

Sustainability-related disclosure: statement on sustainable investment objective



Introduction

This statement is published by the European Fund for Southeast Europe (EFSE, “the Fund”) on its website in accordance with Article 10 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR, “the Regulation”). Its purpose is to provide transparency on the promotion of environmental or social characteristics and, as applicable to EFSE, of sustainable investments¹ on websites.

Additional publicly available documents that are related to and complementing this statement include:

- Periodic reports (including Annual Impact Report), fact sheets, and information published on the [EFSE Website](#)
- [EFSE statement on consideration of principal adverse impacts on sustainability factors](#) (March 2021) in accordance with Article 4 of the Regulation
- [EFSE statement on integration of sustainability risks](#) (March 2021) in accordance with Article 3 of the Regulation
- Finance in Motion’s² (“the Advisor”) [Disclosure statement to the Operating Principles for Impact Management](#)

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

¹ The Regulation defines ‘sustainable investment’ as “an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance”.

² Finance in Motion serves as EFSE’s Fund Advisor.

Sustainable investment objective of the financial product

EFSE is an impact fund that aims to foster economic development and prosperity in Southeast Europe and the E.U. Eastern Neighbourhood Region by supporting micro and small enterprises (MSEs) and improving living conditions for households (“the final target group”). At this final target group level, the positive impact goal of the Fund is to support employment opportunities (as both self-employed and as employee), supporting the generation of income and improving livelihoods. In pursuing this explicit sustainable (social) investment objective³ it therefore falls within the scope of Art. 9 of the SFDR. EFSE further strives for systemic impact by contributing to strengthening the financial sector serving those target groups.

The entire EFSE portfolio is dedicated to this social investment objective, requiring each investment to work towards making contributions to tackling inequality, fostering social cohesion, or investing in the economically disadvantaged.

EFSE’s activities have been mapped towards the Sustainable Development Goals (SDGs) at an SDG target level, based on which 6 have been selected as core SDGs. For more information on EFSE’s contributions towards these SDGs, please refer to the [2019 Annual Impact Report](#).

EFSE carries the LuxFLAG Microfinance label⁴. This label, which must be renewed on an annual basis, signals that the Fund meets internationally recognized standards in the microfinance sector and invests to a large share in microfinance.

No index has been designated as a reference benchmark. Details on how the Fund’s social impact objective is being attained are provided in the below sections on investment strategy and monitoring approach.

(Investment) Strategy to achieve sustainable investment objective

Investment strategy. The investment strategy of the Fund focuses on providing dedicated debt financing to financial intermediaries in the Southeast Europe region and in the European Eastern Neighbourhood region (“target regions”), particularly commercial banks, microfinance institutions, and leasing companies. The strategic approach of providing dedicated finance through financial intermediaries has been shown as particularly effective in building outreach, strengthening local systems, and creating impact at scale.

In addition to providing dedicated financing, EFSE is advancing strategic issues to strengthen local financial markets, such as local currency financing.

Investee selection. Investees of the Fund are referred to as “partner lending institutions” (PLIs). Selection is guided based on a comprehensive set of eligibility requirements and investment criteria, as defined in the Fund’s Issue Document and Investment Guidelines. Linked to the Fund’s social objective, these include commitment to internationally recognized environmental, social, and

³ In the following, the terms “sustainable investment objective” and “positive/social impact objective” shall be used interchangeably.

⁴ <https://www.luxflag.org/labels/microfinance/about-label.html>

governance (ESG) standards, responsible finance standards and principles of good corporate governance as well as potential to reach EFSE's target group. EFSE's Responsible Investment Policy complements the Issue Document and Investment Guidelines and governs EFSE's Responsible Investment commitments in relation to development impact, responsible finance, governance, and environmental and social management.

Use of Proceeds. EFSE provides its PLIs with dedicated funding for on-lending through loans ("sub-loans") to urban and rural MSEs as well as to households (for housing purposes) ("end-borrowers") in line with market needs and according to contractually agreed, EFSE-specific use-of-proceeds requirements including limits to sub-loan size.

Sub-loans to urban and rural MSEs feed into the Fund's social investment objective by addressing two core challenges:

- Access to finance is a key challenge for MSEs, limiting their development and growth. Through its dedicated MSE financing, EFSE is increasing the resources available for MSEs⁵.
- MSEs are a key driver of employment and local economic development. By facilitating access to finance for MSEs, EFSE fosters their ability to start, maintain, and grow their business activities, thereby supporting employment opportunities and income generation, including through self-employment.

Housing finance is considered a tool to improve livelihoods and starting or consolidating a development pathway for individual households by increasing social security and resilience, presenting an asset for the future and indirectly contributing to local economic opportunities.

Technical assistance. The Fund's investment activities are complemented by the nonfinancial support of the EFSE Development Facility, which provides tailored technical assistance, including to the PLIs, to build capacities, facilitate knowledge exchange, and support a conducive ecosystem for the Fund's target group.

No significant harm to sustainable investment objectives and good governance

EFSE places a priority on the effective management – i.e., avoiding, minimizing, and mitigating – of potential environmental and social (E&S) risks associated with the Fund's investments. To that end, EFSE maintains, implements, and continuously improves an Environmental and Social Management System (ESMS). The ESMS includes EFSE's Responsible Investment policy, the Fund's E&S Exclusion List, and detailed E&S procedures.

Investments are screened positively and negatively. The Fund requires its PLIs to carry out their activities in compliance with the EFSE Exclusion List, which prohibits the use of EFSE funding for activities with an elevated risk of causing adverse social or environmental impacts, such as those

⁵ Independent evaluations have shown that investments by funds such as EFSE indeed enable the financed FIs to increase their investment volume and expand their portfolios in absolute terms, so that more sub-borrowers can be reached. Please refer to: Deutsches Evaluierungsinstitut der Entwicklungszusammenarbeit (2020): Structured funds: A balancing act between financial sustainability and development impact.

https://www.deval.org/files/content/Dateien/Evaluierung/Berichte/2020/DEval_Report_2020_Structured_Funds_web.pdf

related to the coal or oil and gas sectors, activities involving child or forced labor, and those involving the destruction of high conservation value areas, among others.

Equally, PLIs must carry out their activities in compliance with national law, and in a manner consistent with the key principles of the relevant IFC Performance Standards, the International Labour Organization's core labor standards.

EFSE is committed to actively promoting good governance, integrity and transparency standards in its financing/investment activities. A set of governance principles have been adopted by the Fund with details set-out in the Investment Guidelines.

For more details, please refer to [EFSE's statement on the integration of principal adverse impact](#).

Monitoring of sustainable investment objective

Assessing EFSE's impact is important to the Fund as it demonstrates progress towards the Fund's social objective, as well as providing insights and learnings that inform EFSE strategy. The attainment of EFSE's social objective is monitored continuously through a set of key positive impact indicators (see below), combining different data sources and assessment methodologies. These indicators were selected based on [EFSE's Impact Pathway](#) reflecting both the direct impact on the investee (for example, by improving the financial sector's capacity to serve the MSE sector) as well as the indirect impacts on or through the PLI's clients.

Data sources. The Fund draws on the following data sources:

- **Fund monitoring:** Covering a range of data points at the fund and portfolio level, allowing monitoring of the Fund's overall activities related to resource mobilization, financing, and technical assistance.
- **PLI reporting:** Contractually agreed reporting on a set of predefined indicators, submitted by the PLIs to the Fund on a regular basis, utilized for continuous monitoring of use of proceeds and outreach to target group.
- **Third-party data:** External parameters and studies from academia and the impact investing industry, utilized to inform underlying impact assumptions and model final socio-economic impacts.
- **Studies and evaluations:** In-depth studies that collect and analyze primary quantitative and qualitative information directly from EFSE's final target group are conducted periodically for a deeper understanding of the Fund's impact mechanisms and the scale of its impact, complemented by external evaluations which provide additional perspectives and analysis.
- **On-site visits:** Site visits facilitated through the Advisor's staff operating from several offices across the region, facilitating continuous exchange with PLIs, and the incorporation of on-the-ground knowledge of market needs into investment strategies.

Assessment methodologies. For a large proportion of its monitoring, EFSE utilizes first-hand data, such as from PLIs' reporting or EFSE's own, internal Fund monitoring data. In order to assess and monitor its social impact, the Fund applies the following assessment methodologies:

- Quantitative and qualitative studies in the target region: EFSE periodically commissions end-borrower studies to review of the effects of its financing on the final target group. These are conducted by external, specialized research institutions and focus on assessing changes in the employment, income, and livelihoods of MSEs and households that received financing through an EFSE PLI. Results are utilized to confirm the underlying assumptions of EFSE's impact pathway (particularly at an outcome and final impact level) as well as its impact reporting and measurement, and to inform future strategy and outreach of the Fund. [Results of the most recent study are available on the EFSE website.](#)
- Modelling: For a continuous estimation of the Fund's employment effect, a modelling approach has been developed. The approach combines PLI reporting on sub-loans disbursed with job intensity factors derived by combining insights from the Fund's own end-borrower studies, academic research, and industry data. Underlying data and assumptions are periodically reviewed and updated.

Due diligence on underlying assets (concerning the social objective of the Fund). Assessing the potential of an investment to contribute to the Fund's positive impact objective follows a two-step approach in the pre-investment phase:

- During pre-screening, the investee's alignment with the Fund's requirements is assessed. This relates to minimum requirements for ESG and responsible finance practices, as per the Fund's Issue Document and Investment Guidelines.
- During the due diligence phase, the investment's alignment with the Fund's impact objective is reviewed, taking into consideration different elements such as potential outreach to the target group, the investee's capacity to deliver the expected impact, and the Fund's specific impact contribution.

Positive impact indicators and reporting. In order to measure its overall sustainable impact, EFSE has identified a set of indicators. These were selected based on the Fund's impact pathway and include:

- Cumulative number of loans distributed to micro and small enterprises and households
- Volume of loans disbursed to MSEs
- Volume of loans disbursed to rural businesses
- Number of active sub-borrowers
- Average size of loans facilitated to MSEs and low-income households
- Percentage of local currency lending
- Number of jobs supported by MSEs receiving EFSE financing through a PLI

Results towards these indicators along with additional metrics are regularly published on the Fund's website and in periodic publications and reports.

For **more information** on monitoring approach and results please see:

- [The EFSE 2019 Annual Impact Report](#)
- [The Factsheets on Development Performance](#)
- [The EFSE Website](#)
- The Advisor's [Disclosure statement to the Operating Principles for Impact Management](#)

Engagement policies and impact management

Engagement with PLIs is an integral component of the Fund's investment process and central to managing its positive development impact. EFSE considers itself a long-term partner to its PLIs in line with its target to sustainably strengthen the local financial sector. This engagement includes (but is not necessarily limited to) the provision of tailored technical assistance to strengthen the abilities and capacities of PLIs to enhance outreach to the EFSE target group or manage E&S risks. In addition, engagement with PLIs takes place on a continuous basis, facilitated through the Advisor's strong presence in the target regions as well as through regular reporting requirements, and through the networking and platform building efforts of the Fund, which contribute to knowledge sharing and scaling up of good practices among and across PLIs.

In the limited instances where EFSE holds equity stakes, the Fund may take up Board representation.