

SACE AND SUSTAINABLE LENDING

The importance of external financing for the economic development of low-income countries as well as the risks inherent in unsustainable levels of indebtedness have required SACE to draw up specific principles for the granting of insurance guarantees that combine prudent risk management criteria with the practices common to official creditors. This brief note addresses sustainable lending and its repercussions on SACE's export credit insurance activities.

Debt-management improvements by low-income countries. In recent years, the economic and financial situation of many low-income countries has improved significantly in comparison to past decades. The factors that contributed to this phenomenon include not only international conditions (commercial and financial globalization, high commodity prices) but also these countries' progress in political stabilisation and budgetary rigour. In this sense, the partial or total cancellation of debt, achieved in the framework of the actions promoted by International Financial Institutions (IFI), has played a fundamental role as it enabled these countries to earmark resources previously used to service public debt to initiatives for medium and long-term social and economic growth. The governments of creditor countries have also made a major financial contribution to these initiatives, especially Italy, which in derogation from multilateral agreements decided to reimburse 100% of the value of the debt of low-income countries.

The concept of sustainable lending and its repercussions upon the operations of Export Credit Agencies (ECAs)¹. Notwithstanding undoubted improvement in their economic situation, the risk remains that new and imprudent spending policies may plunge these countries into debt distress once again. Consequently, the policy of sustainable lending was recently introduced to address this danger. This deals with the need to define and pursue lending activities that take account of the real debt-carrying capacity of the contracting party, and as such is fully compliant with the economic and financial support programmes promoted by IFIs. Lenders/financiers undertake that their commercial operations with sovereign borrowers or counterparts backed by sovereign guarantees will not compromise low-income countries' debt-carrying capacity. Therefore, a financing programme is deemed sustainable if it is able to: (i) generate beneficial economic and social returns; (ii) avoid unproductive spending projects that are not in line with programmes approved under each country's poverty reduction strategy paper (PRSP), (iii) maintain the sustainability of the debt and (iv) promote good governance and transparency. This commitment, which until recently was not a mandatory requirement but essentially an undertaking freely entered into, is now codified by the OECD into "Principles and Guidelines to Promote Sustainable Lending in the Provision of Official Export Credits to Low-Income Countries".

The due diligence performed by SACE. SACE has long been applying prudential criteria that comply with the concept of sustainable lending in issuing new credit guarantees to counterparts in low income countries. In the evaluation of operations with counterparts in low-income countries, SACE performs a due diligence based upon the general corporate prudential principles for risk management applied to all its counterparts (creditworthiness, net asset worth, economic

¹ Further information on the concept of sustainable lending can be found on the website of the International Monetary Fund (<http://www.imf.org/external/np/pdr/conc/>).

and financial quality of the project to be financed, IFIs' valuation) along with specific criteria to applying to operations with low-income counterpart countries. The purpose of this latter analysis is to verify that:

- insured financing complies with concessionality requirements of the IMF/IDA²;
- in the absence of minimum concessionality requirements, insured financing complies with the sustainability debt analysis carried out by IMF/IDA³;
- there is an assurance by the government authorities of the debtor country attesting to the compliance of the project with existing indebtedness and development plans (e.g. Poverty Reduction Strategy Paper and/or budget);
- all the procedures laid down by national legislation on the subject matter have been complied with (e.g. Parliamentary approval, where required).

SACE shares information with the other ECAs and IFIs on low-income country operations. It is also actively involved in defining the operational aspects of sustainable lending practices.

² The concessionality requirements refer to limits on external indebtedness specified by programmes supported by IMF. They lay down minimum grant element percentages that a financing/financial package must satisfy in order to ensue its repayment without risks of debt distress. For a full and updated list of the countries subject to IMF/IDA concessionality requirements:

[http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21021578~pagePK:51236175~piPK:437394~resourceurlname:FY06grantimplementation%5E\\$%5Epdf~theSitePK:73154.00.html](http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21021578~pagePK:51236175~piPK:437394~resourceurlname:FY06grantimplementation%5E$%5Epdf~theSitePK:73154.00.html).

³ In the Debt Sustainability Framework jointly approved by IMF and IDA, such analyses are intended to provide: a dynamic analysis of the indebtedness of countries; countries' real debt-carrying capacity; an optimum strategy for both creditors and borrowers. Countries' debt sustainability analyses can be found at:

<http://www.imf.org/external/pubs/ft/dsa/lic.aspx>.