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LEGAL PRACTITIONERS

DEBT SUSTAINABILITY

IN THE WAKE OF ZAMBIA'S DEBT RESTRUCTURE

WHAT LENDERS NEED TO KNOW

Zambians can finally breathe a sigh of relief as the outline of a deal aimed at lifting the country out of its debt crisis have been unveiled.

The restructure, future borrowings by the Government of the Republic of Zambia (the "Government") and reporting must be implemented in line with the Zambian Constitution and the newly enacted Public Debt Management Act No 15 of 2022 (the "PDM") that aims at ensuring sustainable, transparent and accountable borrowing.

It is important to ensure that in the wake of Zambia's debt restructure, all state institutions and public bodies restructuring debt or raising any future loans do this in accordance with the Constitution and the PDM.

In 2020, Zambia became the first African country to default on its sovereign debt during the COVID-19 pandemic and has struggled since then with protracted discussions with various lenders under the G20 Common Framework Zambia. This landmark achievement is a significant step towards restoring Zambia's long-term debt sustainability.

Zambia has now successfully agreed new repayment terms with its state creditors of up to $6.3bn debt, including over $4bn owed to China. Although the details of the deal have not yet been released, it appears that Zambia will be granted an extended repayment time of over 20 years, including a three-year grace period with interest-only payments. The Ministry of Finance has reported that the specific terms of the agreed treatment will be further described and formalized in a memorandum of understanding between Zambia and official creditors, which will be implemented through bilateral agreements.

The revised terms make the burden of servicing the debts more manageable, reducing the risk of default and preserving the government's creditworthiness. Additionally, by demonstrating commitment to resolving its debt issues, Zambia becomes an increasingly attractive destination for foreign direct investment.

Key legislation regulating Zambia's public debt

The Constitution, being the supreme law of the Republic of Zambia, gives the Government the power to raise loans for itself, state organs and state institutions and also issue guarantees in accordance with an Act of Parliament.

The Constitution requires that the Act of Parliament relating to the contraction or guarantee of loans by the Government must provide, amongst other issues, the class of loans that require approval by the National Assembly, these include:

(a) loans not captured in the annual borrowing plan that the Minister of Finance (the "Minister") is required to prepare every year;

(b) loans raised by public bodies, which includes parastatals and state-owned institutions, from outside Zambia; and

(c) sovereign guarantees issued by the Minister.

Previously the legislation that regulated the contraction, or guarantee of loans, by the Government of the Republic of Zambia was the Loans and Guarantees (Authorisation) Act Chapter 366 of the Laws of Zambia and the General Loan and Stock Act Chapter 350 of the Laws of Zambia (the "Old Acts") which had outlived their purpose. Many critics argue that these laws were not sufficient to ensure that Zambia was (a) borrowing in a sustainable manner, (b) debt was being managed prudently and (c) there was transparency in the manner and amount of debt that the Government was contracted, which the PDM is meant to address.

Partly to address these concerns, the PDM repealed the Old Acts to create a new regime in relation to raising debt by the Government and state institutions, which include:

- the requirement for the Minister to prepare a yearly medium-term debt strategy – to address prudent and transparent management of debt;

- the requirement for the Minister to prepare, and for the National Assembly to approve, an annual borrowing plan ("ABP");

- the establishment of the Debt Management Office – a specific statutory office to manage debt;

- the requirement for public bodies, which includes state-owned enterprises, to obtain approval from the Secretary to the Treasury to raise a loan or issue a guarantee;

- the limitations on raising loans and issuing guarantees based on Zambia's gross domestic product to address sustainable borrowing;

- creating an offence of financial misconduct if stakeholders do not adhere to requirements in the PDM; and

- clearly stipulating that any loans or guarantees that are not implemented in accordance with the PDM are void making every stakeholder accountable to ensure that all the procedures are met.

The limitations on the Minister of Finance's power to borrow

The Minister, with the approval of the National Assembly, is responsible for raising finances and issuing sovereign guarantees. The PDM also specifically provides that the Minister can extend the tenor of an existing loan, except that the terms and conditions of the amended loan shall not be less favorable than the terms and conditions of the existing loan. It will be important to ensure that this is adhered to in Zambia's debt restructure.

The PDM limits the total amount that the Minister may borrow on behalf of Government. This total amount must not exceed 65% of the total gross domestic product and the aggregate amount of debt service cost due and payable in a financial year for outstanding debt shall not exceed 20% of the average annual recurrent revenue computed based on the 3 preceding financial years. These two specific limitations on the Minister's borrowing powers will only apply after 5 years from commencement of the PDM.

In addition to these limitations, this power must be exercised in line with the annual borrowing plan and the Medium-Term ebt Strategy (the "Debt Strategy") both of which must be approved by the National Assembly and are specifically discussed below.

However, the constraints placed on the constraints placed on the Minister's borrowing powers do not apply to natural disasters, public emergencies, and exceptional expenditure in accordance with the National Planning and Budgeting Act No 1 of 2020.

The Old Acts did not have similar limitations on the borrowing powers of the Minister. This is indeed a progressive move aimed at ensuring the prudent contraction of sustainable debt.

Establishment of Debt Management Office

Under the Old Acts, there was no specific statutory office, or obligation, placed on any public body or person in the management of debt in Zambia. Generally, this was a function of the Ministry of Finance. Public Debt Management Department. However, the PDM now creates a Debt Management Office, within the Ministry of Finance, responsible for public debt management and the negotiation of loan agreements and guarantees by the Government.

The Debt Management Office is headed by a director who reports to the Permanent Secretary of the Ministry of Finance. The Debt Management Office has the statutory mandate to assist the Minister in its functions of raising debt and issuing sovereign guarantees.

Transparency and Accountable Debt Management

The PDM makes it mandatory for several reports to be prepared, and approved by various stakeholders, in the raising, reporting or management of debt which creates a transparent accountable framework for the contracting and reporting of Government debt.

The primary report that is required to be prepared is the Debt Strategy of Zambia which deals with public debt. The Debt Strategy must be approved by Cabinet and must be updated yearly. The Debt Strategy must be published every second Friday of July in each year thus making Government debt contraction transparent and accountable.

Secondary reports include:

(a) annual borrowing plan – the Debt Management Office is required to prepare an annual borrowing plan that is presented to the Minister. The Minister then presents this plan to the National Assembly for approval. The annual borrowing plan must consist of the total borrowing needs and the maximum limit that the Government intends to borrow for the next financial year, thus creating a yearly debt ceiling, amongst other information. Once the annual borrowing plan is approved by the National Assembly, the Minister can then contract debt up to that limit and subject to limitations discussed above. If the Government wishes to contract additional debt not contained in the annual borrowing plan, then National Assembly approval must be obtained specifically for such borrowings. In light of this, it will be important to ensure that all these approvals are obtained to guarantee the legality of each borrowing.

(b) debt sustainability reports and bulletins - Every year the Minister is required to conduct a debt sustainability analysis. This analysis is an assessment of the manner in which Zambia's current level of public debt and prospective borrowing affects the present and future ability to meet debt service obligations. The analysis must be published by the end of the first quarter of the following financial year. In addition to this analysis, the Minister is required to prepare, and publish, in every quarter of the year, a debt statistical bulletin which generally gives an overview of the Government's debt position.

(c) the annual public debt, guarantees and grants execution report (the "Debt Report") – the Minister is required to prepare the Debt Report within 3 months at the end of every financial year, for submission to the National Assembly, which must be published within 30 days. The Debt Report provides a review of the debt position of Zambia and if there has been a deviation of the Debt Strategy, the justification for such deviation, amongst other issues.

(d) public bodies, including parastatals and state-owned enterprises, quarterly reporting – public bodies are required to submit quarterly reports to the Minister which is a statement of total debt and any other information relating to public

These reporting requirements under the PDM create a robust framework for transparency and accountability of debt management, to the National Assembly and the public making the Government more accountable in its debt contraction. The reporting obligations are aimed at addressing the concerns raised by critics and lenders that there was no adequate framework to ensure that the Government was reporting debt that is accurate and backed by the law with adequate punishment.

Borrowing by public bodies and state-owned enterprises

The PDM now specifically deals with borrowing not only by public bodies, but by state-owned enterprises as well.

The PDM requires that were public debt to a public body, which includes a parastatal or state-owned enterprise, is raised locally, it must be approved by the Secretary to the Treasury following an assessment that shows that the public body has the financial capacity to repay the loan. Breach of this requirement is an offence which is punishable by either a fine not exceeding ZMW 150,000 or imprisonment of up to 5 years, or both and the contract is void.

Where a public body intends to raise a loan from outside Zambia, it must first submit a proposed external borrowing plan for that financial year, which is assessed for credit risk by the Debt Management Office, to the Minister. This external borrowing plan is submitted together with the Government's annual borrowing plan for approval of the National Assembly.

Sovereign guarantees

In addition to the borrowing powers, the Minister, has the power to issue guarantees, subject to approval by the National Assembly but only for the benefit of the following institutions:

(a) a public utility;

(b) a body corporate established by an Act of Parliament;

(c) a local authority; and

(d) an entity that the Government owns shares in, either directly or indirectly.

(the above will be defined as the "Beneficiary")

This means that the only projects that the Government can guarantee are those implemented by Beneficiaries.

The PDM now requires that prior to the issuance of a sovereign guarantee, the Minister must be satisfied that the Beneficiary can pay the loan based on a credit risk assessment and the purpose for the guaranteed loan is a project under a National Development Plan formulated in accordance with the National Planning and Budgeting Act No 1 of 2020.

Sovereign guarantees attract a fee between 0.5% and 2% of the guaranteed amount payable by the Beneficiary to the Zambian Consolidated Fund. However, this fee can be exempt by statutory instrument passed by the Minister.

The PDM also limits the quantum of how much can be guaranteed by Government to nothing more than 10% of the gross domestic product (the "Sovereign Guarantee Limitation") based on the immediate past financial year. The Sovereign Guarantee Limitation will only apply after 5 years from commencement of the PDM. A sovereign guarantee will not be valid if issuedto guarantee an obligation above the Sovereign Guarantee Limitation. Previously, the limit to the ceiling of what could be guaranteed by the Government was set by National Assembly and not linked to the gross domestic product of the country.

Consequences of contracting debt in breach of the Public Debt Management Act

Under the Old Acts, there was no prescription for any breach. However, the PDM provides that all loans by Government or public bodies must be raised in accordance with its provisions or any other written law which specifically authroises the raising of the loan. Breach of this provision will not create binding obligations on the Government or the public body.

Further, wilful or negligent breach of a power or a duty by a public officer or a person in a public body is a financial misconduct, which can lead up to prosecution.

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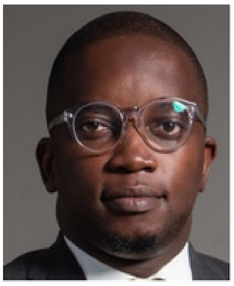

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