legal profession and judiciary<br>• Percentage of professionals in |

| Component | Intermediate outcome | KPI |
|---|---|---|
| | | the judiciary who have job satisfaction<br>- Percentage of legal professionals who have the skills to support financial and commercial sector development |

GOK is developing a national M&E system that will define: institutional structures; methodologies and procedures; information and data sources; capacity building needs. The objective of this initiative is to ensure that information is captured for multiple uses including: Annual Progress Reports on Kenya's ERSWEC; joint GOK/ development partner appraisals; consultations with and dissemination of progress to various stakeholders.

Both the financial sector and GJLOS constitute priority areas in the ERSWEC. It will therefore be imperative that FLSTAP's M&E framework is interfaced with the national system to ensure information sharing. This linkage can only be achieved by ongoing consultations during implementation between the PIU and M&E Department of the Ministry of Planning and National Development.

## 5.2 Major loan covenants

Schedule 4, Section II of the FLSTAP's DCA requires GOK to:

- Prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about September 30, 2007, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

- Review with the Association, by November 30, 2007, or such later date as the Association shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

## 5.3 Critical risks

There are two key risks that may undermine the sustainability of the M&E system. First, with the exception of a few programmes and projects, M&E capacity is deficient in many GOK agencies. Second, in the absence of adequate controls, there is the risk that trend data on KPIs may not be credible. It will therefore be critical to ensure that systematic efforts go into building skills in this area. In addition, the PIU will need to institute mechanisms for periodic audits of data quality. These requirements are captured under component 1 of the FLSTAP.