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**IMMEDIATE
ATTENTION**

EBS/99/240

CONFIDENTIAL

December 30, 1999

To: Members of the Executive Board

From: The Secretary

Subject: **Poverty Reduction and Growth Facility—Proposed Borrowing
Agreement with the Kreditanstalt für Wiederaufbau (KfW) of Germany**

Attached for consideration by the Executive Directors is a paper on the Poverty Reduction and Growth Facility—Proposed Borrowing Agreement with the Kreditanstalt für Wiederaufbau (KfW) of Germany.

It is not proposed to bring this matter to the agenda of the Executive Board for discussion unless an Executive Director so requests by noon on Friday, January 7, 2000. In the absence of such a request, the draft decision that appears on page 3 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter.

Mr. Menon (ext. 37640) and Mr. Elizalde (ext. 37796) are available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

**Poverty Reduction and Growth Facility (PRGF)—Proposed
Borrowing Agreement with the
Kreditanstalt für Wiederaufbau (KfW) of Germany**

Prepared by the Treasurer's and Legal Departments

(In consultation with the Policy Development and Review Department)

Approved by Eduard Brau and François P. Gianviti

December 30, 1999

I. INTRODUCTION

1. In response to a request for additional loan resources for the Loan Account of the Poverty Reduction and Growth Facility (PRGF) Trust¹, the Kreditanstalt für Wiederaufbau (the "KfW") of Germany has agreed to lend to the Fund, as Trustee of the PRGF Trust, the equivalent of SDR 350 million for the purpose of providing resources to the Loan Account of the Trust. Germany has provided both loan resources and subsidy contributions to the Trust since its inception. This paper presents the attached draft of a new borrowing agreement for approval by the Executive Board. The terms and conditions for the proposed agreement, which are basically the same as those of the 1994 agreement between the KfW and the Fund as Trustee of the PRGF Trust, are consistent in all respects with the general provisions that have been agreed for the Trust's borrowing operations.

II. PRINCIPAL ELEMENTS OF THE PROPOSED BORROWING AGREEMENT

2. **Drawings.** Paragraph 1 of the proposed borrowing agreement provides for drawings to be made through December 31, 2003, and specifies that the Trustee will seek normally to make drawings in amounts that are not less than SDR 20 million.

3. **Denomination and Media.** Loan commitments and operations are to be denominated in SDRs. Disbursements by the KfW would be made by the transfer of the equivalent amount of U.S. dollars, the euro as the currency of Germany and France, Japanese yen, and pounds sterling, in proportion to the amounts of each currency unit in the SDR (paragraph 2).

¹On October 21, 1999, the Executive Board decided to rename the Enhanced Structural Adjustment Facility (ESAF) as the "Poverty Reduction and Growth Facility" (PRGF) and to change the objectives of the renamed facility (EBS/99/193, 10/14/99). The decision became effective on November 22, 1999.

Similarly, payments of principal and interest by the Trust will be made by crediting the accounts of the KfW with the equivalent amount of the four currencies in proportion to the amounts of each currency unit in the SDR (paragraph 6).

4. **Maturity.** As the KfW's loans to the Trust will continue to be funded through short term borrowings in the money markets of the four currencies that make up the SDR basket, the proposed agreement provides for the KfW to renew its loans to the Trust at the end of each six-month maturity period, with final maturities of 5 1/2–10 years (paragraph 3). Paragraph 3 also deals with situations in which the KfW may be unable to agree to a requested renewal because of the unavailability of a currency or currencies at the time of a renewal. The memorandum of understanding, which is appended to (and is a part of) the proposed borrowing agreement is for purposes of clarification and does not alter the obligations of either party under the agreement.

5. **Interest.** The agreement provides for drawings to earn interest at the six-month SDR rate (paragraph 4).

6. **Suspension of Drawings in the event of nonpayment by the Trust.** In the event that any installment of principal or interest is not paid within a period of ten days after its due date, paragraph 1(d) of the proposed agreement provides for the suspension of further drawings pending consultations on this matter with the KfW.

7. **Transfer of claims.** Provision is made in the agreement for the voluntary transfer of claims on the Trust (paragraph 7).

8. This further contribution by Germany to the PRGF Trust is most welcome. The staff considers that the proposed borrowing agreement between the Kreditanstalt für Wiederaufbau and the Fund, as Trustee of the PRGF Trust, for the Loan Account of the Trust is consistent with the provisions of the PRGF Trust Instrument. Accordingly, the following decision is proposed for adoption by the Executive Board.

Proposed Decision

Pursuant to Section III, Paragraph 2 of the Instrument to Establish the Poverty Reduction and Growth Facility Trust, the International Monetary Fund, in its capacity as Trustee of that Trust, approves the terms of the agreement for borrowing from the Kreditanstalt für Wiederaufbau set out in the attachment to EBS/99/240, and authorizes the Managing Director to take such action as is necessary to conclude and implement the agreement.

Attachments

Dear Mr. Klein:

Reference: Poverty Reduction and Growth Facility: Proposed Borrowing Agreement with the Kreditanstalt für Wiederaufbau (KfW)

I have been authorized to propose on behalf of the International Monetary Fund (the "Fund") as Trustee (the "Trustee") of the Poverty Reduction and Growth Facility Trust (the "Trust") that Kreditanstalt für Wiederaufbau (the "KfW") agree to lend to the Fund as Trustee for the purposes of providing resources to the Loan Account of that Trust, in accordance with the Instrument establishing the Trust (the "Instrument") adopted by the Executive Board of the Fund by Decision No. 8759-(87/176) ESAF, adopted December 18, 1987. The amount of the loan is to be the equivalent of SDR 350 million and the terms and conditions of this loan shall be as follows:

1. (a) The Trustee may make drawings under this agreement at any time during the period from the effective date of this agreement through December 31, 2003, upon giving the KfW at least ten business days' notice by tested telex.

(b) Unless otherwise agreed between the Trustee and the KfW, the Trustee shall seek normally to make drawings in amounts not less than SDR 20 million.

(c) Under exceptional circumstances, a drawing may be canceled by the Trustee or the KfW by tested telex at least five business days (Frankfurt a.M.) before the date of the drawing, such notice to be received not later than 12:00 noon (Frankfurt a.M.) in case of cancellation by the Trustee or 9:00 a.m. (Washington, D.C.) in case of cancellation by the KfW.

(d) If any amount of principal or interest due to the KfW is not paid within a period of ten days after the due date, the Trustee shall not make further drawings under this agreement, pending consultations with the KfW on the matter. However, the Trustee may resume drawings under this agreement once arrears to the KfW have been paid.

2. The amount of each drawing shall be denominated in SDRs. Unless otherwise agreed between the Trustee and the KfW, the amount shall be paid by the KfW, on the value date specified in the Trustee's notice, by transfer of the equivalent amount of U.S. dollars, the euro as the currency of Germany and France, Japanese yen, and pounds sterling in proportion to the amounts of each currency unit in the SDR, to the accounts of the Trust as specified in the Trustee's notice.

3. (a) Drawings shall be for maturity periods of six months. The Trustee may request that all or part of each drawing be similarly renewed on giving notice as provided in

paragraph 1(a), subject to the provisions of paragraph 3(c). The KfW shall consider sympathetically and is expected to agree to such requests.

(b) In the event that the KfW is unable to agree to a requested renewal, it shall inform the Trustee accordingly at least three business days that are also business days in Washington, D.C. and Basle before the date of that renewal, such notice to be received not later than 12:00 noon (Washington, D.C.). The Trustee shall repay the relevant drawing on the date of due renewal. In any event the KfW shall provide a renewed drawing of an equal amount six months after the date of due repayment or at such earlier time as may be agreed between the KfW and the Trustee. In the event that the KfW provides a renewed drawing at such earlier time, that drawing shall mature six months after the date of due repayment.

(c) One tenth of the amount of each drawing shall become finally due and payable and no longer subject to renewal under paragraph 3(a) five and one-half years following the date of the drawing, and a further one tenth of each original drawing will similarly become due and payable at the end of each succeeding period of six months through the tenth year following the date of the drawing. Repayments by the Trustee shall be made on the relevant maturity date.

4. (a) The amount outstanding in respect of each drawing, including any amount that may not have been paid on its due date, shall bear interest at an annual rate determined two business days before each drawing according to the definition in the Annex to this agreement, from the product of:

(i) U.S. dollar-rate on six-month certificates of deposit, the euro as the currency of Germany—six-month interbank rate, the euro as the currency of France—Euribor, Japanese yen—LIBOR, as well as pound sterling—LIBOR, as defined in the Annex to this agreement; and

(ii) the percentage weight of that currency in the valuation of the SDR on that business day, calculated by using the same amounts and exchange rates for currencies as are employed by the Fund for calculating the value of the SDR in terms of the U.S. dollar on that day.

The applicable interest rate shall be the sum of the products so calculated, plus 0.10 percentage points, rounded to two decimal places.

(b) Subject to paragraph 4(c), interest in respect of each drawing shall be paid six calendar months after the drawdown date for each drawing or each respective renewed drawing. In the event a renewed drawing is for a period of less than six months, interest shall be paid at the end of that shorter period.

(c) If the Fund changes the method of valuing the SDR, interest in respect of each drawing shall be paid:

(i) on the second business day after the effective date of the change, the interest payable to be calculated on the balance outstanding from the drawdown date for each drawing or each respective renewed drawing till that interest payment date; and

(ii) six calendar months after the drawdown date for each drawing or each respective renewed drawing, the interest payable to be calculated on the balance outstanding from the second business day after the effective date of the change till that interest payment date.

5. Interest shall be computed on the basis of actual days divided by 360 days.

6. Unless otherwise agreed between the KfW and the Trustee, payments by the Trustee shall be made by crediting the equivalent amount of U.S. dollars, the euro as the currency of Germany and France, Japanese yen, and pounds sterling, in proportion to the amounts of each currency unit in the SDR, to the accounts of the KfW as specified by the KfW in advance of such payments.

7. (a) The KfW shall have the right to transfer at any time all or part of any claim to any member of the Fund, to the central bank or other fiscal agency designated by any member for purposes of Article V, Section 1, or to any official entity that has been prescribed as a holder of SDRs pursuant to Article XVII, Section 3 of the Fund's Articles of Agreement.

(b) The transferee shall, as a condition of the transfer, notify the Trustee prior to the transfer that it accepts the obligations of the KfW relating to the transferred claim with respect to drawings and renewal of drawings under paragraphs 3(a) and 3(b), and shall acquire all the rights of the KfW under this agreement with respect to repayment of and interest on the transferred claim.

8. In the event that the KfW will be indemnified by any guarantor, the KfW reserves the right to convey to the guarantor its rights with respect to payments of principal and interest to the extent that the guarantor has indemnified the KfW. Unless otherwise requested by the KfW, payments shall continue to be made to the KfW.

9. If the Fund changes the method of valuing the SDR, all transfers, exchanges and payments of principal and interest made three or more business days after the effective date of the change shall be made on the basis of the new method of valuation.

10. (a) If any payment due under this agreement matures on a date that is not a business day, the maturity date shall be on the following business day.

(b) Except as otherwise provided for in this agreement, "business day" means a day on which commercial banks are open for domestic and foreign exchange business in Frankfurt a.M., New York, Paris, London, and Tokyo.

11. Any question arising hereunder shall be settled by mutual agreement between the KfW and the Trustee.

If the foregoing proposal is acceptable to the KfW, this communication and your duly authenticated reply accepting this proposal shall constitute an agreement between the KfW and the Trustee. This agreement shall enter into effect on the date the Trustee acknowledges receipt of the KfW's communication that the Federal Republic of Germany has extended a guarantee in respect of the Trustee's payment obligations under this agreement.

Yours sincerely,

The Managing Director

Mr. Rudolf Klein
Kreditanstalt für Wiederaufbau
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60325 Frankfurt am Main
Germany

Definitions

1. (a) **U.S. dollar rate on six-month certificates of deposit:**

The rate on six-month certificates of deposit, as reported by the United States Federal Reserve, adjusted to reflect an annualized return using a 365-day year.

(b) **The euro as the currency of Germany—six-month interbank rate:**

The rate calculated by the Bundesbank as the middle rate derived from the six-month domestic interbank money market rates which the Bundesbank has ascertained in the Frankfurt market.

(c) **The euro as the currency of France—Euribor:**

The rate at which euro interbank term deposits are offered for a period of six months within the European Monetary zone by one prime bank to another at 11:00 a.m., Brussels time.

(d) **Japanese yen—Libor:**

The rate for deposits in yen which is endorsed by the British Bankers' Association. This rate will be determined on the basis of the rates at which deposits in yen are offered by major banks at approximately 11:00 a.m., London time, to prime banks in the London interbank market for a period of six months or approximately.

(e) **Pound sterling—Libor:**

The rate for deposits in sterling which is endorsed by the British Bankers' Association. This rate will be determined on the basis of the rates at which deposits in sterling are offered by major banks at approximately 11:00 a.m., London time, to prime banks in the London interbank market for a period of six months or approximately.

2. If the Fund changes the method of valuing the SDR or a renewed drawing is provided for a period of less than six months, the above-mentioned rates for six months or approximately shall be replaced by the rates described in paragraph 1 above that correspond to the relevant period as defined in paragraph 4(c) of the agreement or established pursuant to paragraph 3(b) of the agreement, as the case may be. If the relevant periods do not correspond to such quotations, the interest rate for the next higher period available, or such lower rate as the KfW may be able to obtain using its best efforts, shall be made applicable.

3. If more than one rate is quoted in respect of the relevant period as defined in paragraph 4(c) of the agreement or established pursuant to paragraph 3(b) of the agreement, as the case may be, the arithmetic mean of the rates shall be rounded up to the nearest multiple of 1/10,000 percent.
4. If it is determined that an interest rate has been established under paragraph 4 of the agreement on the basis of rates incorrectly reported, an appropriate adjustment shall be made.
5. The KfW and the Managing Director, on behalf of the Trustee, shall agree on the information vendors that shall be used in the collection of each interest rate mentioned in paragraphs 1(a) and 1(c) to 1(e) above.

Memorandum of Understanding

The purpose of this memorandum is to clarify the meaning of certain provisions of the borrowing agreement dated () between the Kreditanstalt für Wiederaufbau (the "KfW") and the Fund as Trustee (the "Trustee") of the Poverty Reduction and Growth Facility Trust (the "Trust"), which stem from the basic fact, that the KfW will have to raise its funds in the money markets to which it may not always have free access.

1. Lending by the Trust is for maturity periods of 5 1/2 to 10 years. Any loan to the Trust must be extended for these same maturity periods. Even when a loan is financed from short-term renewable drawings, the cumulative maturities of the successive drawings are 5 1/2 to 10 years. Thus, as reflected in the text of paragraphs 3(a) and 3(b) of the agreement, the renewal of a drawing at the request of the Trustee is the normal course of action to which the KfW is committed. The only exception is the lender's inability to renew, as provided in paragraph 3(b). This exception may be invoked by the lender only after every effort has been made on its part to renew the drawing. Moreover, any nonrenewal is of a temporary nature: the drawing must be restored six months after the nonrenewal or at such earlier date as may be agreed. Any nonrenewal is related to a specific drawing and to the special circumstances faced by the lender at the time of the requested renewal of that drawing. There can be no systematic nonrenewal of all outstanding drawings. As for the periodic review of the valuation of the SDR, it is inherent in a SDR-denominated borrowing agreement and thus cannot justify a nonrenewal.

2. (a) Paragraph 3(b) of the borrowing agreement contemplates the case where the KfW is "unable" to agree to a requested renewal. The meaning of "inability" has to be understood in the context of this agreement. The KfW is obligated to provide the equivalent of the relevant SDR amount upon each renewal. As it will fund its disbursements to the Trust in the financial markets for the currencies constituting the SDR basket in the respective amounts reflecting the composition of the SDR basket, it may face a situation in which one or more of these currencies is unavailable to it. In the context of the borrowing agreement, inability to agree to a renewal is understood as being caused by the unavailability to the KfW of one or more of the currencies constituting the SDR basket, at the time of renewal.

(b) Unavailability to the KfW of one or more currencies constituting the SDR basket would constitute an "exceptional circumstance" within the meaning of paragraph 1(c), under which the KfW may cancel a drawing by the Trustee at least five business days before the date of the drawing.

3. A currency would be considered unavailable to the KfW if the KfW is unable to obtain that currency in the corresponding financial market because of a governmental decision, or because access to that financial market is denied to the KfW for other reasons beyond the control of the KfW.

4. The obligation of the KfW to restore a drawing six months after the date of repayment in the event of nonrenewal is not affected by the unavailability of one of the currencies

constituting the SDR basket at that time. It is not expected that a situation of unavailability would persist for an extended period. Should such unavailability, however, extend beyond a period of six months following a nonrenewal, the KfW and the Trustee would have to discuss that situation and seek to find a solution by mutual agreement in accordance with paragraph 11 of the borrowing agreement under which any question arising under the agreement shall be settled by mutual agreement between the KfW and the Trustee. The Trustee, in considering solutions to the KfW's funding constraints, would also take into account the Trust's constraints deriving from its lending and the need to preserve the integrity of its reserve for all lenders to the Loan Account of the Trust on an equal basis in accordance with the provisions of the Instrument establishing the PRGF Trust. Solutions that could be considered would need to be determined in light of circumstances at the time, and could include the following: good offices provided by the Trustee to obtain a waiver of regulations that caused an unavailability or to obtain advances to the KfW of necessary funds from official institutions of the countries whose currencies are unavailable; temporary investment of the requisite amount with the KfW of resources of the Trust and/or the Fund, taking into account considerations of liquidity, yield of the investment and the adequacy of investible resources held by the Trust or the Fund; or, eventually, prolongation of the nonrenewal period. It is understood that prolongation and some forms of investment would require decisions by the Executive Board and consent of other creditors. It is also understood that, for its part, the KfW will explore possibilities for obtaining needed funding from other sources in the event of a situation of unavailability.

