

# THE DEVELOPMENT FINANCE FOR PORTUGUESE-SPEAKING AFRICA – “LUSOPHONE COMPACT”



## LUSOPHONE COMPACT GUARANTEE

March 2023

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# Overview of the Guarantee

## Key terms

- ❖ **Size:** EUR400m **unfunded** guarantee
- ❖ **Guarantor:** the Government of Portugal (GOP) through the Ministry of Finance
- ❖ **Beneficiary:** AfDB
- ❖ **Coverage:** Loan **principal** only
- ❖ **Maturity:** up to 15 years
- ❖ **Term** - 30 days after final repayment date as defined in loan agreement or when all guaranteed liabilities are paid, whichever comes first
- ❖ **Ramp up period:** Possibility to add new projects in reference portfolio up to **28 December 2023** - subject to renewal upon mutual agreement
- ❖ **Termination:** any time or occurrence of: (i) Portugal in **breach** of its **obligations** and not able to remedy within 30 days; (ii) **rating downgrade** of GOP to a level that eliminates any capital benefits or makes the transaction not financially viable, (iii) Portugal **repudiates** the LCG
- ❖ **Guarantee Fee:** payable semi-annually in arrears by AfDB

## Eligible Transactions

- ❖ **Borrowers:** Eligible Non-sovereign project, private sector entities and State-Owned Enterprises (SOEs) located in PALOPs with demonstrable capacity to repay the guaranteed debt
- ❖ **Sectors :** All sectors eligible per Bank rules
- ❖ **Instrument type:** **Debt** only (**equity** investments **not covered**)

## Other features

- ❖ **Currency** of underlying loans: EUR, USD
- ❖ **Recoveries:** Pro-rata
- ❖ **Non-reinstatable**
- ❖ **Acceleration** clause granted to AfDB
- ❖ **Subrogation:** Allowed
- ❖ **Acceleration:** Authorized for AfDB

#### Scrutiny of Sponsor/Project Stakeholders

Projects to be credit enhanced by the Lusophone Compact Guarantee must reflect Portuguese Interest as defined below:

- (i) Borrower being a company **incorporated under Portuguese law**, or being a subsidiary of a company incorporated under Portuguese law, or
- (ii) Entity incorporated under or **governed by Portuguese law**, providing professional services to the Project
- (iii) including **EPC contracts, O&M contracts, EPCM contracts, OEM contracts**

*It is important to note that this is not a negotiable point – it is matter of Portuguese law. Secondly, the Portuguese Interest should to the extent possible be maintained throughout the guaranteed loan life.*

#### Should align with Bank rules & due diligence

- **Previously included in the annual work program of the Development Finance Compact for PALOPs approved by Standing Committee of the Lusophone Compact**
- Domiciled/Located in a PALOP
- Falls within the Bank's **internal rating scale classified between very low risk and high risk**
- **AfDB loan amount < EUR 15 million**
- **Maximum tenor of up to 15 years** (including grace period) and grace period of up to 5 years
- Only sectors eligible for financing according to AfDB policies
- Compliance with **applicable ESG, anti-bribery, anti-corruption, anti-money, anti-terrorism** required
- Evidence of AfDB's **KYC checks**



**DEFINED AS THRESHOLD PROJECTS**

# Operational Modalities

## Origination Processes

Does it satisfy Portuguese Interest requirement?

Yes



No



Non-Threshold Project

What level of cover is needed / possible?

- Portuguese Interest is at least 50%  
➔ *Maximum Guaranteed Percentage up to 85%*
- $30\% < \text{Portuguese Interest} < 49.9\%$   
➔ *Maximum Guaranteed Percentage up to 50%*
- Portuguese Interest  $< 30\%$   
➔ *Maximum Guaranteed Percentage determined by written agreement between GOP*

Is the transaction a THRESHOLD PROJECT?

Yes



No



**Prior consideration and approval from GOP required** before inclusion in Reference Portfolio. Applicable to projects that do not meet the threshold project eligibility criteria but that the Bank determines could be of interest for GOP provided that there are some Portuguese Interest. This would include for example projects where:

- Loan amount  $> \text{EUR } 15 \text{ million}$
- Loan tenor  $> 15 \text{ years}$
- Grace period  $> 5\text{-year}$
- Bullet or other non-traditional repayment structure
- Portuguese Interest  $< 30\%$

**Automatic inclusion in the reference portfolio** following (i) submission by the Bank of a suite of justificative documents (i.e., Project Information Note) and (ii) receipt by AfDB of the signed Inclusion Notice from Portugal. In other words, no added review processes by GOP.



## Structural challenges

### Conditionality

- Aggregate *Portuguese Interest* in Reference Portfolio > 45%
- Any breach to be restored within 9 months
- GOP can suspend unilaterally inclusion of new assets in the reference portfolio if AfDB fails to restore the 45%

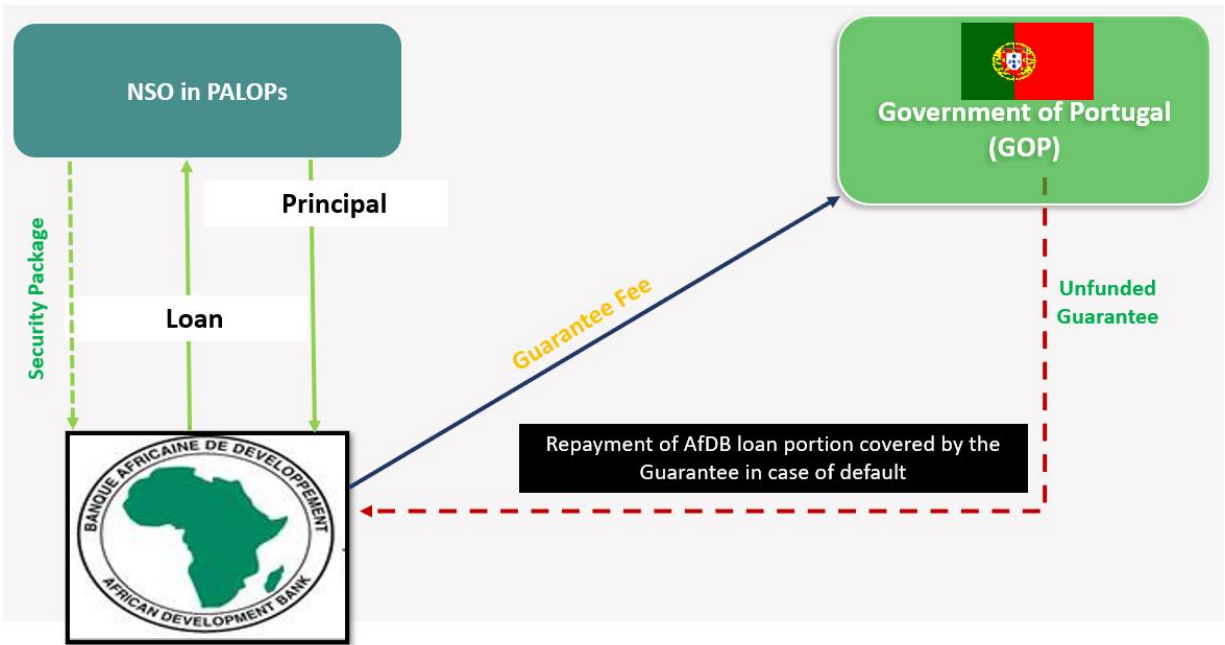
**Reporting** (submitted semi-annually to GOP)

## Exposure limits

- ❖ **Country limit** – Total amount of cumulative guarantee exposure allocated to a single country under the program = 50%
- ❖ **Single Obligor Limit** – Total amount of the program exposure allocated to a single AfDB Borrower = 25%
- ❖ **Amount covered** – Total maximum amount guaranteed by GOP on a single AfDB loan = 85%

# How does the Lusophone Compact Guarantee work?

Portugal Guarantee: Indicative Structure



## LCG Claim Process

**Step 1:** Default trigger-missed principal payment 30 days past due date

**Step 2:** Claim notification by AfDB -30 days after default trigger

**Step 3:** Claim settlement-compensation by GOP within 30 days of receipt of claim notice

## Illustration - Indicative Payout in case of default on a loan in the Reference Portfolio

- Assume a loan amount of \$15mln of which \$11.3mln is covered in the reference portfolio
- Payout amount calculated using the percentage covered on the loan by GOP before default occurrence
- On each year, GOP compensates the Bank \$1.5mln
- Payouts will continue up to the amount covered
- If the borrower is in arrears for 5 years, GOP would have paid \$7.5mln for overdue principal
- After 5 years the borrower clears its arrears and the \$7.5mln is reimbursed to GOP ensuring full recovery of paid amounts

Loan Amount	15.0
Portuguese Interest	60%
Amount Covered	11.3
Percentage Cover (x)	75%

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Scheduled Principal Payment (y)	2.0	2.0	2.0	2.0	2.0	10.0
Payout amount (x * y)	1.50	1.50	1.50	1.50	1.50	7.5

# Current Status, Impact & Next Steps

## Positive Impact

- RWA reduction
- Risk Capital benefit
- Benefit-to-cost ratio of 3.2X
- Up to \$136mn of risk capital expected to be released

## Current status

- **Board approval** since **December 2020**
- **Legal Opinion** on compliance with Basel rules **obtained**
- **Rating Evaluation Services** with **S&P completed**
- **Guarantee Agreement signed** in Sept-2022
- Draft of Operational Guidelines **ongoing**
- **Onboarding of projects in Reference Portfolio ongoing**

## Reporting considerations

### **Routine** – Semi-annual reporting to include:

- List of Projects in the Reference Portfolio; aggregate Defaulted Amounts
- Aggregate recoveries if any
- Value of claim notices submitted and paid by the Guarantor if any
- Confirmation of compliance with exposure limits
- Any accrued but unpaid Guarantee Fees and unutilized guarantee amount
- Proposed pipeline projects
- Outstanding AfDB loan amount as per the Credit Agreement and;
- Attestation that, to the knowledge of AfDB, Borrower is in compliance with the Credit Agreement.





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Thank you  
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