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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
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Subject: REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT,
THE COUNCIL AND THE COURT OF AUDITORS **on the management
of the Guarantee Fund of the European Fund for Sustainable
Development**

Delegations will find attached document COM(2020) 346 final.

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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE
COUNCIL AND THE COURT OF AUDITORS**

**on the management of the Guarantee Fund
of the European Fund for Sustainable Development**

CONTENTS

1. Introduction	2
2. Operational context	2
3. Management of the EFSD Guarantee Fund in 2019	3
3.1. Financial management.....	3
3.2. Composition and key characteristics of the portfolio.....	3
3.3. Performance	4
4. Financial accounts	4
4.1 Financial statements of the EFSD Guarantee Fund as of 31 December 2019	5
4.2. Provisioning	8
5. Assessment of the adequacy of the target amount and the level of EFSD Guarantee Fund ..	8

1. INTRODUCTION

The legal basis for this report is the Regulation (EU) 2017/1601 ('EFSD Regulation')¹. Article 16.3 of the EFSD Regulation sets that the Commission shall provide to the European Parliament, to the Council and to the Court of Auditors a report on the management of the European Fund for Sustainable Development ('EFSD') Guarantee Fund in the previous calendar year, including an assessment of the adequacy of the provisioning and the level of the EFSD Guarantee Fund and of the need for its replenishment.

2. OPERATIONAL CONTEXT

The EFSD covers the financing of operations in Africa and EU Neighbourhood, including both blending operations and the EFSD guarantee. The EFSD guarantee is a key innovative element used to reduce the risks for investment in sustainable development in partner countries, thus helping mobilise investments, foster sustainable and inclusive economic and social development, maximise additionality, as well as to crowd-in private sector funds. The guarantee is intended to serve as a risk mitigation mechanism to leverage private sector financing whilst avoiding market distortions.

The EFSD guarantee has been established for an overall amount of EUR 1.5 billion to be covered by the general budget. By end of 2019, additional contributions to support the EFSD Guarantee Fund include USD 50 million from the Bill and Melinda Gates Foundation, EUR 9.6 million from Denmark, EUR 300 000 from the Czech Republic and EUR 100 000 from Estonia.

Article 14 of the EFSD Regulation sets up the EFSD Guarantee Fund, which constitutes a liquidity cushion from which the eligible counterparts shall be paid in the event of a call on the EFSD Guarantee. The Union has made available EUR 750 million to cover its financial liabilities, which corresponds to 50% of the EU guarantee obligations.

The EFSD Guarantee Fund has been effectively established in 2018. An amount of EUR 600.1 million has been paid to the Fund as of 31 December 2019.

Information about the EFSD implementation was included in the recent Report from the Commission to European Parliament and the Council². The report, based on the outcome of an independent external assessment, concludes that EFSD is highly relevant to the need for a new global development finance model, as well as to the investment needs of Sub-Saharan Africa and the EU Neighbourhood regions.

¹ Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development, the EFSD Guarantee and the EFSD Guarantee Fund

² COM(2020) 224, Report from the Commission to the European Parliament and the Council on the implementation of the European Fund for Sustainable Development

3. MANAGEMENT OF THE EFSD GUARANTEE FUND IN 2019

3.1. Financial management

The investment portfolio of the EFSD Guarantee Fund is invested in accordance with the management principles laid down in Commission Decision C(2017)7693 of 22 November 2017 approving the asset management guidelines of the EFSD Guarantee Fund.

These guidelines foresee that the assets in the investment portfolio shall provide sufficient liquidity in relation to the potential guarantee calls, while still aiming at optimising the return and risk level that is compatible with maintaining a high degree of security and stability.

Investment and risk management strategies were adopted reflecting the investment objectives and outlook of market conditions. The investment approach aimed at enhanced diversification across various fixed income asset classes.

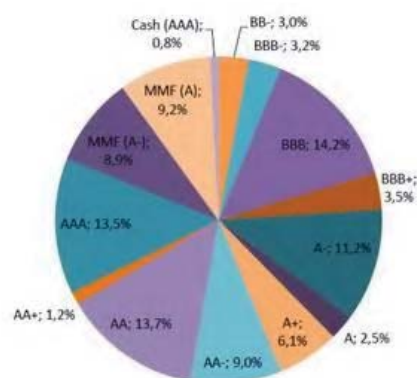
3.2. Composition and key characteristics of the portfolio

An investment strategy guides the management of the assets of the EFSD Guarantee Fund's investment portfolio in order to achieve the investment objectives. This investment strategy is expressed in the form of a benchmark, which sets the indicative target allocations to different categories of eligible financial assets in the portfolio.

On 31 December 2019, the investment portfolio was made predominantly of securities issued by Sovereigns, Sub-sovereigns, supnationals and agencies (SSA) and foreign governments (45% of market value against 52% for the benchmark), unsecured bonds issued by corporates and financial institutions (22% of market value against 18% for the benchmark) and covered bonds (14% of market value against 0% for the benchmark). The remainder was mainly allocated to Money Market Funds.

At the end of 2019, the exposure of the portfolio to bonds complying with environmental, social and governance criteria was more than 2 times higher than in the benchmark.

The portfolio duration at the end of 2019 was 2.51 years, and credit ratings of EFSD securities are split as follows:



The bulk of the portfolio is invested in liquid securities and an adequate part (14% of the total portfolio value) matures in less than 12 months.

The profile of the portfolio, in terms of duration, credit risk and liquidity, has been calibrated in line with the forecasted cash-flows arising from the EFSD operations under the EU Guarantee (e.g. projected calls, revenues).

3.3. Performance

The annual performance is calculated on a time-weighted basis in order not to be affected by the size of the portfolio, which grew considerably during the year.

In a very challenging market environment characterised by overall negative or historically low yields coupled with significant market volatility and uncertainties, the Fund delivered an annual absolute performance of 0.242% (time-weighted performance, before any costs and fees) in 2019. This return is in line with the annual performance of the EFSD benchmark (0.149 %) and was achieved against a background of negative rates in the euro-area (especially for what is perceived by the markets as "credit risk free" and liquid exposures in Europe).

4. FINANCIAL ACCOUNTS

Financial information concerning EFSD Guarantee Fund is presented below. There were no calls on the EFSD Guarantee in 2019.

4.1. Financial statements of the EFSD Guarantee Fund as of 31 December 2019

The positive market developments, with the drop of the EUR yield curve combined with the good performance of most of fixed income sectors, as described in point 3.3 above, kept the total assets of the EFSD Guarantee Fund close to the total contributions to the fund of EUR 600.1 million and stood at EUR 599.59 million on 31 December 2019, despite the impact from negative interest. The assets comprised the investment securities portfolio classified as available-for sale (EUR 594.71 million) and cash (EUR 4.88 million).

In terms of the 2019 statement of financial performance, the EFSD Guarantee Fund ended the year with a slightly negative economic result of EUR -0.26 million³. Main reason for these are the negative interest charges on cash holdings and securities (EUR -0.45 million), due to a

³ This is in line with the money-weighted return of -0.103%, which considers the significantly growing size of the EFSD Guarantee Fund in 2019 due to budgetary contributions in the building-up phase. Money-weighted return was lower in 2019 than the time-weighted performance referred to in point 3.3. The time-weighted return is the official performance reported for all EC Asset Management activities, as it allows to eliminate the distorting effects created by inflows and outflows.

largely negative interest rate environment, which could only be partially compensated by realised gains from security sales and security lending income (EUR 0.19 million).

Balance sheet as at 31 December 2019

(amounts expressed in EUR)

ASSETS

	31 December 2019	31 December 2018
	EUR	EUR
NON-CURRENT ASSETS	348 061 980	3 577 001
Available for sale financial assets	348 061 980	3 577 001
CURRENT ASSETS	251 527 281	271 469 460
Available for sale financial assets	246 643 539	5 795 882
Receivables (i.e. securities lending fees)	1 595	-
Cash and cash equivalents	4 882 147	265 673 578
<i>Current accounts</i>	<i>4 885 215</i>	<i>265 721 781</i>
<i>Accrued interest on cash and cash equivalents</i>	<i>(3 068)</i>	<i>(48 203)</i>
TOTAL ASSETS	599 589 261	275 046 461

NET ASSETS AND LIABILITIES

	31 December 2019	31 December 2018
	EUR	EUR
NET ASSETS	599 567 587	275 030 778
Contribution from EU Budget	600 100 000	275 100 000
Fair value reserve	(188 713)	(655)
Retained earnings	(68 567)	-
Economic result of the year	(275 133)	(68 567)
CURRENT LIABILITIES	21 674	15 683
Other payables	21 674	15 683
TOTAL NET ASSETS AND LIABILITIES	599 589 261	275 046 461

Statement of financial performance for the year ended 31 December 2019

(amounts expressed in EUR)

	2019	2018
	EUR	EUR
Revenue from operating activities	-	-
Expenses from operating activities	-	-
Other expenses from operating activities	(15 000)	(15 000)
<i>Audit fees</i>	(15 000)	(15 000)
RESULT FROM OPERATING ACTIVITIES	(15 000)	(15 000)
Financial revenue	188 403	(1 088)
Interest revenue on:	(54 689)	(1 088)
<i>Cash and cash equivalents</i>	-	-
<i>Available for sale assets</i>	(54 689)	(1 088)
<i>Other interest revenue</i>	-	-
Realised gains on sale of AFS assets	240 839	-
Securities lending income	2 253	-
Financial expenses	(448 536)	(52 479)
Interest expenses on cash and cash equivalents	(404 272)	(50 958)
Realised losses on sale of AFS assets	(15)	-
Custody fees and other financial expenses	(44 249)	(1 521)
FINANCIAL RESULT	(260 133)	(53 567)
ECONOMIC RESULT OF THE YEAR	(275 133)	(68 567)

4.2. Provisioning

The EFSD Guarantee Fund is provisioned from the budget of the Union and the European Development Fund (EDF). For the current MFF (2014-2020), the detailed sources of funding of the EFSD Guarantee Fund include: EUR 400 000 000 from the EDF general reserve and EUR 350 000 000 from the general budget of the Union, including from the European Neighbourhood Instrument (ENI). The EFSD Guarantee Fund may also be endowed by voluntary contributions from Member States or other contributors, returns on invested resources, revenues and amounts recovered from defaulting debtors. Estonia, Czech Republic, Denmark and the Bill and Melinda Gates Foundation signed by end-2019 agreements for additional contributions totalling c. EUR 49 million.⁴

The Guarantee Fund was established in 2018 and the first payment accounting for EUR 75 million was made in November 2018. By 31 December 2019 the total payments received from the EU Budget into the Guarantee Fund amount to EUR 600.1 million. Until end-2019, there have been no calls on the EFSD guarantee.

5. ASSESSMENT OF THE ADEQUACY OF THE TARGET AMOUNT AND THE LEVEL OF EFSD GUARANTEE FUND

As of 31 December 2019 in total three EFSD guarantee agreements that amount to EUR 165 million were concluded, including one signed in 2018, and two in 2019⁵.

The target amount of the EFSD Guarantee Fund has been set at 50% of the total EU Guarantee obligations. The total payments received as of 31 December 2019 from the EU Budget into the Guarantee Fund amount to EUR 600.1 million, thus the provisioning covers in full the risk of the guarantees signed.

In line with Article 4.2 of the EFSD Regulation, in the operational management of the EFSD, the Commission is supported by the Guarantee Technical Assessment Group (G-TAG) comprised of credit-risk experts drawn from several European financial institutions. The role of G-TAG is to provide independent and impartial technical expertise on banking related matters to the Commission, to support its decisions related to the allocation of the EFSD Guarantee, as well as on the risk-monitoring during the implementation of the projects benefitting from the guarantee.

⁴ Estonia: EUR 100,000; Czech Republic: EUR 300,000; Denmark: c. EUR 9.4 million; Bill and Melinda Gates Foundation: c. EUR 39.2 million (USD 50 million) – with EUR 19.2 million paid-in.

⁵ And additional four for the total amount of EUR 196 million had been signed by April 2020.