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Delegations will find attached document COM(2021) 88 final / ANNEX.

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ANNEX

ANNEX

to the

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the entry into operation of the Common Provisioning Fund

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PRESENTATION OF CPF PREPARATIONS

1. Asset Management Guidelines

The Commission Decision on the Asset Management Guidelines (AMGs) was adopted in March 2020. The AMGs define the objectives, structure and operations of the CPF, and identify the source of the assets that are to be included in the CPF. The AMGs establish a prudent investment policy for the CPF intended to ensure stability of the CPF's value and to preserve the capital in difficult market conditions (to the largest extent possible), so that the CPF would be able to honour the guarantee calls against the provisioning of the compartments on time and in full.

This is also reflected in a conservative approach to the definition of eligible investments. The Decision incorporates environmental, social and governance (ESG) factors in the asset management process. Separate articles of the AMGs' Decision describe the principles in the valuation, cost attribution, accounting and reporting. In addition, the AMGs provide an overview of the process of payment of the guarantee calls and describe how the investment strategy is implemented by the Financial Manager. Finally, the Decision delegates the responsibilities and tasks of the Financial Manager to the Director-General of DG Budget.

2. Effective Provisioning Rate

The Commission has adopted the Delegated Decision, establishing the methodology and detailed conditions for the calculation of the effective provisioning rate (EPR), as foreseen by Article 213 of the Financial Regulation.

The objective of the EPR is to deliver efficiency gains in use of budgetary guarantees and financial assistance, by optimising the level of individual provisioning pooled in the CPF in view of the diversification of risks. It was expected that where the calls on the resources of the different guarantees were not closely correlated that the Union budget could afford to hold a slightly lower level of resources against the risks inherent in the guaranteed operations.

The Financial Regulation provides for the Commission to adopt a delegated act supplementing the Financial Regulation in accordance with the procedure established in Article 269(4) Financial Regulation, following consultation of Member State experts. According to the requirements of the Financial Regulation, the EPR is applied to the amount of resources needed to cover the foreseen guarantee calls over a one-year period. The methodology for the EPR calculation takes account of the risk correlation between budgetary guarantees and financial assistance programmes, as well as market conditions and forecasts of inflows and outflows.

Apart from establishing the formula for the EPR calculation, the Decision lists the relevant duties of the Financial Manager and of the Authorising Officers for the contributing instruments of the CPF with respect to the effective provisioning. Moreover, a safeguard measure was established which allows the protection of the Union budget at times when the EPR methodology cannot be applied in a prudent manner – because, for example sufficient information on the exposures incurred by the different guarantees is not available.

The Delegated Decision was adopted by the Commission in November 2020 and was subsequently transmitted to the European Parliament and the Council for scrutiny in accordance with Article 269(6) of the Financial Regulation. No objections were received during the scrutiny period and the Delegated Decision entered into force on 25 February 2021.

3. Strategic asset allocation and benchmark

The Asset Management Guidelines (AMG[1]) of the CPF set out the general principles which guide the process (Strategic Asset Allocation, SAA) for constructing a benchmark portfolio to guide the composition of the CPF and against which its performance can be compared. This benchmark captures the long-term risk-return profile of the CPF and will provide guidance for the investment decisions during the life of the CPF. The benchmark reflects the SAA and provides a reference structure in terms of maturity distribution, asset classes, credit quality and duration, against which the performance of the CPF assets will be assessed on a regular basis.

In a separate process to set the strategic benchmark, the Financial Manager used the investment objectives stated in the AMGs (e.g. capital preservation and the necessary liquidity to meet fully and promptly guarantee calls) and CPF's cash flow schedule, to assess the investment horizon of the CPF portfolio over which the objectives should be achieved and to determine the CPF portfolio risk tolerance consistent with these objectives and investment horizon.

This strategic benchmark was approved by the Accounting Officer in September 2020, after review by the governance bodies. The SAA and the strategic benchmark are fixed for several years. They will guide the management of the CPF assets until the time the benchmark is updated in case of significant change of market conditions or if the underlying long-term risk-return characteristics of the CPF change.

4. Tactical asset allocation

Following the adoption of the strategic asset allocation and the strategic benchmark for the CPF, the Financial Manager developed the tactical asset allocation (TAA) which sets target investment allocations over shorter horizons (6-12 months), to guide the day-to-day implementation of the investment strategy. The TAA incorporates contemporary dynamics (e.g. expected policy developments, outlook of fundamental, valuation and technical factors) into investment decisions in order to better position the portfolio to face changing market conditions. The development of the tactical asset allocation is a structured process. Using scenario analysis to deal with uncertainty and optimisation techniques, it aims at building portfolios that are resilient under different market conditions. Investment limits ensure risk mitigation and coherence with the longer term SAA. While the tactical asset allocation constitutes the short-term reference for actual portfolio management, it will be regularly calibrated on the basis of the evolving flow of information from financial markets.

5. IT and operational set-up

The operation of a pooled fund required the development and testing of new IT and accounting processes within a short timeframe. This work has centred on the creation of a

[1] Article 5 of the AMGs

Shareholder Register - an IT solution that will keeps track of the transactions, number of units per shareholder and the evolution of CPF asset value. Other IT developments related to the development of new IT modules to manage the inflows and outflows, to track and report the ownership and to determine the value at the end of each month.

6. Liquidity management and cash flows

The proposal for the efficient procedures related to the management of cash flows between the CPF, the EC Central Treasury and the Authorising Services, representing the underlying contributing instrument, caters for 3 objectives: to ensure the effective liquidity management and timely payments while maintaining light administrative burden. The system of liquidity buffers, whereby each compartment is represented by a separate liquidity buffer, is aligned with the requirements of the CPF AMGs. For the effective management of the cash flows, the separate procedures, defining the operations of the liquidity buffer, replenishment and payment of guarantee calls relies heavily on the close co-ordination between the three main counterparts - CPF portfolio, EC Central Treasury and the line DGs, implementing the budgetary guarantees and other programmes.

7. Manual of Procedures and Shareholders Information Memorandum

As foreseen in Article 212(3) of the Financial Regulation, the Accounting Officer has agreed the Manual of Procedures for the CPF operations. This provides a comprehensive, easy to use reference document providing an overview of the main business processes. It covers the full lifecycle of the CPF, includes references to the governance and accountability arrangements, explains the estimation of the liquidity needs, procedures for payment of guarantee calls and liquidity management, etc. The Manual of Procedures draws on the Asset Management Guidelines (AMGs), Financial Regulation provisions and consolidates the work carried out by the Financial Manager to prepare for the implementation of CPF. An additional benefit of this composite overview is that it clearly demonstrates the interdependencies between operations, workflows and facilitates the co-ordination of all actors. In addition to the Manual of Procedures, the most relevant information for the 'shareholders' (Commission services whose policy instruments contribute provisions to the CPF) is distilled in a separate 'Shareholder Information Memorandum'. The Shareholder Information Memorandum presents the main aspects on the risk management, trading, portfolio management and extensively explains the operations, such as inflows or payment of guarantee calls, etc.