

CREDIT NUMBER 3992 KE

Development Credit Agreement

(Kenya Financial and Legal Sector Technical Assistance Project)

between

Republic of Kenya

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated

, 2004

CREDIT NUMBER 3992 KE

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated _____, 2004, between Republic of Kenya (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Association has received a letter from the Borrower, dated August 31, 2004, describing a program of actions, objectives and policies designed to enhance the capacity of its financial, commercial and judicial institutions, promote the reform within its financial and legal sectors and deliver services efficiently and effectively (the Program) and declaring the Borrower's commitment to the execution of such program;

(B) the Borrower intends to obtain from United Kingdom's Department for International Development (DFID) a grant in the amount equivalent to six million Pounds Sterling (£6,000,000) (the DFID Grant) to assist in financing the Project on the terms and conditions set forth in an agreement to be entered into between the Borrower and DFID (the DFID Grant Agreement);

(C) DFID intends to appoint the Association to coordinate disbursement of the DFID Grant in accordance with an agreement to be entered into between the Association and DFID (Co-financiers Agreement); and

(D) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project;

WHEREAS the Association has agreed, on the basis, inter alia, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

The "General Conditions Applicable to Development Credit Agreements of the Association dated January 1, 1985 (as amended through May 1, 2004) (the General Conditions) constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective

meanings therein set forth and the following additional terms have the following meanings:

(a) “AFAM” means the Administration, Financial and Accounting Manual that sets out the financial management arrangements, organization structure (including internal audit functions), staffing, standard accounting forms, books, ledgers for the implementation of activities under the Project and as referred to in paragraph 1 of Schedule 4 to this Agreement;

(b) “BRPP” means Bank Restructuring and Privatization Project as referred to in Part B.1 of Schedule 2 to this Agreement;

(c) “CBK” means the Central Bank of Kenya established pursuant to Law No. 488 of 1996;

(d) “Eligible Categories” means Categories (1) through (4) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(e) “Eligible Expenditures” means the expenditures for goods and consultants’ services referred to in Section 2.02 (a) of this Agreement;

(f) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement;

(g) “Implementing Agencies” means the Borrower’s Ministry of Finance, Central Bank, Retirement Benefits Authority, Capital Markets Authority, Insurance Commission, Deposit Protection Fund Board, Department of the Registrar General, Law Reform Commission, Office of the Attorney General, Ministry of Justice and Constitutional Affairs, the Judiciary, Kenya School of Law, Ministry of Lands, Kenya Revenue Authority, and all assisting with the implementation of the Project;

(h) “Initial Deposit” means the initial amount to be deposited into the Project Account (as hereinafter defined) and referred to in Section 3.04 (b) of this Agreement;

(i) “Procurement Plan” means the Borrower’s procurement plan, dated July 29, 2004 covering the initial 18 month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding 18 month periods (or longer) of Project implementation;

(j) “Project Implementation Plan” or “PIP” means the plan referred to in paragraph 1 of Schedule 4 to this Agreement, adopted by the Borrower, setting forth, all procedures and arrangements governing the implementation of the Project, such as procurement and disbursement procedures, and the terms, conditions, and procedures pertaining to the carrying out of the Financial Sector Development Strategy and Judicial

Strategic Action Plan, as the same may be amended from time to time, and such term shall include any schedules, tables and annexes to the PIP;

(k) "Project Implementation Unit" or "PIU" means the unit to be established by the Borrower to oversee the day-to-day implementation of the Project and referred to in paragraph 4 of Schedule 4 to this Agreement;

(l) "Project Account" means the account referred to in Section 3.04 (a) of this Agreement;

(m) "Project Preparation Advance" means the project preparation advance granted by the Association to the Borrower pursuant to the letter agreement signed on behalf of the Association on February 9, 2004 and on behalf of the Borrower on February 12, 2004;

(n) "Project Steering Committee" means the Borrower's committee referred to in paragraph 3 of Schedule 4 to this Agreement;

(o) "Report-based Disbursements" means the Borrower's option for withdrawal of funds from the Credit Account referred to in Part A. 7 of Schedule 1 to this Agreement;

(p) "RTGS" means Real Time Gross Settlement under Part E of Schedule 2 to this Agreement; and

(q) "Special Account" means the account referred to in Part B of Schedule 1 to this Agreement.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to twelve million two hundred thousand Special Drawing Rights (SDR 12,200,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit.

(b) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and

outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be March 31, 2010 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on March 1 and September 1 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each March 1 and September 1 commencing March 1, 2015 and ending September 1, 2044. Each installment to and including the installment payable on September 1, 2024 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the

Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, commercial, legal education and judicial practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. (a) Except as the Association shall otherwise agree, procurement of the goods, and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with guidelines acceptable to the Association, and furnish such update to the Association not later than 12 months after the date of the preceding Procurement Plan, for the Association's approval.

Section 3.03. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan for the future operation of the Project; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

Section 3.04. The Borrower shall for purposes of making the counterpart contribution to the financing of the Project:

(a) open and thereafter maintain, until the completion of the Project, an account in the currency of the Borrower in a commercial bank on terms and conditions satisfactory to the Association (Project Account) into which it shall deposit from time to time its local counterpart contribution to the cost of the Project;

(b) promptly thereafter, deposit the initial contribution equivalent to \$100,000 into the Project Account by the Effective Date;

(c) thereafter, replenish the Project Account up to the initial amount on a quarterly basis throughout the Project implementation until the completion of the Project; and

(d) ensure that amounts deposited into the Project Account shall be used exclusively to make payments to meet expenditures made or to be made in respect of the reasonable cost of goods and services for the Project in addition to those financed from the proceeds of the Credit.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall establish and maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

- (i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Association), commencing with the fiscal year in which the first withdrawal under the Project Preparation Advance was made, audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;
- (ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Association): (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and
- (iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of reports referred to in Part A.6 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall:

- (i) retain, until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such reports and statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Section 4.01 of this Agreement, the Borrower shall prepare and furnish to the Association a Financial Monitoring Report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (l) of the General Conditions, the following additional events are specified:

(a) A situation shall have arisen which shall make it improbable that the Program or a significant part thereof will be carried out.

(b) The DFID Grant Agreement shall have been amended, abrogated, repealed or waived so as to, in the opinion of the Association, materially and adversely affect the ability of the Borrower to perform any of its respective obligations in the pursuit of the objectives of the Project.

(c) (i) Subject to subparagraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the DFID Grant made to the Borrower for the financing of the Project shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the DFID Grant Agreement.

(ii) Subparagraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Association that: (A) such suspension, cancellation or termination is not caused by the failure of the Borrower to perform any of its obligations under the DFID Grant Agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) the DFID Grant Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Borrower to make withdrawals thereunder, except only the effectiveness of the Development Credit Agreement, have been fulfilled;

(b) the Borrower has established the Project Steering Committee in form and substance satisfactory to the Association;

(c) the Borrower has established the PIU in form and substance satisfactory to the Association;

(d) the Borrower has prepared and furnished to the Association a PIP in form and substance satisfactory to the Association; and

(e) the Borrower has opened the Project Account and has deposited therein the Initial Deposit referred to in Section 3.04 (b) of this Agreement.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Minister of the Borrower responsible for finance is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
P.O Box 30007
Nairobi
Kenya

Cable address:	Facsimile:
FINANCE	254 20 330426
NAIROBI	254 20 218 475

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Nairobi, Republic of Kenya, as of the day and year first above written.

REPUBLIC OF KENYA

By

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed by the Association</u>
(1) Goods and equipment	2,400,000	57 %
(2) Consultants Services including Audits	4,550,000	56 %
(3) Training and Workshops	2,400,000	60 %
(4) Operating Costs	350,000	22 %
(5) Refunding of Project Preparation Advance	500,000	Amount due pursuant to Section 2.02 (b) of this Agreement
(6) Unallocated	2,000,000	
Total	12,200,000 =====	

2. For the purposes of this Schedule, the term:

(a) “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower; provided, however, that, if the currency of the Borrower is also that of another country from the

territory of which goods or services are supplied, expenditures in such currency for such goods or services shall be deemed to be “foreign expenditures”; and

(c) “Operating Costs” means the incremental expenses incurred on account of Project implementation, including office supplies, vehicle operation and maintenance, communication and insurance costs, reasonable Special Accounts banking charges, rental expenses, office maintenance costs, office equipment maintenance, utilities, documents duplication/printing, consumables, travel cost and per diem for Project staff for travel linked to the implementation of the Project and salaries of contractual staff for the Project, but excluding salaries of officials of the Borrower’s civil service.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR680,000, may be made in respect of Categories (1) through (4) of the table in paragraph 1 of this Schedule, on account of payments made for expenditures before that date but after August 1, 2004.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than \$150,000 equivalent per contract; (b) services of consultants firms costing less than \$100,000 equivalent per contract; (c) services of individual consultants costing less than \$50,000 equivalent per contract; (d) workshops; (e) local training; and (f) Operating Costs, all under such terms and conditions as the Association shall specify by notice to the Borrower.

5. It is understood that the percentages of expenditures to be financed under the table set forth in paragraph 1 of this Schedule have been calculated on the basis of the provisions of a letter issued by the Borrower’s Ministry of Finance pursuant to Legal Notice Numbers 138 and 145 (as amended in 1996) of the Borrower, which provides for an exemption of taxes and customs duties levied in the territory of the Borrower on works, goods and services for this Project. If any change is made to said letter and Legal Notices which has the effect of levying taxes or customs duties on such works, goods and services, the percentages referred to above shall be decreased in accordance with the provisions of Section 5.08 of the General Conditions.

6. The Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may open and maintain in Dollars a special deposit account in a commercial bank acceptable to the Association, on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure and attachment.

2. After the Association has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Credit Account of amounts to be deposited into the Special Account shall be made as follows:

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.6 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account; or

(c) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Association shall

determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

6. (a) If the Association determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Credit Agreement.

Annex A

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements**

1. For the purposes of this Annex, the term “Authorized Allocation” means an amount equivalent to \$2,000,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 2 of this Annex, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$1,000,000 until the aggregate amount of withdrawals from the Credit Account plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of SDR 2,700,000.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which in the aggregate do not exceed the Authorized Allocation. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested.

(b) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to Part B.3 of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall equal the equivalent of twice the amount of the

Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

Annex B

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are
Report-based Disbursements**

1. Withdrawals from the Credit Account shall be deposited by the Association into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Credit, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.6 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objective of the Project is to support the Borrower in carrying out reforms to create a sound financial system and strengthened legal framework necessary to implement the Borrower's Program.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: Financial and Judicial Sector Development Strategy

1. Development of a financial sector strategy through: (a) carrying of studies on specific identified issues; and (b) facilitation of workshops for stakeholder consultation.
2. Development of a judicial strategic action plan, through: (a) evaluation of administrative measures; (b) identification of measures to accelerate judicial reform; (c) assessment of methods to improve responsiveness of the judiciary to demands; and (d) development of alternative dispute resolution mechanisms, all through the provision of technical advisory services, training and workshops.
3. Development of a framework for monitoring and evaluation of progress in financial and legal sector reforms through facilitation of workshops and the provision of technical advisory services and training.

Part B: Restructuring and Privatization of Financial Institutions

1. Strengthening the banking system, including: (a) carrying out of a bank restructuring and privatization project; (b) identification of strategic options for divestiture; and (c) restructuring of development finance institutions, all through the provision of legal and technical advisory services and audits.
2. Strengthening the role and effectiveness of Co-operative Bank as a key institution for improving access to financial services and Kenya Post Office Savings Bank as a safe depository for low income and rural savers) through the provision of legal and technical advisory services and audits.

Part C: Strengthening Financial Sector Regulators and the Deposit Protection Fund Board

1. Improving the legislative framework for making regulatory agencies operationally independent and promoting a market-based approach to financial intermediation, including: (a) vesting the CBK with key powers to license, de-license and deal with problem banks; (b) development of mechanisms for increasing CBK

accountability; (c) repeal of legislative provisions which facilitate Government control of bank interest rates, fees and other charges; and (d) revision of current regulations, all through the provision of legal and technical advisory assistance for legislative drafting, implementation, and capacity building.

2. Provision of legal and technical advisory services to: (a) transform the Deposit Protection Fund, the Insurance Commission, the Capital Markets Authority and Retirement Benefits Authority into autonomous agencies; and (b) improve the liquidation processes of the Deposit Protection Fund; all through the provision of legal and technical advisory assistance in implementation and capacity building.

3. Establishment of an effective regulatory and supervisory framework for savings and credit co-operatives and micro-finance institutions, including: (a) provision of support for drafting of legislations and regulations; (b) planning for effective implementation of the new framework; and (c) development of appropriate regulatory capacity; all through the provision of legal and technical advisory assistance for implementation and capacity building.

4. Carrying out of activities to achieve specific legislative changes, including: (a) enhancement of the management information systems; (b) capacity building of staff; and (c) increasing information sharing and coordination of activities among the regulators; all through the acquisition of goods and equipment and provision of technical advisory assistance and training.

Part D: Strengthening Debt Management and Debt Markets

1. Strengthening central government debt management including: (a) provision of a full diagnostic of the strategic options; (b) establishment of a comprehensive debt database and debt recording system; (c) establishment of a unified and sustainable debt management office, including review of relevant legislation; (d) drafting a new public debt management law; (e) an assessment of required staff capacity; and (f) establishment of a central security depository system, all through the acquisition of goods and equipment and provision legal and technical advisory assistance and training.

2. Restructuring the primary markets including: (a) preparation of an institutional survey; and (b) preparation of recommendations on phasing in new benchmarks all through the provision of technical advisory assistance.

3. Restructuring the secondary market for government securities, including: (a) development and implementation of rules and regulations to facilitate over-the-counter trading in government securities; (b) development of a proposal for a primary dealer system which includes a securities lending facility as well as oversight and prudential issues; (c) facilitation of a workshop on primary dealer operations, regulatory compliance and other issues related to the primary dealership; and (d) provision of training for central

bank staff and an internal operations manual for the primary dealership, all through the provision of technical advisory assistance and training.

4. Provision of support for money market development including establishment of a money market index, contribution parameters and dissemination procedures, all through the provision of technical advisory assistance and training.

Part E: Modernizing the National Payments System

Acquisition and implementation of new RTGS system, including: (a) provision of support for CBK to acquire a modern scripless security settlement and central depository system; (b) reviewing and development of adequate legal and regulatory framework and mechanisms for effective oversight by the CBK; and (c) development of payments and securities system reform, all through the provision of technical advisory assistance and training.

Part F: Improving the Lending Environment

Enhancement of the environment in which banks and other institutions extend credit, including: (a) improving and streamlining of processes in the Borrower's Department of the Registrar General; (b) amendment of necessary laws such as the Companies Act; (c) development of a new unified system of creating and registering charges; (d) establishment of a legal and regulatory framework to support the operation of private credit reference bureaus; (e) transforming the manual land records into a digital format; and (f) development and implementation of appropriate rules for the taxation of leasing through provision of assistance to Kenya Revenue Authority, all through the acquisition of goods and equipment and provision of technical advisory assistance and training.

Part G: Legal and Judicial Reform

1. Carrying out activities related to judicial reform, including: (a) reviewing and analysis of the existing procedures for court and case management and records management systems; (b) automation of court and case management through the acquisition of equipment, software and provision of training; (c) establishment of small claims court system; (d) reviewing the policy institutional framework on judicial education; (e) development of a comprehensive judicial education program; (f) introduction of a summary court procedure for uncontested debt enforcement; and (g) implementation of a pilot judicial education program on financial and commercial law, all through the acquisition of goods and equipment and provision of technical advisory assistance and training.

2. Strengthening the law reform process, including but not limited to: (a) reviewing, amendment and dissemination of information on laws in the financial and commercial sectors; (b) increasing accessibility to updated legal information to the public and private

sectors; (c) development of the capacity of the Borrower's Law Reform Commission, Office of the Parliamentary Counsel, Office of the Attorney General, Ministry of Justice and Constitutional Affairs, and Parliamentary Service Commission through an in-house training program to improve legal drafting and legal research skills; (d) provision of technical assistance for drafting of priority bills, and development of a sustainable, participatory approach to law reform; (e) provision of assistance for updating of the laws and law reports; and (f) development of a publicly accessible legal information system, all through the acquisition of goods and equipment and provision of technical advisory assistance and training.

3. Strengthening the legal education system, including: (a) strengthening basic university legal education and continuing legal education for lawyers, judges and magistrates; (b) revision of admission, graduation and bar membership standards; (c) provision of support to the Borrower's Council of Legal Education on the review of curricula for the national legal training institutions; (d) development of specialized courses in financial and commercial law and legal drafting; (e) professional development of law faculties; and (f) acquisition of books, periodicals for a law school commercial law library and publication of teaching materials, all through the acquisition of goods and equipment and provision of technical advisory assistance and training.

* * *

The Project is expected to be completed by September 30, 2009.

SCHEDULE 3

Procurement

Section I. General

A. All goods and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

B. All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and with the provisions of this Schedule.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Association of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods and Services (other than Consultants' Services)

A. International Competitive Bidding.

1. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding. The provisions of paragraphs 2.55 and 2.56 of the Procurement Guidelines, providing for domestic preference in the evaluation of bids, shall apply to goods manufactured in the territory of the Borrower.

2. The following provisions shall apply to goods to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Section II.

Grouping of contracts

To the extent practicable, contracts for goods shall be grouped in bid packages estimated to cost \$150,000 equivalent or more each.

B. Other Procurement Procedures

1. Limited International Bidding. Goods which the Association agrees can only be purchased from a limited number of suppliers may be procured under contracts awarded on the basis of Limited International Bidding.

2. National Competitive Bidding. Goods estimated to cost less than \$150,000 equivalent per contract may be procured under contracts awarded on the basis of National Competitive Bidding.

3. Shopping. Goods estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded on the basis of Shopping.

4. Direct Contracting. Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$100,000 equivalent per contract may comprise entirely national consultants.

B: Other Procedures

1. Quality-based Selection. Services for assignments which the Association agrees meet the requirements set forth in paragraph 3.2 of the Consultant Guidelines may be procured under contracts awarded on the basis of Quality-based Selection in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Selection Under a Fixed Budget. Services for assignments which the Association agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

3. Least-cost Selection. Services for assignments which the Association agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

4. Selection Based on Consultants' Qualifications. Services estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

5. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

6. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis.

Section IV. Review by the Association of Procurement Decisions

Except as the Association shall otherwise determine by notice to the Borrower, the following contracts shall be subject to Prior Review by the Association: (a) each contract for goods or services (other than consultants' services) procured on the basis of International Competitive Bidding, Limited International Bidding or National Competitive Bidding; (b) each contract for goods estimated to cost the equivalent of \$150,000 or more; (c) each contract for consultants' services provided by an individual estimated to cost the equivalent of \$50,000 or more; and (d) each contract for consultants' services provided by a firm estimated to cost the equivalent of \$100,000 or more. All other contracts shall be subject to Post Review by the Association.

SCHEDULE 4

Implementation Program

Section I: General Provision

1. The Borrower shall prepare, in form and substance satisfactory to the Association, furnish to the Association, and thereafter implement the Project in accordance with the procedures, guidelines, timetables and criteria set forth in the PIP and AFAM, and, except as the Association shall otherwise agree, the Borrower shall not amend, abrogate or waive any provision thereof if, in the opinion of the Association, such amendment, abrogation or waiver may materially and adversely affect the implementation of the Project.

Section II: Reviews, Supervision, and Coordination

2. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators specified in Schedule 5 to this Agreement, the carrying out of the Project and the achievement of the objectives thereof;

(b) 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

(c) 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.

Section III: Institutional Framework

3. Overall Project Management and Coordination: The Borrower shall establish and thereafter maintain throughout the period of Project implementation a Project Steering Committee chaired by a high level official of the Ministry of Finance and comprising of representatives of the CBK, Ministry of Justice and Constitutional Affairs, and the Association and DFID, as observers, for purposes of providing policy guidance, and ensuring coordination and supervision in the implementation of the Project. Decision making by the Committee will be reached on the basis of consensus. However in the event

of a failure to reach consensus, simple voting will be employed by the representatives with the chair of the committee retaining a casting vote. The Project Steering Committee may from time to time include other members from the beneficiary agencies or other Government agencies depending on the issue being discussed.

4. Daily Project Implementation: The Borrower shall establish and thereafter maintain throughout the period of Project implementation a Project Implementation Unit (PIU). The PIU shall be responsible for the day-to-day implementation of the Project, including, *inter alia*:

(a) assessing and prioritizing project proposals prepared by beneficiary institutions;

(b) undertaking quality control of terms of reference once a project proposal has been approved by the Project Steering Committee;

(c) overseeing project implementation activities;

(d) administering project funding and procurement processing (including the employment of consultants) and managing the Project Account and the Special Account;

(e) following up on the agreed financial covenants and disbursement conditions;

(f) proposing any necessary adjustments and amendments to implementation methods;

(g) providing quarterly and annual project progress reports, including documents related to Project Steering Committee meetings, such as background information and minutes of deliberation;

(h) acting as the focal point of contact between the Government of Kenya and the Association during the project implementation period; and

(i) liaising closely with the various Implementing Agencies to ensure the Project Activities are implemented effectively.

5. Technical Implementation Arrangements: Except as the Association shall otherwise agree, the Borrower, for the duration of the Project implementation, shall fully integrate, in a form satisfactory to the Association, the Project implementation functions into the structures of its Ministry of Finance.

SCHEDULE 5

Performance Indicators

For the purposes of this Agreement, the performance indicators to be used for the Project implementation are as follows:

1. Percentage of population with access to appropriate financial services increases by 20%.
2. Increase in private credit provision relative to the Gross Domestic Product (GDP) by 30%.
3. The ratio of non-performing loans to the total loan portfolio of the banking system is reduced to less than 10%.
4. Spread between average deposit rate and lending rate for prime customers decreased by 30%.
5. Reduction of backlog in commercial cases by 25%.
6. Appropriate adoption of key commercial sector laws.
7. Increase in measured satisfaction of the business community with the judiciary by 25%.