



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.11.2002
COM(2002) 603 final

Proposal for a

COUNCIL DECISION

**concerning the coverage of costs incurred by the EIB for the management of the
Investment Facility of the Cotonou Agreement**

(presented by the Commission)

EXPLANATORY MEMORANDUM

The Cotonou Agreement of June 2000, gives a central role to the private sector in the fulfilment of the main objectives of the EU-ACP partnership i.e. the reduction and ultimately the eradication of poverty, the promotion of sustainable development and the progressive integration of the ACP countries into the world economy. The Agreement recognises that by promoting investment and stimulating the development of the private sector, the ACP countries can significantly improve their prospects of more rapid and sustainable growth, which will in turn contribute to the reduction of poverty. To this end, as stated in article 21, the ACP-EU co-operation shall support inter alia, the development of entrepreneurial skills and business culture, privatisation and enterprise reform, the development of mediation and arbitration systems, the improvement of the quality, availability and accessibility of financial and non financial services to private enterprises, the catalysing and leveraging flows of private savings both domestic and foreign into the financing of private enterprises, the provision of guarantee facilities and technical support.

One of the main instruments for private sector development is the Investment Facility, a 2.2 billion EUR fund managed by the European Investment Bank, EIB. The Facility "shall provide long term financial resources including risk capital to assist in promoting growth in the private sector and to help mobilise domestic and foreign capital for this purpose" (article 76 (1)). Special emphasis will be put on the development of the local financial sector, making it an efficient channel for the financing and development of small businesses, and on domestic ACP capital markets, with the view to foster their capacity to mobilise domestic savings. The Investment Facility will also fund viable public or private infrastructure projects, as a prerequisite to encouraging investment and sustainable growth. It will deploy a series of financial instruments such as loans, equity participation, quasi-equity and guarantees.

Specific features of the Investment Facility The Investment Facility differs from risk capital funding under the Lomé Conventions on the following counts:

1. the size of the capital endowment: M€ 2,200, or a 120% increase over the second Financial Protocol of the Lomé IV Convention;
2. the focus on private sector financing in regions with variable and often limited opportunities for investment,
3. The Facility's revolving nature, implying that ultimately future resources will depend on reflows, and the requirement for long term financial viability. This calls for yet more rigorous project appraisal and financial monitoring, as well as for risk analysis and risk management, including the application of risk mitigation measures;

Staffing requirements

The Bank considers that up to 49 Equivalent Full Time (EFT) additional staff will be ultimately required to manage the Investment Facility at full capacity, i.e., by the end of the first financial protocol:

- specific expertise not currently available and staff to relieve existing bottlenecks (16 EFT). To make greater use of financial intermediation and to fulfil the Bank's new role in the support and development of financial markets in the ACPs, it will be necessary to acquire new expertise, with direct relevance to the ACP context. In particular, skills will be required to establish or strengthen the capacity in the following areas: bank analysis;

appraisal and monitoring of investment funds; appraisal and structuring of guarantee operations. Expertise will also be needed to follow policy issues relevant to the operations of the Facility and country creditworthiness issues; supervise the sector analyses which may be required to identify possible future investment opportunities; study capital markets (instruments, prudential regulation, bank supervision) as a prerequisite to financial sector operations; and review the assessment of the overall economic and developmental impact of operations.

- a net staff increase of 33 EFT to manage the larger volume of operations, of which, up to 5 EFT staff could be posted in the field. Such presence would offer the dual benefit of facilitating project identification and strengthening co-ordination with other donors, not least the Commission's Delegations. It would also be in line with the mandate requirement for greater involvement by the Bank in the development process of the ACP. However, these advantages would have to be gauged against the experience of other institutions, the risk that the results may not be conclusive, as well as the additional costs involved. An option to minimise such risks would be to launch it as a pilot project, starting with one region on a temporary basis.

This staff increase of up to 49 EFT will result in a total Bank-wide staff of 115 EFT to carry out operations in the ACP countries, out of which up to 75 EFT staff will be responsible for operations under the Investment Facility. Some three quarters Of these 75 EFT will be professional staff and assistants and the balance support staff; in terms of allocation by department, approximately half thereof are intended for the ACP lending department, 40% for the Legal and Project Directorates and the balance distributed across other disciplines.

Management costs

The EIB has been a traditional partner of the EU's development assistance programmes, financing investment both on its own resources and, under Member States' mandate, on risk capital. While the Bank covers the cost of own resource operations through the margin that it charges on all such loans, **it has been fully remunerated** by the Member States for the costs incurred in the management of risk capital operations. **The same principle will apply in the future to the management of the Investment Facility, as stipulated in Art. 8 (2) of the Internal Agreement of the 9th EDF.** Thus, the costs presented in this document apply only to the 75 EFT staff dedicated to the management of the Investment Facility. The costs related to the monitoring of Lomé operations are covered by the existing remuneration agreement and that of own resource operations by the Bank's margin.

The costs related to IF operations reflect the progressive staff build-up discussed above and other expenses. Costs have been corrected for future expected cost escalation and include five components:

- Personnel expenses represent the largest item. They have been based on the Bank's 2001 standard costs for operations under mandate, calculated on the principle of full cost recovery, i.e. taking into account both direct costs and a proportion of the Bank's total overhead costs which actually doubles direct costs. The resulting total staff costs are thus estimated at € 178 million for the first five years, assuming that recruitment will be staggered over four years, as presented in the table below.
- The second cost item reflects the impact of the qualitative change in operations, such as more extensive and/or additional missions, greater use of specialised external expertise, specific IT requirements and programmes. These costs have been estimated at € 10 million.

- Start up costs, a substantial share of which have already been incurred over the last three years, are estimated at some € 8 million. These costs also include the expenses related to meetings of the IF Committee before the IF becomes operational
- The cost of posting a maximum of 5 EFT staff to the regions estimated at some EUR 3 million in total.
- In view of the uncertainties surrounding the projections, a further 10% for contingencies

On this basis, total costs add up to € 219 million for the five-year period, or an average annual cost just below EUR 44 million, i.e., 2% of the total endowment of the Facility. This figure is comparable to the lower limit of private investment funds' fixed portion of management costs, which range between 2% to 3% annually of the capital endowment.

The table below summarises the evolution of the business plan, of the staff and of the maximum total costs expected.

	2002*	2003	2004	2005	2006	2007	Total
business plan (MEUR)	--	350	400	450	500	500	2200
Staff	34	51	63	75	75	75	75
total costs (MEUR)	8**	26	34	41	44	46	199 + 10% contingencies= 219

**including envisaged recruitment*

***1/4 of the annual cost, assuming that only 4th quarter activities will apply to future IF operations*

Principles for covering Bank costs

In emerging markets, private investment funds typically charge an annual management fee of 2% to 3%, calculated on the total size of the investment fund during the commitment period and on the amount of investments outstanding thereafter.

A distinction should be made between the long-term solution and the temporary arrangements for the first years of the Investment Facility.

In the long term, logic requires that the Bank be remunerated directly from the Facility. The Cotonou Agreement stipulates that net reflows from the Investment Facility operations will return to the IF. This would imply that only repayments - expressed in terms of principal and interest, as well as returns on equity - net of Bank fees will flow back. However, this option will be feasible only when sufficient reflows have built up. Financial forecasts show that this should occur at best by the 6th or 7th year of operations. The second financial protocol should thus include an explicit provision whereby the Bank's fees would be funded out of the Facility, so that only reflows net of Bank fees would revolve. The principle of putting this issue on the agenda for the next round of negotiations (in 2004-2005) needs to be established by the Member States during this discussion on Bank remuneration.

In the interim period, and particularly for the first financial protocol of Cotonou, another remuneration formula needs to be identified.

Mechanism for covering Bank management fees

This issue has been discussed both by the Investment Facility Committee where Member states are represented and by the ACP/FIN Working Party. Two possible options emerged:

- deducting fees from the Facility itself
- deducting fees from the reflows generated by risk capital operations under the previous Conventions.

The first option was not taken since there is nothing in either the Financial Protocol itself or in Annex II of the Cotonou Agreement, to indicate that the EIB costs for managing the Investment Facility may be deducted from the latter endowment.

Deducting fees from Lomé risk capital reflows

This option entails extending to the IF the cost coverage mechanism currently applied to the payment of Bank fees for managing risk capital under the various Lomé Conventions. The Bank collects the ACP debt service repayments on budget resources under all previous Lomé mandates, and credits the funds to the Member States' accounts. Beforehand, however, it deducts its fees. Consequently, only the reflows net of Bank fees are transferred to the Member States.

Bank fees for managing the Investment Facility could be met on the same basis and from the same Lomé funds. They would be deducted from the debt service reflows alongside the fees for managing risk capital, so that only the amounts net of management fees for Lomé and IF operations would return to the Member States. One complication is that the three newest Member States have only contributed to Lomé IV bis and their reflows will not be sufficient to meet their share until 2006. The Bank envisages to pre-finance the contribution of these Member States, until their share of the reflows has built up sufficiently.

Projections indicate that these debt service reflows would be sufficient. But should they be insufficient, the Member States must commit themselves to cover Bank fee from other sources.

It must be born in mind that only the net costs incurred by the Bank for managing the Investment facility will be met. In other words the fees paid by the Member States will correspond to the actual costs which may turn out to be lower than the 2% per annum figure. The IF annual business plan will include a specific section on staffing including proposed increases in staff numbers and forecast costs. The IF Annual Report will contain a section on the costs of managing the Facility and their breakdown. If actual costs are lower than initial forecasts, provisions will be made for the utilisation of the balances, either from one year to the next, or at the end of the first protocol: they could be credited to the IF for purposes to be determined, or reimbursed to the Member States.

Validity period

The legal base of this Council decision is the Internal Agreement of the 9th EDF. If adopted, it therefore can enter into force only when the latter does. Moreover, Article 9 of the proposed decision provides that the decision shall be applicable for the same period as the Internal Agreement.

Conclusion

For the reasons which are set out above, the Commission proposes to the Council to adopt the attached decision.

Proposal for a

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concerning the coverage of costs incurred by the EIB for the management of the Investment Facility of the Cotonou Agreement

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to the Partnership Agreement between the members of the African, Caribbean and Pacific Group of States of the one part, and the European Community and its Member States, of the other part, signed in Cotonou on 23 June 2000¹

Having regard to the Internal Agreement of 12 September 2000 between Representatives of the Governments of the Member States, meeting within the Council, on the Financing and Administration of Community Aid under the Financial Protocol to the Partnership Agreement between the African, Caribbean and Pacific States and the European Community and its Member States signed in Cotonou (Benin) on 23 June 2000 and the allocation of financial assistance for the Overseas Countries and Territories to which Party Four of the EC Treaty applies² and in particular Article 8 (2) thereof

Having regard to the proposal from the Commission drawn up in agreement with the Bank,

Whereas:

- (1) Whereas there is no provision in the Cotonou Agreement for meeting the costs incurred by the European Investment Bank (hereinafter referred to as 'the Bank') for the management of the Investment Facility,
- (2) Whereas the Bank shall apply all income generated from standard appraisal fees charged to clients of the Investment facility towards the coverage of its normal costs, with the exclusion of exceptional fees received to cover extraordinary expenses incurred,

HAS ADOPTED THIS DECISION:

Article 1

The provision for the fees charged by the Bank to manage the Investment Facility and the interest rate subsidies including the resources reserved for the Overseas Countries and Territories (hereinafter referred to as 'the OCT', shall be equivalent to a maximum of EUR 220 million. The fees are intended to cover in full the cost of managing the Investment

¹ OJ L 317, 15.12.2000, p. 3

² OJ L 317, 15.12.2000, p. 355

Facility, including the sums allocated to finance interest subsidies for operations in the ACP States and the OCT, during the five years of the First Financial Protocol of the Cotonou Agreement.

Article 2

To the extent that the remit of the Bank as defined in Annex II of the Cotonou Agreement and in the operational guidelines of the Investment Facility remains unchanged, the maximum fee specified under Article 1 shall constitute a ceiling.

Article 3

Every year, on the first of September at the latest, the Bank shall present to the Investment Facility Committee its cost estimates for the following year and the corresponding level of fees required. These data shall be included in the Investment Facility business plan approved by the Investment Facility Committee. Cost presentation for the first year shall depend on the date of entry into force of the Cotonou Agreement

Article 4

Every year the Bank shall present the actual costs incurred during the previous year in the annual report of the Investment Facility to be approved by the Investment Facility Committee, as well as the amount of appraisal fees recovered from the clients of the Investment Facility during that same year. The draft annual report containing these figures shall be submitted to the Investment Facility Committee on the 28th February at the latest and the final report on the 30th June at the latest.

Article 5

Should the costs incurred by the Bank during a given year be lower or higher than presented in the corresponding business plan, the Bank shall request the Investment Facility Committee to decide on the necessary arrangements.

Article 6

The provisions for the fees referred to in Article 1 shall be met from the reflows to the Member States of debt service payments generated by risk capital operations and special loans undertaken under the successive Lomé Conventions. The amount owed by each Member State will be determined by the relative share of its contribution to the 9th EDF. In the case of Member States, which are not yet recipient of sufficient reflows, the Bank will debit their accounts and charge an annual interest rate equivalent to the prevailing EONIA rate minus twelve and a half basis points.

Article 7

The Council, acting on a proposal from the Commission, drawn up in agreement with the Bank, shall decide on how to finance the Bank fees as agreed in Article 1, should the reflows of debt service payments be insufficient for this purpose.

Article 8

The Member States authorise the Bank to deduct the fees directly from their accounts held within the Bank to which the reflows specified under Article 6 are credited. Fees shall be deducted on the first working day of each quarter and shall be remunerated at an annual rate equivalent to the prevailing EONIA rate minus twelve and a half basis points.

Article 9

This decision will enter into force on the day of its adoption. It shall be applicable for the same period as the Internal Agreement.

This Decision is addressed to the Member States.

Done at Brussels,

*For the Council
The President*