



# State On-lending Policy

Prepared by the Department of Treasury

31<sup>st</sup> May, 2024

## Background

### Previous On-lending

As at 31<sup>st</sup> December 2023, the State had an on-lending balance of K6, 3445.0 million via the Subsidiary Loan Agreements (SLAs). The terms and conditions of these SLAs unfortunately have been individually negotiated with borrowers outside of a policy framework. As such, only around 10% of all on-lent money is likely to be recovered whilst the remaining 90% maybe lost completely. This poor performance by State on-lent loans is caused by a number of factors including the following:

- lending to private firms that are no longer in business or have changed their names and cannot be located;
- lending to six (6) Provincial Governments, all of whom have defaulted with only one having made any repayments at all;
- lack of proper record keeping by the Department of Treasury (DoT); and
- lending to loss making State entities that are unable to make loan repayments.

Given this experience, this On-lending Policy aims to make amendments by lending State loans only on commercial terms and conditions (whether to State entities or private entities). As well, improvements will be made in record keeping, loan repayment capability assessments, and halting Provincial Governments from accessing State on-lent loans.

### Funding and Financing of Development Projects

Development projects are allocated National Government funds as part of the Public Investment Program (PIP) which is administered by the Department of National Planning and Monitoring (DNPM). DNPM will assess the merits of the project against the stated objectives and priorities of the Government's Medium Term Development Plans (MTDPs).

Project proposals are usually submitted by the respective entities (project proponent), who will implement the project. As a key requirement, expected sources of funding are usually included in the project submission.

In the case of loan financing, the lender usually conducts a project evaluation to determine its viability before funding is secured and provided to the project. The DoT assesses whether the financing is consistent with the Government's Medium Term Debt Strategy objectives and guidelines. If it is, negotiations are held between the implementing entity (project proponent), the lender, the DNPM and the DoT to establish the terms of the Loan. In this process, the lender often ensures that the National Government provides part of the project's costs upfront (counterpart funding) before the loan is released to the project implementing entity.

This policy will be applied to the PIP process described above, where the State loans to State entities should be disbursed on a commercial basis. Any subsidy provided by the Government should be strictly in accordance with the existing Community Service Obligations (CSO) Policy.

## 1. Objective

1.1. The overall objectives of this On-lending Policy are:

- a) To protect public finances whilst also supporting economic development;
- b) To ensure transparency and accountability in the analytical and decision making process;
- c) To ensure that any on-lending that is provided, and any applications that are rejected, are done so for sound and justifiable reasons;
- d) To ensure that the justification and documentation for the original borrowing and on-lending and application is available for review and evaluation.

1.2. The intention of this policy is to develop a set of standardised operating procedures governing the application to the State for the Government to onlend loan funding.

## 2. Legal Basis

2.1. The legal basis for on-lending by the State is provided by Article 38 of the Public Finances (Management) Act 1995, which states the following:

**"38. Loans by the State**

- (1) Subject to this section, the Treasurer may, in accordance with the approval of the National Executive Council, for and on behalf of the State, loan funds from any person for a purpose that benefits the State or furthers the interests of the State."
- (2) An approval under Subsection (1) shall-
  - (a) be by way of a notice in writing signed by the Prime Minister; and
  - (b) specify the full and complete terms and conditions of the approved loan; and
  - (c) state the purpose of the loan that benefits the State or furthers the interests of the State; and
  - (d) be published in the National Gazette.
- (3) The Treasurer shall certify, by notice in writing prior to the execution of the borrowing, that a loan under this section was granted on the best available commercial terms.
- (4) A certification under Subsection (3) shall be published in the National Gazette.
- (5) The Treasurer shall, at the first sitting of the Parliament following the execution of the loan, table all documents in his possession relating to the loan and his certification under this section.
- (6) The Treasurer shall, on behalf of the State, charge such fee in respect of a loan made pursuant to this section as he considers appropriate in all of the circumstances in relation to that loan.

2.2. All expenditure under an on-lending arrangement will be included in the National Budget, as no disbursement of funds from the State can be made without a budget appropriation. In addition, any loan will be guided by the Medium Term Development Plan (MTDP), Medium Term Fiscal Strategy (MTFS) and Medium Term Debt Strategy (MTdS).

## 3. Scope

3.1. For the purposes of this policy on-lending is defined as the following:

*"An on-lending arises when the State receives a primary loan from a financial institution and is responsible for making interest payments, principal repayments and payment of fees to that financial institution. The State then passes on the loan principal to a State entity via a Subsidiary Loan Agreement (SLA), that in turn*

*meets the interest payments, principal repayments and payment of fees to the State. The on-lending is on the same terms and conditions as the primary loan subject to the credit risk premium."*

3.2. From the date this policy is given the necessary approval for implementation by the National Government, then all on-lending arrangements should become subject to key requirements and guidelines as prescribed.

## 4. Restrictions & Conditions to On-lending

4.1. All on-lending must be non-transferable.

4.2. The State will only onlend to State Owned Enterprises (SOEs) via a subsidiary loan for:

- a) projects which have been partly or wholly financed by a loan to the State and will be implemented by a State entity (on-lending); and
- b) projects which are partly or wholly funded by general Government revenue and will be implemented by a State entity.

4.2.1. Under this Policy, a State entity is a company, trust or Statutory Authority which is more than 50% owned by the State or more than 40% owned by the State and no other entity owns a greater share than the State. The Policy is also intended to be applicable to funding State entities' participation in Public-Private-Partnerships (PPPs) arrangements.

4.3. With the exception of legislative approved investment activities, the State will not lend to private companies and sub-national Governments as experience shows that they are likely to default on State-loan repayments.

4.4. Treasury Department (DoT) will decline requests by any party that has outstanding arrears on any existing on-lending or previous on-lending, despite the State having paid the debt.

4.5. DoT will refuse any request if the requesting party (entity) has previously defaulted or where the State has taken on any part of their debt. The entity will remain on the list of defaulting entities and becomes ineligible for future on-lending loans for a period of seven (7) years, unless the State is made whole under the on-lending agreement, i.e. all principal and interest amounts owed under the on-lending arrangement to the State, even if the State agrees to forgive the loan.

4.6. DoT will decline any on-lending loan requests if, in its assessment, the entity does not have a reasonable prospect of repaying the loan.

4.7. Government owned entities and statutory authorities cannot on-sell or in any way create a lien against State on-lending.

4.8. Any entity that defaults on its loan repayments to the State as required under this on-lending loan arrangement must provide the following:

4.8.1. current accounts and any other documents requested by the DoT;

4.8.2. a detailed explanation of why they failed to make a payment or have defaulted on payments;

4.8.3. evidence and justification as to whether they remain solvent under section 4 of the *Companies (Amendment) Act 2022*; and

4.8.4. what remedial steps they are going to take to ensure they meet their obligations under the on-lending arrangement.

4.9. If an entity is a wholly owned subsidiary, or has a shareholder that owns a controlling majority of 40% or more, the on-lending arrangement must be guaranteed by the parent company or controlling company, so that State can recover the monies from the parent company in the event that the subsidiary fails to make payments to the State.

## 5. Eligibility

5.1. State entities eligible to apply for a loan under this policy are:

5.1.1. State Owned Enterprises (SOEs) where the State has greater than 50% ownership or greater than 40% ownership and no other entity holds a greater share;

5.1.2. Trustees of SOEs;

5.1.3. Statutory Authorities (SAs).

5.2. Sub-national Governments, including the Local Level Governments (LLGs) are not eligible for on-lending loan arrangements.

5.3. Before the State enters into a SLA with a State entity, there must be a reasonable expectation that the State entity is willing and able to repay the loan. Generally, a State entity will be eligible for a subsidiary loan by meeting the following requirements:

- in each of the two (2) years preceding the loan, the State entity achieves break-even or profit-making financial performance and has positive net operating cash flows;
- the State entity is not in default of an existing loan, this includes on-lending arrangements unless the State entity has finalised a debt restructure for any defaults with FMD (DoT) and has complied with the restructured loan for at least one (1) year;
- the State entity does not have other significant financial obligations which are likely to hinder its ability to repay the State; and
- the State entity has provided DoT with the information listed in 10.4.1 of this policy.

5.4. For a new entity, it is up to the discretion of the DoT to assess its eligibility for on-lending loans. This decision will be based on the entity's viability to make profits.

5.5. In exceptional circumstances, the DoT may consider a loss making State entity eligible for a subsidiary loan. These circumstances must be expected to significantly improve the entity's operating performance such that the entity is expected to earn profits in the future. The circumstances must arise from a transaction or agreement with a party external to the State entity, for example:

- circumstances have arisen which are expected to significantly hinder the entity's performance such that the entity is expected to make losses in the future. Circumstances may include, but are not limited to, a market downturn, undertaking of a large financial commitment, court ruling, regulatory change or natural disaster; or
- the previous two year's positive financial performance were due to exceptional and one-off factors which are not expected to continue into the future.

5.6. Even if the project is suitable for a SLA, DoT will still make the entity ineligible for the loan if it does not have the capacity to repay the loan based on its evaluation. DoT will inform the Government through the Minister of its assessment and decision.

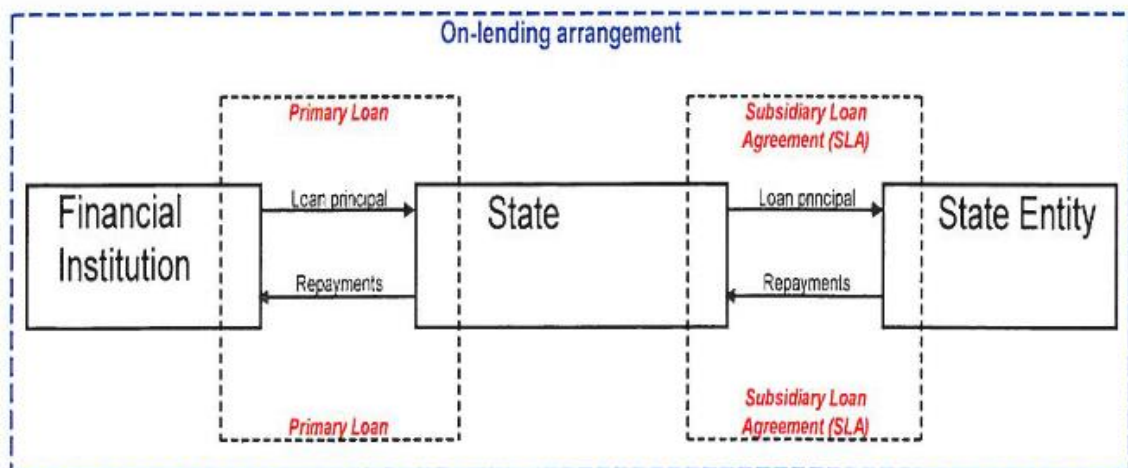
5.7 The Minister of Treasury may, if the Department of Treasury informs him that the project is ineligible for an on-lending arrangement, request the Department have the on-lending request reviewed by an internationally recognised accounting firm for a review of the Department of Treasury’s decision. They must utilise the same material that was available to the Department of Treasury, methodology and criteria. If the review provides a different opinion the Minister may make a decision as to which recommendation to accept.

## 6. What is an On-lending Arrangement?

6.1. An on-lending arises when the State receives a loan from a financial institution and is responsible for making repayments to that financial Institution. The State then passes on the loan principal to a State entity via a Subsidiary Loan Agreement (SLA), that in turn repays the principal to the State. The terms and conditions of the SLA need not correspond with those of the primary loan.

6.2. The primary lender is usually an International Financial Institution that provides finance on concessional terms and conditions, intended for development projects. However, primary lenders can also be commercial domestic financial institutions. Hence, primary loans can be either external or domestic.

### Typical on-lending arrangement



6.3. Often projects are funded from both a primary loan and Government revenue (otherwise known as counterpart funding). Under this Policy the total cost of the project can be lent to the State entity, including the counterpart funding. Hence, the on-lending of the primary loan and lending of counterpart funding will both be governed by the same SLA.

6.4. Related to this policy is the CSO policy, which allows Government to fund a non-economically viable project by a State entity. In this instance, CSO payments will be made under a CSO contract that clearly sets out how funding is released to the State entity.

## 7. Benefits and Risks of On-lending

- 7.1. State entities often have the legal authority to borrow on their own terms; however, they are generally not in a strong financial position. Hence, they are unable to access funds from commercial lenders or international financial institutions. On-lending provides a way for the State entities to benefit from the strength of the Government's balance sheet to access finance. Also, it is a way for State entities to deliver the Government's critical development projects.
- 7.2. On-lending to State entities is only one way for the Government to deliver development projects. Under an on-lending, the Government bears the risk that the State entity will default on their loan repayment. As this risk is significant, on-lending should be carefully considered against other alternatives such as open tenders, public-private-partnerships (PPPs), or direct private sector development.
  - 7.2.1. The high risk of lending to State entities has been reflected in previous on-lending arrangements, with only 10% of all onlent money likely to be recovered whilst the balance remaining (90%) is lost completely.

## 8. Key Elements of the Policy

- 8.1. The Policy aims to promote transparency of State entity funding.
  - 8.1.1. The State will onlend funds to State entities at commercial rates to evade non-transparent subsidies to State entities via cheap financing.
  - 8.1.2. The State may subsidise non-commercial projects through the CSO policy. CSO contracts are a transparent way to recognise Government investment which is not commercially viable.
- 8.2. Lending at commercial rates also encourages efficiency in State entities and efficiency in resource allocation within the economy by:
  - 8.2.1. discouraging State entities from pursuing projects with low rates of return unless directed to do so by the State under a CSO contract; and
  - 8.2.2. ensuring that the State entities do not receive an unfair advantage over private sector firms when they are engaged in direct competition.
- 8.3. To reduce the default rate on subsidiary loans, only State entities which have a reasonable prospect of repaying loans will be eligible for a loan.
  - 8.3.1. The Government may choose an ineligible State entity to implement a project under a CSO contract by transparently allocating subsidy payments to the State entity through the National Budget appropriation.
- 8.4. It is not an objective of this Policy to generate revenue for the State at the expense of State entities. Nonetheless, this ensures that scarce resources are allocated to where they are most needed, such as funding necessary capital expenditure that either generates a commercial return or is subsidised in accordance with CSO policy.

8.5. Projects funded through this Policy may be funded through an on-lending arrangement or a mixture of an on-lending arrangement and other Government funding arrangements such as that provided by a CSO arrangement.

8.5.1. Projects which are commercial in nature may be funded 100% by an on-lending arrangement.

8.5.2. Projects which are non-commercial, that is they are not expected to generate positive cash flows, may be funded solely by CSO payments.

8.5.3. In all cases, the State entity must obtain finance (whether debt or equity from the State or from other entities) on commercial terms and conditions.

8.5.4. For projects that comprise both commercial and non-commercial elements this Policy is to be applied to those sub-elements accordingly.

8.6. The State, like any other commercial lender, would need to determine whether the interest charged on a loan to a State entity is sufficient to compensate it for the credit risk exposure. The interest rate on a subsidiary loan will be the primary loan interest rate plus a margin depending on the credit risk assessment.

## 9. Subsidiary Loan Agreement (SLA)

9.1. All SLAs are required to include a provision to govern events of default by the State entity. This should include provision for the specific points included under 4. Restrictions and Conditions of On-lending.

9.2. The key features of the Subsidiary Loan Agreement (SLA) will include:

- Article I: Definitions, Interpretations and Guidance on Construction of the SLA
- Article II: Amount, Period and Payment Method
  - o Withdrawal/Disbursements
  - o Interest, Fees or Charges
  - o Repayment of SLA
- Article III: Implementation of the Projects
- Article IV: Rights and Remedies of the State
  - o Termination
  - o Remedial Action
  - o Restructuring
  - o Write-off or Swaps
  - o Inclusion of Dividend Payments
- Article V: Effective Date of the SLA
- Article VI: Miscellaneous Provisions and Disputes

9.3. Primary loans are usually made on concessional terms that include long repayment periods, long principal repayment grace periods and low interest rates. These primary loans can be either in foreign currency or domestic currency. However, subsidiary loans to State entities shall be made on commercial terms in Kina only.

9.4. Principal repayments shall begin in the year when the project becomes fully operational and realizes revenue. Principal repayments of loans may be made over 5 or 10 years, whereby this option is negotiable between the State and the State entity.



9.5. The interest rate of subsidiary loans shall be fixed for the life of the loan at the rate as set out in Annex 1.

## 10. The Application Process for State On-lending

10.1. This Policy makes it mandatory for projects to be subject to an evaluation and approval process as provided below.

### 10.2. The Minister for Treasury (Treasurer)

10.2.1. All requests for State on-lending are to be submitted to the Treasurer (Ministry for Treasury).

10.2.2. All requests are to be submitted immediately after the project inception phase.

10.2.3. The Treasurer will forward these submissions to the DoT for their subsequent assessment and advise.

### 10.3. The Department of Treasury (DoT)

10.3.1 DoT through the Financial Management Division (FMD) will liaise with the party requesting on-lending to ensure that all the required documentation for analysis of their request is provided.

10.3.1.1. Requests without the complete set of documentation as set out in 0.3.1 will not be considered.

10.3.2. DoT through the FMD will prepare a guidance note to assist the requesting parties with their application for on-lending, reporting requirements and the process in the event of failing to meet the interest, principal payment and fee obligations of the on-lending. This guidance note will set out how the credit risk assessment will be conducted. It will also provide a Master SLA that will be used for State on-lending.

10.3.3. DoT formal advice and guidance note to the Treasurer will be delivered within thirty (30) days of receipt of full and complete documentation from the requesting party.

### 10.4. The Requesting Party

10.4.1. Any party requesting consideration of an on-lending must supply the following information in their application to the Treasurer:

- a) Previous five years' comprehensive audited financial statements of the party from the date of the application for the on-lending arrangement.
- b) Full financial details of the on-lending, including but not limited to:
  - An estimate of the capital costs of the project and timeframe for project implementation
  - An estimate of the expected operating cash flows arising from the project
  - The entities estimated cash flows for the duration of the project.
  - An estimate of the maximum subsidiary loan that the project could comfortably sustain given its expected cash flows.
- c) A cost benefit analysis of the purpose of the on-lending.

- d) The detailed investment analysis of the on-lending, including the party's capacity to meet all payment obligations.
- e) A detailed risk analysis of the purpose of the on-lending and the party requesting the on-lending which should at a minimum cover the following:
  - o A justification as to why the State should accept such risks.
  - o A justification of what other alternatives (such as commercial borrowing) are available and why this are not suitable.
  - o The price of the risk being taken by the Government.
  - o An appropriate risk management strategy which should include the following elements.
    - Clearly identify all of the risks to be managed.
    - Clarify the possible consequences of the risk and the likelihood that those consequences may occur.
    - Clarify how the risk is going to be managed or treated (i.e. retained, reduced, eliminated, controlled or transferred).
    - Demonstrate a system for monitoring and reviewing the risks.
  - o Arrangements for monitoring the risks before and after the approval for the duration of the on-lending.
- f) A written project evaluation report that contains:
  - o A statement regarding the objectives and proposed outcomes of the project, in particular, whether the project is entered into for profit making purposes or to fulfill social and community obligations.
  - o A statement regarding how the project will assist the Government achieve the targets set out in the Medium Term Development Plan.

10.4.2. Failure to supply any of the required information listed above will result in the application being returned to the party within five (5) working days of the application having been reviewed, and the application will not be processed any further until the required information is provided in full.

10.4.3. The party may supply additional information to support their application.

10.4.4. DoT, through the FMD may request for additional information to assist in their analysis. If an entity fails to provide this information, FMD may take this failure into account when making their recommendation.

## 11. The Approval & Rejection Process for State On-lending

### 11.1. The Department of Treasury

11.1.1. DoT through the FMD will draft the guidance note and official advice to the Treasurer in regard to all applications for on-lending and submit this to the Secretary for his/her review and approval.

11.1.2. In their advice the FMD will, at a minimum, provide the Treasurer with the following information:

- a) Have potential losses been independently assessed and verified?
- b) Have all the foreseeable risks been explicitly identified?
- c) Do the identified benefits outweigh the costs to the State?
- d) Justification as to why the State should accept the risks.
- e) The price of the risk incorporating a credit risk assessment being taken by the Government and how this has been factored into the proposal.
- f) Recommendation on an appropriate interest rate based on the credit risk assessment.

- g) The appropriateness of the risk management strategy.
- h) The arrangements for monitoring the risks before and after the approval for the duration of the arrangement.
- i) The legal provisions that will enable the Government to seek to recover some or all the defaulting or late payments on the on-lending.
- j) Assessment as to whether the party is solvent and capable of repaying the debt and interest on the on-lending arrangement, and whether the party will continue to be able to repay the loan should the on-lending arrangement be approved.

11.1.3. The advice of the DoT's Financial Management Division will also include drafting guidelines for the State Solicitor for the subsidiary loan agreement, which should include the following:

- a) The terms and conditions for the on-lending.
- b) Any early prepayment conditions that can be exercised by the on-lending party.
- c) Maximum financial limits on the claims which can be made?
- d) Subrogation clauses i.e. things that would allow the Government to participate in or take over any litigation related to the default of the on-lending party.
- e) Clauses that clarify that the on-lending cannot be transferred or reassigned in any way.

11.1.4. The advice of the DoT's Financial Management Division should also include a formal correspondence from the State Solicitor, which confirms the following:

- a) The legislative requirements have been met.
- b) The subsidiary loan agreement does not duplicate protections already available under common law.
- c) Confirmation that the amounts payable need an appropriation (or vote) in the budget and whether if it is required that this exists in the current budget.

11.1.5. Where the terms of the on-lending deviate or differ from the standard terms described above and as set out in the master subsidiary loan agreement, the reasons should be recorded in writing.

11.1.6. DoT may advise the Treasurer to either accept or reject an application for an on-lending.

11.1.7. FMD shall return all incomplete applications to the party.

11.1.8. FMD shall return any application to the party if it has failed to pay the application fee.

## 11.2. The Minister for Treasury (Treasurer)

11.2.1. In the event that the DoT recommends that the Treasurer approves an on-lending arrangement, the Treasurer may or may not accept this advice at his absolute discretion.

11.2.1.1. If the Treasurer accepts the advice of the DoT and approves an on-lending arrangement, the necessary legal documents shall be signed and dispatched by the Office of the Treasurer with a copy to the DoT.

11.2.1.2. In the event that the Treasurer rejects the advice of DoT to approve an on-lending arrangement this shall be conveyed by the Treasurer in writing to the Secretary of Treasury.

11.2.2. In the event that the DoT recommends that the Treasurer does not approve an on-lending arrangement, the Treasurer may direct that the Department engage an internationally recognised accounting firm to provide an independent assessment of the decision and provide a view as to whether the Department decision was correct.

11.2.3 When conducting an independent review of the Department of Treasury's decision, the internationally recognised accounting firm must utilise, at a minimum, the same material, methodology and criteria as used by the Department of Treasury.

11.2.4 In the event that the Department of Treasury recommends that the Treasurer does not approve the on-lending arrangement, the Treasurer shall not approve an on-lending arrangement, unless, the Treasurer requested an independent review by an internationally recognised accounting firm and that firm has recommended that the on-lending arrangement be approved. If the recommendations are different, the Treasurer may make a decision as to which recommendation to accept.

## 12. The Party Applying for the On-lending

12.1. In the event of a rejection of an application for an on-lending the party may request the DoT to provide a written explanation as to why the request was rejected.

12.2. If the party wishes the Government to re-consider its rejection of the on-lending, this must be done as a new submission following all of the previous procedural steps outlined above.

## 13. Fees

13.1. The legal basis for charging a fee for on-lending is provided by Article 38 of the *Public Finances (Management) Act 1995* which states the following:

**"38. Loans by the State**

.. (6) The Treasurer shall, on behalf of the State, charge such fee in respect of a loan made pursuant to this section as he considers appropriate in all of the circumstances in relation to that loan.

13.2. All parties including State owned entities requesting an on-lending shall be subject to the fees as set out in Annex 1. The interest rate will be determined according to the credit risk assessment as set out in the guidance note under clause 12.3.2.

13.3. All fees must be paid into the Consolidated Revenue and the receipt of payment must be provided with the application.

## 14. Monitoring and Administration of On-lending

14.1. The DoT through the FMD will maintain a record of all State on-lending in the debt recording system and monitor the risk of each on-lending in accordance with the guidance note. Should the on-lending party fail to comply with all requirements set out in the subsidiary loan agreement or directives issued by DoT, the Treasurer will be notified along with the steps for compliance. No further on-lending will be permitted until the on-lending party fully complies.

14.2. The on-lending party shall monitor the risk during the life of the on-lending in accordance with the guidelines set by the DoT through the Financial Management Division. The on-lending party shall notify the DoT immediately of any developments that significantly increase the risk of default.

14.3. The FMD, or its successor, in the DoT will be responsible for administering this policy.

14.4. FMD will maintain a database using the Debt Recording System which records all the details of subsidiary loans. This database will be used by FMD to:

- invoice State entities for repayments under the subsidiary loans;
- record payments made by the State entity under the subsidiary loans; and
- report on subsidiary loans in the Government's financial statements.

14.5. State entities entitled to apply for a loan under this policy are listed below:

- invoice State entities for repayments under the subsidiary loans;
- record payments made by the State entity under the subsidiary loans; and
- report on subsidiary loans in the Government's financial statements.

## 15. Reporting Requirements

15.1. Reporting of all on-lending shall be in accordance with the requirements of the *Public Finances (Management) Act of 1995* and all subsequent amendments.

15.2. Reporting in the Fiscal Outturn Report and other government reports will be done in line with relevant accounting standards and the principals set out in the latest Government Financial Statistics (GFS)<sup>1</sup>.

15.3. The DoT through the FMD shall report the on-lending on a semi-annual basis at the end of June and December. These will be reported in the Final Budget Outcome (at the end of March), Annual Public Debt Bulletin (at the end of April), the Mid-Year Economic and Fiscal Outlook (MYEFO) (at the end of July), and the Budget under the Chapter on Financing and Debt Management Strategy (in November).

## 16. Registration and Documentation

16.1. The DoT through the FMD must maintain an official register of all on-lending to ensure accurate reporting in both financial statements and budget papers. The register should contain details of the on-lending as well as the scope and nature of the risks involved including the probability of default or late payment.

16.2. The register, which could be part of the same database that is used to record direct government debt, should include the details of each on-lending, the schedule of on-lending payments, the results of monitoring, and any payments that are overdue. It should include all the details of the original loan agreements. Subsidiary loan agreements and original loan agreements need to be stored securely. In addition, the agreements will be recorded in electronic format and stored securely including off-site back-ups.

16.3. All documentation associated with each on-lending should be stored and filed electronically and physically in a secure location for 10 years after the term of the on-lending. This is because these records will be required in the event of future claims or litigation which may even occur after the period of on-lending has lapsed.

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<sup>1</sup> At the time of preparation this was GFSM 2014

## 17. Default on the On-lending

- 17.1. If the on-lending party is unable to make a loan payment due (interest, principal or fees), in full or in part, to the Government, the on-lending party shall notify the DoT in writing as soon as possible. The on-lending party shall state the reasons for not being able to meet the payment obligation and commit to repaying the debt amount to the DoT plus any expenses arising from the late or defaulting payment. If the on-lending party fails to notify in advance to the DoT of the difficulties in meeting its debt payment obligations, thereby impacting directly on the government budget, the on-lending party shall compensate all related expenses to the government budget.
- 17.2. An event of default shall be deemed to have occurred under a SLA if the State entity fails to make good on the full amount of principal and/or interest due as at the close of business of the later of the following dates:
- the repayment date shown on the repayment schedule; and
  - 20 business days after the date of the billing invoice provided by DoT to the State entity.
- 17.3. If this payment difficulty is temporary and the on-lending party is able to resume all future payment obligations and refund the payment made by the DoT within thirty (30) days, the DoT shall undertake an inspection and report to the Treasurer. If repayment is not made after thirty (30) days, the DoT shall charge penalty interest compounded daily on total arrears, on the amount outstanding at the rate set out in Annex 1 as approved by the Treasurer.
- 17.4. If the on-lending party is unable to refund the payment made by the DoT within thirty (30) days in accordance with clause 19.2, but is able to refund over a longer time period, the DoT will prepare a repayment schedule including the penalty interest charge at the rate approved by the Treasurer in clause 19.3 and submit to the Treasurer for approval.
- 17.5. If the payment difficulty is permanent and the on-lending entity is unable to meet any future payment obligations, the DoT shall engage auditors to conduct audits of the entities finances.
- The defaulting entity must provide the auditors with full access to their financial documents and accounts.
  - The DoT shall report to the relevant authorities a default of greater than 3 months to handle the default in accordance with the laws and regulations of Papua New Guinea.
- 17.6. If an organisation has defaulted on a loan in the past, that organization shall not be eligible to receive a future on-lending until a period of seven (7) years after the default.
- 17.7. If the loan is not refinanced and repayments have not recommenced within 3 years of the initial default, the Secretary at his sole discretion may write off the loan as unrecoverable. The entity will remain on the list of defaulting entities and be ineligible for future on-on-lending for a period of ten (10) years.

## Annex 1: Fees

The following fees shall, where applicable, be charged to all on-lending provided by the State:

<b>Nature</b>	<b>Amount</b>	<b>Note</b>
Application Fee	K1,000.00	To be paid with the submission of the application.
Interest rate	Based on the rate the Government received from the lender.	This will be payable annually or semi-annual on the same dates as the primary loan.
Risk/Default rate	Based on probability of default. The higher the probability of default the higher the risk/default rate.	This will be payable annually or semi-annually on the same dates as the primary loan.
Penalty rate	Based on the Kina Facility Rate published by the Bank of Papua New Guinea.	This will be payable in addition to the interest amount and payable annually or semi-annual on the same dates as the primary loan.
<b>Note:</b> The determination of the probability of default will be defined in the credit risk policy prepared by the DoT through the FMD as approved by the Treasurer. The Policy will be documented in the guidance note as stipulated in clause 12.3.2.		