Investment Facility
ACP - EU Cotonou Partnership Agreement
Annual Report 2003
Origin and Mission of the Investment Facility

The origin of the Investment Facility - IF goes back to 1997, when proposals were being made for a successor agreement to the four Lomé Conventions, which had governed the partnership between the ACP countries and the European Community and its Member States since 1975. Over most of this period, public investment in the productive sector had been seen as having the primary role in promoting economic growth and hence, it was believed, of development. As a corollary, development assistance by the EU, as well as by all the other development agencies, was primarily directed towards supporting investment by the government of the recipient country.

However, the results of this public sector investment were increasingly disappointing. Economic growth in Africa, promising in the 1970s, fell away in the 1980s and 1990s while the external debts of the countries concerned accumulated faster than the capacity to service them. Hence the development paradigm began to change; a new approach gave greater prominence to the role of the private sector as the principal source of economic growth. In a shift from earlier thinking, it was acknowledged that growth and development could not rely solely on government planning but also depended on encouraging private sector initiative.

This meant, in turn, recognising the importance of market forces: private sector enterprise has to be competitive to survive, something which had not always been a concern for public investment. This presented a design challenge for the IF. A continuation of the past approach based on concessional funding, and particularly on subsidised interest rates, would be inconsistent, if applied to the private sector, with the need for market discipline, and could adversely affect the growth of domestic financial sectors in the ACP countries. Hence, it was decided to create the IF as a revolving fund, operating on market-related terms in which the returns to the fund would be reinvested in the ACP economies.

This much was established in the Cotonou Agreement itself. The key text states:

The Investment Facility shall operate in all economic sectors and support investments of private and commercially run public sector entities, including revenue generating economic and technological infrastructure critical for the private sector. The Facility shall:

- be managed as a revolving fund and aim at being financially sustainable. Its operations shall be on market-related terms and conditions and shall avoid creating distortions on local markets and displacing private sources of finance; and
- endeavour to have a catalytic effect by encouraging the mobilisation of long-term local resources and attracting foreign private investors and lenders to projects in the ACP States.
The phrase on market-related terms was carefully chosen to reflect the IF’s mission, which is to be prepared to invest in situations where private sector investors are reluctant to do so and, thereby, to aim to fill the gaps that are avoided by other market participants. In doing so it has to marry responsiveness to opportunities with the obvious duties of scrutiny and accountability that go together with the management of public funds.

Implicit in this is the view that there are investment opportunities in the ACPs which the private sector fails to exploit – generally for two reasons. First, perceptions of investment risk, in Africa particularly, are frequently higher than the real risk itself. The African continent still suffers from a negative image despite the steady progress towards improved governance and accountability and the renewed economic growth that many African countries have achieved over the past decade. Second, for most international financial market participants, the cost of acquiring accurate information about investment conditions and opportunities in the ACP States is judged to be too high and there appear to exist easier alternatives elsewhere. In short, there are substantial investment opportunities for the IF but only if it is prepared to take the risk of leading or accompanying the private sector, not simply following it. And not only the private sector. The IF also finances commercially run public sector entities and infrastructure critical for private sector development.

The transition from Lomé to Cotonou was characterised by other important changes, not least a renewed emphasis on human rights and on poverty alleviation – aims and objectives which were expressed by the international community in the UN Millennium Development Goals. Hence, the IF pays particular attention to the broader development impact of the various investments it makes and especially supports those that promise appreciable social, economic or environmental benefits.

(1) Annexe II of the Cotonou Agreement, Article 3
The Investment Facility is established under the ACP - EU Cotonou Partnership Agreement as a EUR 2.2 billion risk-bearing revolving fund under the management of the EIB.

Its purpose is to support economic development by investing in and financing on market-related terms the private sector in the ACP countries, and also financing commercially-run public entities, especially those responsible for key economic infrastructure.

It came into effect on 1 April 2003.

During the first nine months of its existence thirty-eight projects were under appraisal, projects were approved for a total EUR 366 millions of which nine were signed for a total amount of EUR 140 million.

Four of them were regional operations; the others were distributed across Africa in Burkina Faso, Cameroon, Mauritania, Mauritius and Zambia.

Six of the nine operations supported the domestic financial sector of the country or region concerned - a key objective of the IF.

In its preparations for managing the IF the EIB has been gearing up its staff and organisation to respond to this new challenge.

By the end of the year a total of fifty-five EIB staff were directly assigned to operations in the ACP countries.

At the same time the Bank, in collaboration with the IF Committee, and in conformity with the Cotonou Agreement, set out an overall strategy for the IF and agreed detailed Operational Guidelines.

With these arrangements now in place and with a generally improved economic and political situation in most ACP countries the IF will move forward confidently in 2004.
Introduction

The Investment Facility is a new fund established to promote the development of the private sector and commercially-run public enterprises in the seventy-eight (2) countries which make up the African, Caribbean and Pacific (ACP) group. It was created under the Cotonou Agreement between the ACPs and the fifteen Member States of the European Union and is managed under mandate by the European Investment Bank (EIB). The Cotonou Agreement was signed on 23 June 2000 and, following ratification, the Investment Facility came into force with an initial endowment from the ninth European Development Fund of EUR 2.2 billion, on 1 April 2003. Hence this first Annual Report on the IF covers the operations of the Facility during the nine-month period from that date to the end of 2003.

(2) There were originally seventy-seven ACP signatories to the Cotonou Agreement. Timor-Leste (East Timor) signed subsequently and became the seventy-eighth member. The Republic of South Africa is a signatory of the Cotonou Agreement but does not participate in the Investment Facility.
In addition the Bank has made available EUR 1.7 billion of its own resources for lending in the ACPs under the Cotonou Agreement. Further details on the action taken by the Bank to carry out effectively its part of the Cotonou mandate are given in the later section on Organisation and Staffing.

Within the framework of this mandate, responsibility for defining the policy and overall direction of the IF rests with the Bank’s Management Committee and Board of Directors, in close consultation with the IF Committee. The latter consists of representatives of the Member States and the Commission, with the Committee Secretariat provided by the Bank. Indeed, the IF Committee, of which the members are individually nominated by their governments, plays a key role in the successful outturn of the Facility. It commenced its work in late 2002, before the coming into force of the IF, and by the end of 2003 had met on seven occasions. Over this period it has, among other tasks, discussed and approved the IF’s Operational Guidelines and pronounced on issues related to financial instruments such as equity, local currency loans, guarantees and credit risk.

A key task of the IF Committee, very much reflected in the approved Operational Guidelines, is to give guidance to the Bank in its efforts to strike an appropriate balance between two key objectives: to take risks which other market participants would not usually contemplate, in the broad interests of the development of the ACP countries, yet at the same time to aim at being financially sustainable, which the Operational Guidelines interpret as aiming to maintain the value in real terms of the initial EUR 2.2 billion endowment of the Facility.

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As manager of the IF, the EIB brings its considerable expertise in lending to the private sector, its detailed knowledge of the ACPs and their investment climate, and the long experience of its staff in assessing the real risks of operating in these countries.

(3) This and other key IF documents are available on the internet at www.eib.org/lending/IFACP
Financial Instruments

The Cotonou Agreement also sets out the various financial instruments which the IF can deploy, which have been further detailed in the Operational Guidelines.

Since the main value-added of the IF resides in its risk-bearing capacity, the most important of these financial instruments, in development terms if not necessarily in overall volume, will be the various forms of subordinated and conditional loans, quasi-equity (otherwise known as mezzanine finance), and direct and indirect equity instruments. Of course, because of the very nature of these development finance instruments, their contribution to the overall financial viability of the IF will not become apparent for some years.

In addition, two relatively new risk-bearing instruments are likely to enhance the development impact of the IF. The first consists in providing loans in the local currency of the recipient country, at interest rates which reflect the market conditions in that country, so long as there is relative macro-economic stability and good financial sector management in the country concerned. In other words, the IF takes on the foreign exchange risk of the operation for a premium which is contained in the difference between interest rates in the local market and the Euro market. Since, for almost all the ACP countries, it is impossible for a borrower to buy a long-term currency hedge or forex risk cover in the market, such operations genuinely meet the criterion of filling gaps where current market conditions fail. The second instrument is that of guarantees of various forms, which can be effective since in an increasing number of ACPs there is no absolute shortage of financial resources, but rather a lack of capacity to take on risk. The IF will move cautiously into this area, with a particular focus on providing guarantees in circumstances where to do so can support the development of domestic financial markets over the medium term, for example by underwriting or guaranteeing local bond issues.
Investment Conditions in the ACPs

Although a global picture of the ACP economies is difficult to draw, a few comments are worth making on the overall context in which the IF comes into operation. Notwithstanding disappointing setbacks in countries such as Côte d’Ivoire and Zimbabwe, a large number of ACP countries have witnessed improving standards of governance, freedom of speech and public accountability over recent years.

Most significantly of all, the IF comes into effect in a period of declining conflict on the African continent. At the end of 2003, and for the first time in at least fifty years, no major wars were being waged anywhere on the African continent (with the arguable exception of southern Sudan) or indeed anywhere in the ACPs. While local political conflicts still occur and some of these will likely still turn violent, it is nevertheless worth drawing attention to this relatively peaceful moment in history.

At the same time, and perhaps largely as a result of this, there has been a general return to positive rates of economic growth and improved financial stability. Reforms - usually under the auspices of the World Bank and the IMF - aimed at market liberalisation and fiscal discipline have enhanced business prospects and resulted in higher growth rates. In addition, partly as an outcome of the HIPC initiative, external debt burdens have become more manageable. Moreover, although universal primary education is far from being achieved, general educational standards are rising and with them the capacity of public administrations and private businesses to manage their affairs effectively. The latter is particularly important for the IF, since the EIB, more than other development agencies, has always placed great emphasis on project ownership and management by the promoter or borrower himself, and in particular has sought to channel a substantial part of its funds through local financial sector intermediaries.

Yet, in spite of this overall improvement, conditions remain generally fragile, with most economies hampered by a limited absorptive capacity (a consequence of their small size and/or low level of development), poor infrastructure and/or a weak legal and administrative system. Perceptions of risk and opportunities, especially by foreign promoters are slow to evolve, as demonstrated, i.a., by Africa’s inflow of foreign direct investment still lagging behind those of the rest of the world.
A more detailed assessment of the situation by region shows that the economic development of countries in West Africa is far from uniform, hampered - probably more than in the rest of the ACPs - by local tensions and unstable governments. Some areas of peace and relative growth remain, nonetheless. Policies of stabilisation, adjustment and combating poverty have enabled more than half of the 16 countries to qualify for the HIPC initiative. The Sahelian region experienced abundant rainfall in 2003, resulting in a bumper harvest of products like cotton. Senegal, Mauritania and Cape Verde have sound growth prospects, albeit from a small base. In the other three Sahel countries, the investment potential remains limited; however, a number of opportunities could arise in Mali and Burkina Faso, for instance in power, water and mining. In Ghana and Nigeria, the efforts taken to curb inflation and consolidate government finances are showing signs of success. Nigeria is a special case: despite its socio-political instability and uncertain legal and regulatory framework, it is by far the largest economy of the ACP countries and has a generally better educated population. Its enormous potential will continue to attract both foreign and local investment, from sources that are prepared to accept the risk.

However, major problems persist. The crisis in Côte d’Ivoire, previously a pillar of stability and growth, is still far from reaching a solution and its consequences are felt throughout the region. Due to political instability, the coastal countries south of Senegal offer little attraction for private investment but reconstruction programmes will spur public investment if peace can last.

The 18 countries located in the Central and East Africa region present a very heterogeneous picture in terms of size, GDP per capita, natural resources and relations with IBRD/IMF. Thirteen rank among the least developed ACP states. Many of them are suffering the consequences of the long lasting crises in the Great Lakes area and market conditions are difficult in the whole region, albeit to a varying degree. Growth and economic development continue to be negatively affected by widespread political tensions and instability, weak administration and public infrastructure, as well as inefficient legal and judicial systems.

Investment prospects appear encouraging in the more politically stable countries where the privatisation process has made some progress, like in Cameroon and Gabon, or in countries with a traditionally dynamic private sector such as Kenya or Uganda, or in Chad, Equatorial Guinea and Sao Tomé, where surging revenues from oil exploitation are likely to foster investments in economic and social infrastructure.

On the other hand, opportunities are mixed in countries undergoing some form of transition, where the degree of success in achieving balanced macro-economic aggregates and sustained growth will depend on the pace of reforms. This applies in particular to Ethiopia and Tanzania, where prospects could im-
prove if the political and economic situations continue to stabilise in the future. Similarly, both the Congos, Rwanda and Sudan are in a transition period, raising some hope for improvements in the future, as recently evidenced by a return to more political stability and democracy, growing peace efforts and attempts to normalise their relationship with the international community, and by the resumption of a macro-economic and policy dialogue with the Bretton Woods institutions and the EU.

The outlook is substantially less promising in Eritrea, Central African Republic, Burundi, and Djibouti, which are small, politically unstable countries with limited absorptive capacity and an unfavourable business environment. War-torn Somalia has the least favourable prospects of all.

In the Southern Africa and Indian Ocean region, the SACU (4) States of Botswana, Lesotho, Namibia and Swaziland have been traditionally characterised by rather prudent economic management. All four of them offer a propitious environment for business development, in particular a functioning legal system and reasonably good infrastructure. Botswana and Namibia rank among the most prosperous ACP States, with their considerable mineral resources (notably diamonds), contributing to the relatively high levels of income per head. Less wealthy Lesotho and Swaziland rely respectively on water and sugar as sources of revenue. Both countries also have developed industrial estates that still present a comparative advantage with respect to South Africa.

The politico-economic situation of the other SADC (5) States - Angola, Mozambique, Malawi, Zambia and Zimbabwe - is more uncertain, although investment prospects are presently favourable in Mozambique and Zambia. Mozambique’s economy has been well managed over the past decade, with sound macro-economic policies and high growth rates, but remains a very poor country, in spite of its extensive agricultural potential. Zambia has significant natural resources and, for almost a decade, the government has been redressing years of economic mismanagement by fostering pro-business policies, the development of new copper mines and the diversification of the economy into non-mining activities. Debt relief is being addressed within the framework of the HIPC programme. In spite of an abundance of natural resources, Angola’s economy is totally disrupted, but with the end of the war in 2002, recovery is high on the agenda of the government and the international community and in the medium term, Angola could provide interesting opportunities.

Malawi is the poorest country of the region, highly indebted and with few natural resources, although relief is coming from the HIPC initiative. Zimbabwe is rich in human and natural resources, but current policies have led to the almost total collapse of the economy, suspension of all overseas assistance, and a sharp decline in business confidence. Restoration of the economy is only envisageable when a new government comes to power.

A major factor to be taken into account for the entire economy of Southern Africa is the high incidence of HIV/AIDS in the region. Forecasts of mortality rates over the next ten years indicate a major negative impact on productive capacity in the region.

The main countries of the Indian Ocean - Mauritius and Madagascar - present two very different faces of economic development and growth prospects. In spite of bleak economic prospects in the 1980s, Mauritius’ careful economic management has resulted in a good business environment, an efficient legal system and functioning infrastructure. The country has developed successful manufacturing industries, financial services and tourism in the middle-to up-market sector. Madagascar, by contrast, remains essentially dependent on subsistence agriculture with only a few private sector entrepreneurs in the industrial (textiles) and agro-industrial (shrimps) sectors producing for export. Presidential elections at the end of 2001 gave rise to a severe and prolonged crisis, which was only recently concluded. The reconstruction and rehabilitation of the economy now need to be undertaken.

(4) SACU : Southern Africa Customs Union
(5) SADC : Southern African Development Community
The Caribbean and Pacific countries signatories to the Cotonou Agreement are spread across a vast area of the globe, yet in themselves display certain similarities in the development challenges they face, being mostly small island states with small resource bases. Located in the more temperate parts of the world with relatively easy access by air to wealthier countries, high value tourism has been a major growth area for many and promises to continue to expand despite recent short-term setbacks linked to concerns over the safety of air travel. However, a number of areas other than tourism also offer potential for supporting economic development. In the Caribbean, there are significant oil and gas reserves in Trinidad and Tobago, oil in Suriname, potential for forestry and tropical agriculture in Guyana, the Dominican Republic, Haiti and Belize, and large bauxite reserves in Jamaica and Guyana. Papua New Guinea in the Pacific also has substantial mineral and energy resources, and the Pacific region as a whole has great fisheries industry potential, particularly with fish such as tuna where stocks are plentiful.

Compared with 2002, economic activity in the Caribbean picked up in 2003, driven largely by the revival in the tourism sector as the direct effects of the terrorist attacks in the US diminished. However, the largest and previously best-performing economy in the region, the Dominican Republic, ran into severe financial difficulties, partly as a result of slower economic growth but largely due to the shattering of business confidence following the uncovering of a large accounting fraud in the financial sector. Support for the country was forthcoming from the World Bank, the IMF and the Inter-American Development Bank but it will be some time before the country resumes its hitherto sound economic performance. In the Pacific region, there were no significant economic developments during the year and the previous pattern of relatively low economic growth seems likely to continue.
The initial endowment of the Investment Facility of EUR 2.2 billion is exactly double the amount of risk capital resources which was managed on behalf of the EU under the second Financial Protocol of the Lomé IV Convention. Moreover, its nature as a revolving fund, its more ambitious objectives in support of the private sector and the wider range of financial instruments to be deployed, all imply that a great deal of organisational preparatory work was required within the EIB (see further details p.21). In these circumstances, it was inevitable that operational activities themselves would only make a modest start in the nine months from 1 April 2003 to the end of the year.

The Kansanshi Copper Mine project concerns the development of a new open-pit copper mine at Kansanshi (Zambia). In a competitive sector, with high quality promoters having easy access to debt finance, the co-financing by the IF took the form of subordinated debt, an instrument ideally suited to IF’s objectives. In addition to ensuring tax and export revenues to Zambia’s economy, this project contributes to the development of the poor northwestern region (in terms of improved infrastructure, job creation, schools and health facilities).

Operations in 2003

It can be concluded from the presentation of the investment conditions in the ACPs that the IF has been launched at a relatively propitious moment in the development history of these countries. The challenge for the EIB is to give the IF leadership and effective management, so as to take advantage of the development opportunity that lies ahead.
Nevertheless, during the year the appraisal process commenced or continued on thirty-eight projects for the IF, of which fourteen were approved by the EIB’s Board of Directors and nine were signed for a total amount of EUR 140 million (see list, p.17). They were as follows:

- The **Aureos** funds investments involve equity participations by the IF in three sub-regional funds in East, West and Southern Africa respectively, for the purpose of making equity and quasi-equity investments in SMEs that demonstrate strong potential for profitable growth. This serves not only to provide capital but also to strengthen the management skills of SMEs and their capacity to carry out and efficiently run new investment projects. The funds will be managed by Aureos, a joint venture between CDC and Norfund.

- The investment in **African Bank Holdings, LLC** is an equity participation in a regional fund, which aims at acquiring control of commercial banks under privatisation, many of which have been restructured and are now competently run but remain too small to be of interest to the major international banking groups. The importance of this operation is its direct contribution towards the objective of developing and strengthening local financial markets and institutions.

- **Burkina Faso Global Loan II** includes two global loans in

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The **EBTR** project consists in the financing of equipment for a Mauritanian construction company to enable it to compete for the building of roads and other infrastructure. As the local banking sector cannot provide long-term funding, an IF local currency loan was offered to the promoter. In addition to direct employment of local staff on a long-term basis, this project has significant spin-off effects through the diffusion of technical knowledge and management skills.
Burkina Faso, one being granted to four commercial banks, the other to a leasing company, providing medium- and long-term financing to SMEs operating in various sectors. This project serves to strengthen the IF’s support for local private sector development. Particular value-added lies in the IF’s injection of long-term local currency resources, which are scarce on the local capital market, as well as in the diversification of the financial sector’s funding sources and in close cooperation with the intermediaries.

The Cameroon Private Sector Development Global Loan II comprises two lines of credit, one in favour of six commercial banks to finance investments by SMEs in that country, the other being granted to a credit institution specialising in the provision of investment finance to small and very small enterprises (meso-finance). The expected impacts of this operation are similar to those of the Burkina Faso II Global Loan, supporting the development of SME initiatives.

Although a portfolio analysis of just nine projects would not be meaningful, they can, nevertheless, be considered as an illustrative sample of the wide-range of interventions that the IF can be expected to make in the future, and of the particular value-added that the IF can bring to ACP investment. In all of them the IF participation was risk-bearing, either through equity participation/subordination, or through assuming the foreign exchange risk in a local currency loan. Six out of the nine operations were in the financial sector and one of these was directly aimed at financial sector strengthening over the medium term. They were dispersed throughout Africa and four of them had a specific regional focus. All of the IF interventions were made on market-related terms and there was no application of any subsidy element.

The Bel Ombre Hotel project involves the construction and operation of a holiday resort in Mauritius. As tourism has become a key sector for this country’s economic development (both in terms of foreign exchange earnings and employment), the co-financing by the IF through subordinated debt and indirect equity participation is fully in line with both the country’s development strategy – aiming to substitute the marginally competitive sugar industry with high quality tourism – and the EU’s strategy that supports the development of sustainable tourism.
Main features of the signed projects

<table>
<thead>
<tr>
<th>Name</th>
<th>Country / Region</th>
<th>Sector</th>
<th>Nature of operation</th>
</tr>
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<tbody>
<tr>
<td>Burkina Faso Global Loan II</td>
<td>Burkina Faso</td>
<td>Financial sector</td>
<td>Local currency loan</td>
</tr>
<tr>
<td>Private Sector</td>
<td>Cameroon</td>
<td>Financial sector</td>
<td>Local currency loan</td>
</tr>
<tr>
<td>Development – Global Loan II</td>
<td>Mauritius</td>
<td>Tourism</td>
<td>Indirect equity and subordinated loan</td>
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<tr>
<td>Bel Ombre Hotel</td>
<td>Mauritania</td>
<td>Infrastructure</td>
<td>Local currency loan</td>
</tr>
<tr>
<td>EBTR</td>
<td>Mauritania</td>
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<td>African Bank Holdings, LLC</td>
<td>Regional – Africa</td>
<td>Financial sector</td>
<td>Equity</td>
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<td>Aureos East Africa Fund</td>
<td>Regional – Africa</td>
<td>Financial sector</td>
<td>Equity</td>
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<td>Aureos Southern Africa</td>
<td>Regional – Africa</td>
<td>Financial sector</td>
<td>Equity</td>
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<tr>
<td>Aureos West Africa Fund</td>
<td>Regional – Africa</td>
<td>Financial sector</td>
<td>Equity</td>
</tr>
<tr>
<td>Kansanshi Copper Mine</td>
<td>Zambia</td>
<td>Industry &amp; mining</td>
<td>Subordinated loan</td>
</tr>
</tbody>
</table>

Total 140.15

Financing of small and medium-sized entreprises through global loan operations

Disbursements generally follow somewhat behind signature, hence IF disbursements by the end of 2003 amounted to just EUR 4 million, for the equity investments in the regional Aureos funds and African Bank Holdings.
2003 marked a major turning point in cooperation with the European Development Finance Institutions (EDFIs). In January, the Framework Agreement on Financial Cooperation with the EDFIs, AFD and KfW, was signed. Its objective is to improve the impact and the efficiency of European development finance cooperation, in particular but not exclusively with respect to the support of private sector development in the ACP countries, hence making it possible to avoid the duplication of activities and to build on the various parties’ strengths and areas of interest. The first concrete step in this direction then came towards the end of the year with the launch of European Financing Partners (EFP), a Special Purpose Vehicle (SPV) jointly owned by the EDFIs and the EIB (on behalf of the IF), for the purpose of co-investing in suitable private sector projects. At the same time, the EDFIs and the Bank negotiated an agency agreement expected to be signed in the first quarter of 2004, which will be managed through EFP.

Cooperation with Multilateral Development Banks (MDBs) and IFIs entails the coordination of specific institutional approaches to issues such as procurement and the environment, as well as reinforced cooperation, in the framework of various working groups, in a number of fields such as the HIPC initiative and the fight against corruption and money laundering. High-level meetings took place with the World Bank and the Commission with a view to mapping out a common approach. In addition, a draft memorandum of understanding was prepared between the AfDB, the Commission and the Bank on enhanced strategic partnership for co-operation in African countries. This document, which is still at a preliminary stage and may be signed in the course of 2004, reflects the intention of the signatories to reinforce cooperation in policy and sector dialogue, share information on programmes and projects and identify parallel co-financing opportunities of projects.
Financial Statements of the IF

The Balance sheet of the IF at end 2003 and the profit and loss account for the year are shown on p.23 and the Auditor’s Report on p.27.

To properly understand the Financial Statements of the Investment Facility it is important to point out that these Financial Statements are those of the Investment Facility itself. The expenses incurred by the Bank for the management of the Facility are covered by way of management fees paid essentially against re-flows from the previous Protocols. They do not constitute part of these accounts but are summarised in the following section. Accordingly, these financial statements exclude such expenses. Moreover, on a more technical point, the interest on cash deposits placed by the IF within the EIB is not credited to the IF itself, as it is payable to the European Commission. Consequently such interest earnings are also excluded from the IF accounts.

With regard to the situation as at 31 December 2003 the following is noteworthy:

- These financial statements reflect the fact that the IF only started in 2003;
- What is shown in application of the Accounting Directives as other loans and advances corresponds to the funds drawn down from the Member States and not yet disbursed for operations;
- The part of the funds disbursed was in respect of the four equity operations and is shown as Investments in venture capital enterprises, whereas the part committed but not disbursed is shown in the off-balance sheet post Commitments in respect of investments in venture capital enterprises;
- As there have been no disbursements under the loan operations, the full commitment amounts are shown in the corresponding off-balance sheet line;
- The overall loss for the year of EUR 347,000 results from the fact that the equity operations entailed disbursements in USD and that the USD had depreciated against the EUR from the time of disbursement until the year-end closing of the accounts. In application of the accounting policies, this lead to an unrealised exchange loss, whereas the difference between the actual rates applied upon payment and those prevailing at the end of the payment month entailed a realised exchange profit. The result of these two movements is a loss which is set off against the Subscribed Capital.

Philippe Maystadt, President of the EIB, with James Wolfensohn, President of the World Bank, on a visit to the EIB to discuss cooperation between the two institutions.
Cost and Revenue of the IF

Within the EIB, the more sophisticated objectives of the IF, the greater range and complexity of the instruments to be deployed and the increased emphasis on support of the private sector and the development of the ACP financial sector, all imply a greater input of staff and management resources to the IF compared with the previous risk capital operations under the Lomé Convention.

Accordingly, the EU Member States have agreed to remunerate the EIB for its management of the IF in an amount up to an agreed ceiling. At the same time, the EIB has been recruiting more staff and building up its organisation for this new challenge (see further details p.21). This is a process which, for various structural and organisational reasons, will take time; for the moment the ceiling is some way from being reached.

The costs incurred by the Bank for managing the IF in 2003 are summarised below. They include the direct costs incurred by the operational directorates and, pro rata, the costs of the non-operational directorates and other overheads. On the revenue side, the principal source of revenue was the fees paid by the Member States. The latter have agreed to cover expenses incurred by the Bank during the first five years of the Cotonou Agreement to manage the Investment Facility. These fees are supplemented by the appraisal fees charged by the Facility for specific projects.

### Costs and Revenues for 2003

(\textit{in EUR '000})

<table>
<thead>
<tr>
<th>Expenses</th>
<th>20 642</th>
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<tbody>
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<td>of which:</td>
<td>7 404</td>
</tr>
<tr>
<td>Operational staff costs</td>
<td>7 404</td>
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<tr>
<td>Non-operational staff costs and overheads</td>
<td>13 238</td>
</tr>
<tr>
<td>Revenue</td>
<td>20 642</td>
</tr>
<tr>
<td>of which:</td>
<td>20 390</td>
</tr>
<tr>
<td>Member States fees</td>
<td>20 390</td>
</tr>
<tr>
<td>Project appraisal fees</td>
<td>252</td>
</tr>
</tbody>
</table>
In the course of 2003, the EIB geared up to meet the challenge of managing the Investment Facility. It restructured the existing ACP Department as an autonomous department within the Bank, at the same time renaming it the ACP-IF Department within the Directorate for Lending Operations outside Europe.

It is responsible for the management of projects and all other EIB activities in the ACP countries. To this end, it draws on the services of the Project, Legal and Credit Risk Directorates for their input into the analysis and monitoring of operations. It also avails itself of the services of the Bank’s non-operational support Directorates (eg, Human Resources, Information Technology, etc).

The ACP-IF Department was also expanded to include, in addition to the four existing geographical divisions responsible for operations, two horizontal divisions for Resource and Business Development and for Portfolio Management and Policy.

The Resource and Development Division was established to support the geographical divisions in introducing new financing instruments in capital market, corporate finance and project finance operations; including new operational policies and guidelines. It is intended to become a centre of expertise and repository of best practice.

The Portfolio Management and Policy Division is responsible for monitoring and reporting on the IF’s performance objectives and financial management, as well as for business planning and policy and financial and non-financial relationships with other donors.

The decision was also taken to open three regional representative offices in Dakar, Nairobi and Pretoria which should become operational in the course of 2004.

Altogether 15 additional staff were recruited in 2003, bringing to a total of 55 the staff directly assigned to operations in the ACP countries, both in the ACP-IF Department and in the Project, Legal and Credit Risk Directorates. A commensurate staff increase also took place in the non-operational support directorates.
Balance Sheet as at 31 December 2003

(in EUR '000)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>31.12.2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and advances to credit institutions</td>
<td></td>
</tr>
<tr>
<td>a. repayable on demand</td>
<td>0</td>
</tr>
<tr>
<td>b. other loans and advances (note D)</td>
<td>67 473</td>
</tr>
<tr>
<td>Shares and other variable-yield securities</td>
<td></td>
</tr>
<tr>
<td>Investments in venture capital enterprises (note C)</td>
<td>3 693</td>
</tr>
<tr>
<td>Subscribed capital unpaid</td>
<td>133 487</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>204 653</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>31.12.2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facility Capital</td>
<td></td>
</tr>
<tr>
<td>Subscribed capital (note F)</td>
<td>205 000</td>
</tr>
<tr>
<td>Loss for the financial year (note G)</td>
<td>-347</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>204 653</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OFF-BALANCE SHEET ITEMS</th>
<th>(in EUR '000)</th>
<th>31.12.2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In respect of investments in venture capital enterprises</td>
<td>52 010</td>
<td></td>
</tr>
<tr>
<td>Undisbursed loans (note E)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. credit institutions</td>
<td>40 000</td>
<td></td>
</tr>
<tr>
<td>b. customers</td>
<td>44 100</td>
<td></td>
</tr>
<tr>
<td><strong>136 110</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>PROFIT AND LOSS ACCOUNT</th>
<th>(in EUR '000)</th>
<th>31.12.2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Result on financial operations (Note G)</td>
<td>- 347</td>
<td></td>
</tr>
<tr>
<td><strong>Loss for the financial period</strong></td>
<td><strong>-347</strong></td>
<td></td>
</tr>
</tbody>
</table>

The bracketed notes refer to the notes to the Financial Statements.
Notes to the Financial Statements

Note A - General

The Investment Facility (the “Facility”) has been established within the framework of the Cotonou Agreement (the “Agreement”) on operation and development assistance negotiated between the African, Caribbean and Pacific Group of States (“the ACP States”) and the European Union and its Member States on 23 June 2000.

The Facility is managed by the European Investment Bank (the “EIB” or the “Bank”). Under the terms of the Agreement up to EUR 2,200 million may be allocated to finance the Facility. Within the framework of the Agreement, the EIB also manages loans granted from its own resources. All other financial resources and instruments under the Agreement are administered by the European Commission.

These financial statements comprise only the operations of the Facility. Under Council Decision of 8 April 2003, the Member States agreed to cover in full the expenses incurred by the Bank for the management of the Facility. Accordingly, these financial statements exclude such expenses. Interest on bank deposits placed by the Facility with the EIB is not accounted for by the Facility, as it is payable directly to the European Commission.

Note B - Significant accounting policies

B.1. Accounting standards

These financial statements have been prepared in accordance with the general principles of the Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 (as amended by Directive 2001/65/EC of 27 September 2001) on the annual accounts and consolidated accounts of banks and other financial institutions (the “Directive”).

B.2. Foreign currency translation

The accounts of the Facility are expressed in Euro.

For the presentation of the financial statements, assets, liabilities and off balance-sheet items denominated in foreign currencies are translated into Euro at the spot rates of exchange prevailing on the balance sheet date except for loans or participating interests denominated in currencies other than Euro for which the rates used for the translation into Euro of payments made are those in force at the actual date of such payments.

The profit and loss accounts are translated into Euro monthly on the basis of the exchange rates prevailing at the end of each month.

Exchange differences arising on translation are recorded as a currency gain or loss in the profit and loss account.

B.3. Financial assets

Financial assets are accounted for using the settlement date basis.

B.4. Shares and other variable yield securities

B.4.1. Investments in venture capital enterprises

Investments in venture capital enterprises represent shares and other variable-yield securities acquired for the longer term in the normal course of the Facility’s activities and are shown in the balance sheet at their original purchase cost.

Based on the reports received from fund managers up to the balance sheet date, the portfolio of Venture Capital Investments is valued on a line-by-line basis at the lower of cost or attributable net asset value (“NAV”), thus excluding any attributable unrealised gain that may be prevailing in this portfolio.

The attributable NAV is determined through applying either the Facility’s percentage ownership in the underlying vehicle to the NAV reflected in the most recent report or, to the extent available, the value per share at the same date, submitted by the respective Fund Manager. The attributable NAV is adjusted for events having occurred between the date of the latest available NAV and the balance sheet date to the extent that such adjustment is considered to be material.

Unrealised losses due solely to administrative expenses of venture capital funds in existence for less than two years at the balance sheet date are not taken into consideration in determining the attributable NAV.

B.5. Taxation

The Protocol on the Privileges and Immunities of the European Communities, appended to the Treaty of 8 April 1965 establishing a Single Council and a Single Commission of the European Communities, stipulates that the assets, revenues and other property of the Communities are exempt from all direct taxes.
Note C - Shares and other variable-yield securities (in EUR '000)

<table>
<thead>
<tr>
<th>Investments in venture capital enterprises:</th>
<th>Purchase price at the beginning of the period</th>
<th>Additions</th>
<th>Foreign exchange adjustments</th>
<th>Purchase price at the end of the period</th>
<th>Cumulative value adjustments at the end of the period</th>
<th>Carrying amount at the end of the period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0</td>
<td>4 127</td>
<td>(434)</td>
<td>3 693</td>
<td>0</td>
<td>3 693</td>
</tr>
</tbody>
</table>

Note D - Loans and advances to credit institutions (in EUR '000)

As at 31 December 2003, loans and advances to credit institutions were as follows: Less than 3 months

Term deposits:

European Investment Bank (*) .......................................................................................................................... 67 473

(*) Under the terms of the Facility and according to the Financial Regulation applicable to the 9th European Development Fund, the funds received by the EIB on behalf of the Facility are recorded in an account in the Commission’s name. Interest on these deposits is not accounted for by the Facility but is payable by the EIB to the European Commission.

Note E - Summary statement of loans and guarantees as at 31 December 2003 (in EUR '000)

Analysis of aggregate loans granted (1) to intermediary credit institutions directly to final beneficiaries (2) Total 2003

| Disbursed portion | 0 | 0 | 0 |
| Undisbursed loans | 40 000 | 44 100 | 84 100 |
|Aggregate loans granted | 40 000 | 44 100 | 84 100 |

(1) Aggregate loans granted comprise both the disbursed portion of loans and the portion still to be disbursed.
(2) Of which EUR 37.3 million are subordinated

Note F - Subscribed Capital (in EUR)

The subscribed capital of the Investment Facility amounts to EUR 205 million of which EUR 71.5 million has been called and is paid-in. The statement of subscriptions to the capital as at 31 December 2003 is as follows:

<table>
<thead>
<tr>
<th>Member States</th>
<th>Subscribed Capital</th>
<th>Unpaid Capital</th>
<th>Paid-in Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>5 432 500</td>
<td>3 312 500</td>
<td>2 120 000</td>
</tr>
<tr>
<td>Belgium</td>
<td>8 036 000</td>
<td>4 900 000</td>
<td>3 136 000</td>
</tr>
<tr>
<td>Denmark</td>
<td>4 387 000</td>
<td>2 675 000</td>
<td>1 712 000</td>
</tr>
<tr>
<td>Finland</td>
<td>3 034 000</td>
<td>1 850 000</td>
<td>1 184 000</td>
</tr>
<tr>
<td>France</td>
<td>49 815 000</td>
<td>37 665 000</td>
<td>12 150 000</td>
</tr>
<tr>
<td>Germany</td>
<td>47 888 000</td>
<td>29 200 000</td>
<td>18 688 000</td>
</tr>
<tr>
<td>Greece</td>
<td>2 562 500</td>
<td>1 562 500</td>
<td>1 000 000</td>
</tr>
<tr>
<td>Ireland</td>
<td>1 271 000</td>
<td>775 000</td>
<td>496 000</td>
</tr>
<tr>
<td>Italy</td>
<td>25 707 000</td>
<td>15 675 000</td>
<td>10 032 000</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>594 500</td>
<td>449 500</td>
<td>145 000</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10 701 000</td>
<td>6 525 000</td>
<td>4 176 000</td>
</tr>
<tr>
<td>Portugal</td>
<td>1 988 500</td>
<td>1 503 500</td>
<td>485 000</td>
</tr>
<tr>
<td>Spain</td>
<td>11 972 000</td>
<td>7 300 000</td>
<td>4 672 000</td>
</tr>
<tr>
<td>Sweden</td>
<td>5 596 500</td>
<td>4 231 500</td>
<td>1 365 000</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>26 014 500</td>
<td>15 862 500</td>
<td>10 152 000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>205 000 000</td>
<td>133 487 000</td>
<td>71 513 000</td>
</tr>
</tbody>
</table>

Note G - Result on financial operations

The investments in venture capital operations were disbursed and are denominated in USD; the exchange loss recorded results from the depreciation of the USD against the EUR between the time of disbursement and the financial year-end (see note B2 concerning the foreign currency translation policy).

As at 31 December 2003, the result of financial operations comprised:

| Unrealised exchange loss | EUR | - 433 673 |
| Realised exchange profit | EUR | 86 891    |
| | EUR | - 346 782 |
Report of the Auditor

The Chairman of the Audit Committee
EUROPEAN INVESTMENT BANK
Luxembourg

We have audited the accompanying financial statements of the Investment Facility as at 31 December 2003 and for the initial accounting period then ended. These financial statements are the responsibility of the management of the European Investment Bank. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give, in accordance with the general principles of the Directive of the European Union on the annual accounts of banks and other financial institutions, a true and fair view of the financial position of the Investment Facility as at 31 December 2003 and of the results of its operations for the initial accounting period then ended.

ERNST & YOUNG
Société Anonyme

Luxembourg, 2 March 2004

Kenneth A. HAY
The Audit Committee

The Audit Committee reports to the Board of Governors, the following statement being communicated to the Governors prior to their approval of the Annual Report and the financial statements for the first financial period.

Statement by the Audit Committee

The Committee, instituted in pursuance of Article 14 of the Statute and Article 25 of the Rules of Procedure of the European Investment Bank for the purpose of verifying that the operations of the Bank are conducted and its books kept in a proper manner, having

- designated Ernst & Young as external auditors, reviewed their audit planning process, examined and discussed their reports and noted that their opinion on the financial statements is unqualified,
- convened on a regular basis with the Heads of Directorates and relevant services, and studied the documents which it deemed necessary to examine in the discharge of its duties,
- received assurance from the Management Committee concerning the effectiveness of the internal control structure and internal administration,

and considering

- the financial statements for the financial period ending on 31 December 2003 as drawn up by the Board of Directors at its meeting on 2 March 2004,
- that the foregoing provides a reasonable basis for its statement and,
- Articles 22, 23 & 24 of the Rules of Procedure,

to the best of its knowledge and judgement:

has verified that the Investment Facility's operations have been carried out in compliance with the formalities and procedures laid down by the Statute and Rules of Procedure;

confirms that the financial statements, comprising the balance sheet, the profit and loss account, and the notes to the financial statements give a true and fair view of the financial position of the Investment Facility as at 31 December 2003 and of the results of its operations for the period then ended.

Luxembourg, 31 March 2004

The Audit Committee

C. NACKSTAD  M. HARALABIDIS  M. COLAS

(6) The Financial Regulation applicable to the 9th European Development Fund in article 112 with regard to the operations managed by the European Investment Bank states that these operations shall be subject to the audit and discharge procedures laid down in the Statutes of the Bank for all of its operations. On this basis, the Audit Committee issues the above statement.
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