EUROPEAN FUND FOR SOUTHEAST EUROPE

Sustainability-related disclosure: statement on consideration of principal adverse impacts on sustainability factors

Introduction

This statement is published by the European Fund for Southeast Europe (EFSE, “the Fund”) on its website in accordance with Article 4 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR, “the Regulation”). The Fund takes into account principal adverse impacts on sustainability factors.

Against this background, the purpose of this statement is to provide transparency on (i) how EFSE considers the principal adverse impacts and (ii) the principal adverse impacts of investment decisions on sustainability factors. Other documents that are related to this statement include:

- EFSE statement on the integration of sustainability risks in the investment process (March 2021) in accordance with Article 3 of the Regulation
- EFSE statement on the promotion of sustainable investment objectives (March 2021) in accordance with Article 10 of the Regulation
- EFSE Responsible Investment Policy
- Other periodic reports, fact sheets and information published on the EFSE website

This statement is made on 9th March 2021 in reference to the calendar year 2020.

The strategic focus of EFSE is to foster economic development and prosperity by supporting micro and small enterprises (MSEs) and low-income households. Investees of the Fund are referred to as Partner Lending Institutions (PLIs).

Description of principal adverse impacts and the policies and actions to identify and prioritise and address such impacts

EFSE engages with PLIs through private debt and equity investments in financial intermediaries for on-lending to micro and small businesses and low-income households. Although likely to be limited given the nature of its investments, adverse impacts on sustainability related factors may occur, particularly in relation to, emissions and pollution; human rights; social and employee matters; anti-corruption and anti-bribery matters. Against this background, EFSE places a priority on the effective management of (potential) principal adverse impacts of its investment decisions on these factors.

When investing in financial intermediaries, strict use-of-proceeds requirements are put in place, including type of end borrower (MSE and individual households) and limits to loan amounts to end borrowers. As a result of this investment strategy, the risk of causing principal adverse impacts on the environment and/or the society via individual end borrowers is inherently diminished.

While the level of management of potential adverse sustainability impacts depends on the size, nature and scale of an investment, EFSE acknowledges that effective management of adverse impacts requires careful governance and therefore maintains a comprehensive environmental and social management system (ESMS) and a detailed risked-based AML/CFT framework that define the Fund's commitments to managing adverse impacts.

The key document summarizing the Fund's ESMS is the EFSE Responsible Investment Policy complemented with detailed E&S procedures and tools to support implementation. The EFSE Exclusion List is an integral part of the Responsible Investment Policy and prohibits the use of EFSE funding for activities with an elevated risk of causing adverse impacts, such as activities involving child and forced labour, pesticides/herbicides subject to international bans, activities related to coal, oil and gas sectors, and those involving destruction of high conservation value areas, among others. In addition to the activities outlined in the exclusion list, the Fund does not permit proceeds to be used to fund activities which involve involuntary resettlement, adverse impacts to indigenous peoples, significant risks to or impacts on the environment, community health and safety, biodiversity, cultural heritage, or significant occupational health and safety risks.

Within the investment process, thorough E&S due diligence processes are a key tool for identifying potentially significant adverse sustainability impacts and assessing the PLI's capacity and commitment to address and mitigate against these impacts. The scope of the E&S due diligence is customized depending on the initial E&S risk categorization of the investment. The categorization (high, medium, low) takes into consideration the potential and likelihood of causing principal adverse sustainability impacts.

The E&S due diligence process of the Fund is focused on assessing the policies, procedures and capacity in place at the financial intermediary PLI, to effectively manage the risks and impact of the lending portfolio to be financed by the Fund. All PLIs are required to implement or maintain a comprehensive environmental and social management system (ESMS) that define the PLI's commitments to managing adverse impacts.

Results of the E&S due diligence form an integral part of each investment proposal. Where principal adverse impacts are identified during the E&S due diligence process, these are described along with the Advisor's assessment of the ability of the PLI to mitigate and manage the impacts to international standards. If the E&S due diligence appraisal determines that additional measures are required for the PLI to meet the Fund's E&S requirements, these are presented in the Investment Proposal and included in the loan documentation. PLI's which are not considered to have the capacity to manage potential principal adverse sustainability impacts (even with appropriate technical assistance support) are excluded from financing.

Regular monitoring of the PLIs' E&S performance is considered crucial in order to effectively manage the potential risks of principal adverse impacts of the Fund investments. PLIs are required to report on E&S performance on an annual basis. Where appropriate, third party consultants may be engaged to support the E&S monitoring of investments. When incidents do occur that may lead to principal adverse impacts, such as explosions, spills, or accidents resulting in death, serious health impacts or environmental contamination, PLIs are required to inform the Fund. Where the management of principal adverse impacts is not satisfactory, the Fund will agree with the PLIs on remedial measures to be implemented.

The Fund ensures that governance factors are assessed as part of the investment process, to ensure that corruption, bribery and other adverse governance practices are not promoted. The Fund's AML/CFT policy defines the minimum eligibility requirements for investees, the scope of which is determined on risk-sensitivity basis, and refrains from financing sanctioned investees and investees assessed as prohibited or at very high-risk for money laundering/terrorist financing.

Engagement policies

The Fund focuses on private debt transactions and has only very limited exposure to publicly traded securities or listed companies and as such does not undertake investor engagement within the meaning and context provided by Article 3(g) of Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies. Nevertheless, engagement with PLIs is an integral component of the Fund's investment process and contribution to positive development impact. This engagement often includes (but is not necessarily limited to) the ability and capacity of the PLI to manage adverse ESG impact. Where appropriate, e.g., when a PLI does not meet the required standards of ESG management, technical assistance or capacity building is provided as part of the engagement with a PLI.