

EFSE – Promoting Responsible Finance

Being a Responsible Investor

The Fund puts great emphasis on being a responsible investor, promoting responsible lending practices in our target region. Our emphasis on responsibility is derived from our commitment to our development mission, facilitating access to finance for less privileged population groups. This ranks first before any return expectations. However, as the financial performance over the last two years has shown, being a responsible investor does not mean having to forego profits. While the Fund invests responsibly, it has also generated adequate returns to its shareholders over the last two years, which is key to ensuring the long-term sustainability of the Fund.



What are the dimensions of responsible finance the Fund cares about?

General business principles

Additionality and complementarity

The Fund aims to provide additional development finance, complementing ongoing initiatives. From this perspective, the Fund's objective is to crowd in private capital for development purposes. Once private investors start tapping the market, the Fund is ready to change its role and move into areas that represent new development finance frontiers.

Mission: Facilitating access to finance for low-income clients

The Fund's primary focus is on providing long-term funds for micro and small enterprises in rural and urban areas. Additionally, the Fund promotes housing finance, ensuring decent shelter in Southeast Europe to stabilise the region, which is characterised by considerable migration and poor levels of housing

investment during the past few decades. In view of this situation, the Fund seeks to boost local investment and production. The Fund deliberately refrains from providing funds for consumer lending. By the same token, the Fund actively promotes the use of cash-flow based lending technologies that respond to the specific economic profile of the target clientele.

Promoting responsible financial instruments

The Fund aims to provide long-term funding in a manner that is conducive to developing local financial markets. The Fund, for example, provides local currency financing when possible. With the objective to further promote local currency lending in markets where no hedging possibilities are available, the Fund invested in The Currency Exchange Fund (TCX), which offers hedging facilities in illiquid markets. The Fund also offers guarantees to leverage funds in local

currency from local financial institutions. Furthermore, the Fund provides fixed interest rates to those financial institutions that have limited possibilities to manage interest rate risks.

Financial sector level

Raising awareness of responsible finance among the public

We are engaged in promoting responsible financing practices throughout our target region. In this context, for example, we support the central banks, e.g. through workshops and conferences that sensitise the public to these issues (see “Our Development Facility” on page 27 and the box “Responsible Finance Panel Discussion” on page 29).

Conducting research on responsible finance practices.

Furthermore, we commission studies and research projects in the area of responsible finance. For example, we are currently conducting a study on responsible finance practices in Southeast Europe. We are also preparing a study on the level of indebtedness or over-indebtedness among micro and small enterprises and private households.

Fund investment level

Group of like-minded investors

Fund Notes or Shares are not for public sale but exclusively reserved for informed investors, primarily institutional investors. In general, our shareholders have a long-term view and make a long-term commitment. European Fund for Southeast Europe’s (EFSE) Board decides on the entry of new investors. Through this mechanism, the Fund ensures that all investors endorse the development mission of the Fund and share similar corporate values and business principles.

Transparency and disclosure of information

The Fund promotes transparent operations. We publish information on the Fund’s investment portfolio, financial and development performance on a quarterly basis in addition to official reporting to the

Luxembourg Supervisory Authority for the investment fund industry (CSSF). The respective reports are available at the EFSE website for download free of charge (www.efse.lu).

The Fund is among the few microfinance investment vehicles that were granted the LuxFLAG label in early 2007. This label provides assurance to investors that their funds are effectively invested in the microfinance sector. In this context, we provide regular information to the labelling agency to update the label.

We also submit information on the Fund’s operations and performance to MIX Market. This is a global, web-based microfinance information platform (www.mixmarket.org) that publishes information on a large number of microfinance investment vehicles, among them EFSE.

At present, we also participate in the Consultative Group to Assist the Poor (CGAP) initiative on establishing performance benchmarks for microfinance investment vehicles.

Partner lending institutions’ level

Demanding high standards of business ethics from our partner lending institutions

In addition to assessing the financial performance of our partner lending institutions, the Fund requires that the partner lending institutions adhere to minimum standards regarding corporate values and business ethics. As part of our due diligence process, we particularly scrutinise the following areas:

- Anti-money laundering and anti-terrorist financing
- Integrity checks of owners and managers
- Existence of transparent and fair business practices towards clients
- Implementation of environmental and social guidelines as an integrated part of the credit risk management.

Establishing a long-term relationship with partner lending institutions

We establish relationships with partner lending institutions with a long-term perspective. This contrasts at times with the ad hoc, opportunistically driven business practices of investment funds that aim at maximising profits within the shortest period possible. Our investment philosophy seeks to establish the Fund as a long-term funding source, underlining our commitment to individual financial institutions as well as the region at large. Particularly in challenging times when liquidity dries up, the Fund endeavours to be perceived as a stable funding source for our partner lending institutions. As part of this concept, we offer focused technical assistance and training to partner lending institutions. In this perspective, the Fund aims to support the institutional development and strengthen the institutional capacities of our partner lending institutions to better respond to the demands of micro and small enterprises as well as private households.

Promoting sound environmental and social management

The Fund strives to promote the implementation of sound environmental management systems and social policies in each partner lending institution. We require each partner lending institution to respect a social and environmental exclusion list when on-lending our funds to micro and small enterprises. The main objective is to prevent our funds from financing economic activities that involve child labour or have a detrimental effect on the environment. Second, we provide training to our partner lending institutions to adjust their credit risk management system to better cater for environmental and social values.

End-borrower level

Promoting financial literacy among end-borrowers

We endeavour to build public understanding about how the financial sector functions and the important aspects that borrowers should be aware of when applying for a loan. With this objective, the Fund's Development Facility has sponsored a client educational booklet (see "Our Development Facility" on page 27 and the box "Promoting financial literacy" on page 32).

Promoting responsible financial products

We recognise the importance of stimulating product innovations that create positive effects beyond increased capital formation and better use of business opportunities, e.g. innovations which create positive spill-over effects on environmental protection. With this objective, we are promoting a pilot scheme for housing energy efficiency that seeks to promote specific housing energy loan products for private households. This pilot scheme is driven by the fact that private households represent an extraordinarily high share in total energy consumption in the target region compared to Western Europe.

Fund operations' level

Decentralised operations through local offices of Fund Advisor

Regarding the origination and monitoring of the Fund's investments, the local offices of the Fund Advisor play a key role: our local staff is often in daily contact with the partner lending institutions. This entails various responsibility dimensions. First, this decentralised approach promotes better service quality and swifter problem-solving. Second, the Fund operates as an integrated part of the local financial market. Finally, the continuous presence of local staff of the Fund Advisor limits international travel and, hence, has a positive effect on CO² emissions as well as cost savings.