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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

on the common provisioning fund in 2022

{SWD(2023) 170 final}

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INTRODUCTION

This report is the second annual report on the common provisioning fund (CPF) ⁽¹⁾, for the period from 1 January 2022 to 31 December 2022.

The CPF, established under Article 212 of the Financial Regulation (FR), is the capital reserve from which funds are drawn to meet required outflows and guarantee calls stemming from supported operations. It serves to smooth out the impact of individual calls on the EU budget related to losses in respect of operations supported by financial instruments, budgetary guarantees or financial assistance to third countries, established by different EU legislative instruments. The CPF is managed in a way that should, at least, strive for capital preservation over its investment horizon (9 years) ⁽²⁾.

The CPF became operational in January 2021. At the end of 2022 its market value stood at EUR 14.39 billion, making it the largest portfolio directly managed by the Commission.

This report outlines key developments related to the functioning of the CPF in 2022 – a year marked by steep interest rate rises and the war of aggression against Ukraine, which exacerbated inflationary dynamics and strongly impacted the valuation of fixed income portfolios, while fuelling market volatility. It presents the financial and investment characteristics of the fund in light of the prevailing market situation, as well as gives an update on the actions the Commission took to enhance its longer-term performance.

This report is strictly focused on asset management aspects. Contingent liabilities will be discussed in a separate report under Article 250 of the Financial Regulation (FR).

⁽¹⁾ Pursuant to Article 214 of the Financial Regulation (Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, OJ L 193, 30.7.2018, p. 1, the Commission shall report annually to the European Parliament and to the Council on the common provisioning fund. The Asset Management Guidelines of the CPF (Commission Decision of 25.3.2020 on the Asset Management Guidelines of the common provisioning fund (C(2020) 1896 final, OJ C 131, 22.4.2020, p. 3–11) provide further guidance on the contents of this report.

⁽²⁾ Article 2(1) of the Asset Management Guidelines.

The report consists of three sections:

- Section I presents key events related to the functioning of the CPF in 2022. It also gives an overview of calls on guarantees and transactions, as well as an update on the applied effective provisioning rate.
- Section II focuses on the portfolio's composition, risk profile and performance in 2022, presented against the benchmark, along with its environmental, social, and governance (ESG) profile. Additionally, it describes the market environment and developments that shaped the fund's performance in 2022.
- Section III presents the results of actions taken by the Commission to ensure value protection and growth opportunities for the CPF over the longer term: a diversified investment universe and an enhanced, ESG-focused benchmark

1. SECTION I

1.1. Key milestones in 2022

In 2022 the CPF received EUR 3.26 billion of net contributions. As in 2021, it functioned without operational incidents in line with established asset management procedures and within the framework of the relevant governance structure ⁽³⁾.

Over the period 2023-2030, the CPF is expected to receive an additional EUR 23.17 billion in inflows from the contributing instruments.

As at 31 December 2022, the value of net assets ⁽⁴⁾ was EUR 14.39 billion, as compared to EUR 12.31 billion as at 31 December 2021.

1.2. Opening of new compartments

The resources of the CPF are accounted for in compartments for the purpose of tracing the amounts relating to the various contributing instruments ⁽⁵⁾. This is necessary to ensure that each instrument is allocated both its share of resources and any returns, positive or negative, proportionate to assets owned. Liabilities resulting from different policy instruments (guarantees or provisioned loans) are ascribed fully to that policy, and therefore require accurate accounting and tracking of assets belonging to the different policies. Different financial and risk characteristics of the underlying policy instruments also need to be managed and tracked separately, in the dedicated compartments.

Despite being allocated to different compartments, all assets managed in CPF follow a common asset management strategy, generating important efficiencies in terms of asset management and risk management.

In October 2022 several new compartments were opened in the CPF, as envisaged under the various basic acts, bringing their number up to 14 ⁽⁶⁾. As at 31 December 2022, eight out of these compartments were fully operational and contained funds, as presented in Figure 1 and Figure 2. The remaining compartments will be activated at a later stage upon reception of corresponding first inflows.

⁽³⁾ The governance structure was presented in the CPF annual report for 2021, [EUR-Lex - 52022DC0213 - EN - EUR-Lex \(europa.eu\)](#).

⁽⁴⁾ The net asset value (NAV) of the CPF is determined by the value of the total assets, less the liabilities, at the respective NAV calculation date.

⁽⁵⁾ According to Article 3 of the AMGs, the resources of the CPF are allocated into compartments corresponding to each of the contributing instruments as outlined in Article 1 of the AMGs.

⁽⁶⁾ Opening of two additional InvestEU MS guarantee compartments will take place in 2023, bringing their total number to 16.

	Market value in EUR as at 31.12.2022
Compartments opened in 2021	
EFSI ⁽⁷⁾	8,463,863,835.36
GFEA ⁽⁸⁾	2,466,536,435.38
EFSD ⁽⁹⁾	697,793,925.32
InvestEU	1,651,342,768.93
Compartments opened in 2022	
EFSD+	1,066,911,767.96
EFSD+Post-2020 MFA	-
Exceptional MFA Ukraine	-
Post-2020 Euratom loans	-
Repurposed ELM loans Ukraine	-
InvestEU Guarantee Romania	-
InvestEU Guarantee Czech Republic	13,457,062.53
InvestEU Guarantee Finland	17,419,930.38
InvestEU Guarantee Greece	-
InvestEU Blending Operations	17,760,000.00

Figure 1 –CPF compartments as at 31.12.2022

⁽⁷⁾ European Fund for Strategic Investments

⁽⁸⁾ Guarantee Fund for external actions (GFEA), holding the provisions for the external lending mandate (ELM), legacy (macro-financial assistance - MFA) and Euratom programmes.

⁽⁹⁾ European Fund for Sustainable Development.

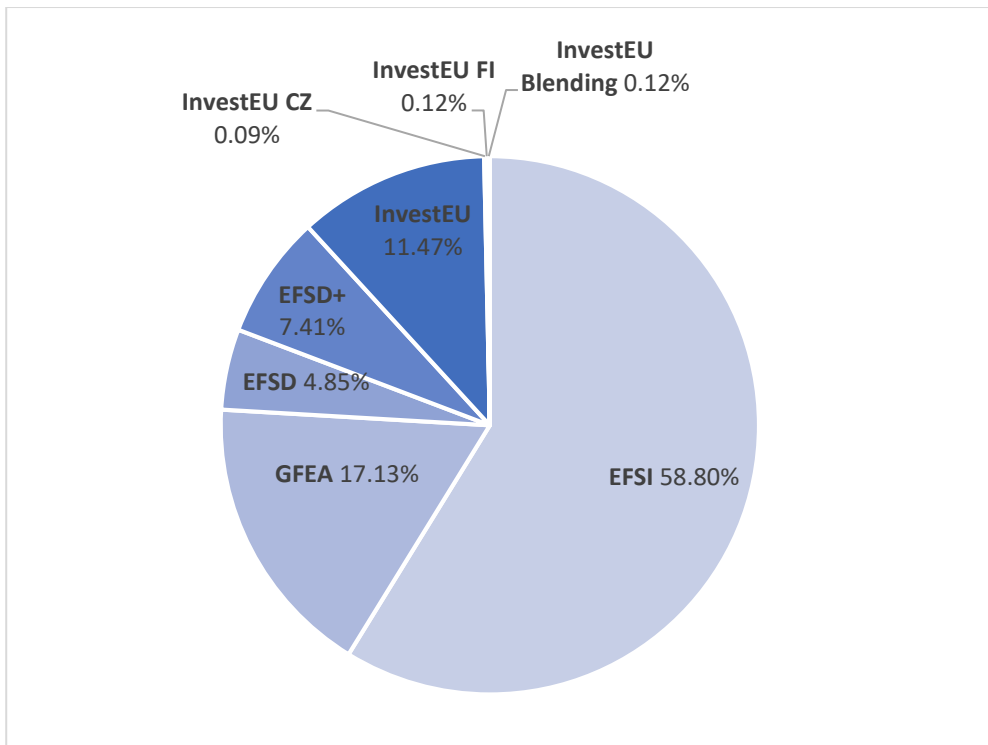


Figure 2 –Fully operational CPF compartments containing funds as at 31.12.2022

1.2.1. New compartments under the InvestEU Regulation

The InvestEU Regulation ⁽¹⁰⁾ enables Member States (MS) to provide additional contributions to the InvestEU programme. Separate compartments for each MS ensure separate tracking of the level of provisioning.

To this end, four new InvestEU MS compartments were opened in 2022, two of which already received funds by the end of the year. A separate compartment with contribution from several Union sectoral programmes/funds was also opened for blending operations that provide for top-up of EU guarantee/InvestEU Fund.

1.2.2. New compartments under the NDICI Regulation ⁽¹¹⁾

Upon entry into force of the regulation establishing the Neighbourhood, Development and International Cooperation Instrument (NDICI), three new compartments were open to hold provisioning for the EU's actions in the external dimension, under the External Action Guarantee:

1. the new European Fund for Sustainable Development Plus (EFSD+);
2. post-2020 macrofinancial assistance (MFA) loans;
3. post-2020 Euratom loans.

⁽¹⁰⁾ Regulation (EU) 2021/523 of the European Parliament and of the Council of 24 March 2021 establishing the InvestEU Programme and amending Regulation (EU) 2015/1017 (OJ L 107, 26.3.2021, p. 30-89)

⁽¹¹⁾ Regulation (EU) 2021/947 of the European Parliament and of the Council of 9 June 2021 establishing the Neighbourhood, Development and International Cooperation Instrument – Global Europe, amending and repealing Decision No 466/2014/EU and repealing Regulation (EU) 2017/1601 and Council Regulation (EC, Euratom) No 480/2009 (OJ L 209, 14.6.2021, p. 1-78).

1.2.3. New compartments for Ukraine-related exposures

To reflect the need to manage different asset/liability profiles separately, two new compartments were foreseen in the basic acts for Ukraine-related exposures for the period 2021-27:

1. MFA 1⁽¹²⁾ and MFA2⁽¹³⁾ loans;
2. Repurposed EIB's loans under the 2014-20 external lending mandate (ELM).

1.3. Financial statements of the CPF as at 31 December 2022

The net assets of the CPF stood at EUR 14.39 billion as at 31 December 2022. As per current investment strategy (see section 2.1), the main assets comprised the securities portfolio investing mainly in investment grade bonds (sovereign, SSA⁽¹⁴⁾, corporate⁽¹⁵⁾, financial), classified at fair value through surplus or deficit (EUR 14.06 billion) and cash and cash equivalents (EUR 0.33 billion).

In terms of the 2022 statement of financial performance, the CPF ended the year with a return of EUR -8.8%, caused by valuation losses due to steep interest rate rises. The CPF performance in its macroeconomic context will be further explained in the next two sections.

More information on the financial statements is available in the staff working document accompanying this report.

1.4. Guarantee calls and payment claims

The liquidity management of the guarantee calls and payment claims is facilitated by a liquidity buffer, as provided for in the Asset Management Guidelines. The liquidity buffer is constituted by limited reserves of cash held at the Commission's Central Treasury to cover the expected imminent cash outflows.

The buffer started the year with a balance of EUR 92 million; during the year it received inflows of EUR 473 million, while a net amount of EUR 222 million was paid out in 2022⁽¹⁶⁾. At the end of 2022, the remaining balance of the liquidity buffer amounted to EUR 342 million.

The 2022 calls on the CPF provisions by the respective budgetary guarantees⁽¹⁷⁾, as well as other demands on the resources held by the CPF compartments, can be summarized as follows⁽¹⁸⁾:

- EFSD compartment: a call of EUR 0.4 million was paid.

⁽¹²⁾ Decision (EU) 2022/1201 of 12 July 2022 of the European Parliament and of the Council providing exceptional macro-financial assistance to Ukraine (OJ L186, 13.7.2022, p. 1-7).

⁽¹³⁾ Decision (EU) 2022/1628 of 20 September 2022 of the European Parliament and of the Council providing exceptional macro-financial assistance to Ukraine, reinforcing the common provisioning fund by guarantees by Member States and by specific provisioning for some financial liabilities related to Ukraine guaranteed under Decision No 466/2014/EU, and amending Decision (EU) 2022/1201 (OJ L 245, 22.9.2022, p. 1-13).

⁽¹⁴⁾ Supranational, sub-sovereigns and agency

⁽¹⁵⁾ Investment in corporate bonds is done via both individual issues and, since 2022, Exchange Traded Funds tracking corporate bond indices.

⁽¹⁶⁾ Compared to EUR 73.5 million in 2021.

⁽¹⁷⁾ Individual guarantee calls are mentioned in a separate report under Article 41(5) of the Financial Regulation (FR).

⁽¹⁸⁾ It is important to mention that payments may arise in 2023 or later which may require ex post adjustment of the 2022 accounts.

- GFEA compartment: calls of EUR 194.3 million were paid under the external lending mandate (ELM) guarantee. In addition, there were minor operational expenses for an amount slightly below EUR 0.3 million;
- InvestEU EU compartment: outflows in the amount of EUR 0.17 million for expenses and EUR 0.07 million for restructuring losses were registered;
- EFSI compartment: net consumption of the EFSI guarantee amounts to EUR 27.0 million, including net calls and value adjustments of equity portfolios of EUR 17.5 million, SMEW calls for liquidity management ⁽¹⁹⁾ on guarantee products of EUR 6.2 million, and expenses (funding and recovery costs) of EUR 3.3 million.

1.5. Effective provisioning rate

The concept of effective provisioning rate (EPR) was described in the first CPF annual report for 2021 ⁽²⁰⁾.

Following calculations based on the established methodology ⁽²¹⁾, the Commission proposed that the EPR for 2022 remained at 100%. Accordingly, in the Draft Budget 2023, the Commission proposed to the budgetary authority that no surplus of provisions is to be returned. This approach was confirmed in the adopted Annual Budget 2023.

⁽¹⁹⁾ Net of replenishments.

⁽²⁰⁾ [EUR-Lex - 52022DC0213 - EN - EUR-Lex \(europa.eu\)](#)

⁽²¹⁾ Commission Delegated Decision (EU, Euratom) C(2020)7684 supplementing Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council with detailed conditions for the calculation of the effective provisioning rate of the common provisioning fund (OJ L 42, 5.2.2021, p. 9–12).

2. SECTION II

2.1. Investment strategy

The general assumptions behind the CPF investment strategy were described in the first CPF annual report for 2021 ⁽²²⁾.

The bulk of the CPF has been to date restricted to investment in Euro- and US Dollar-denominated investment-grade fixed income securities (bonds).

2.2. Composition and characteristics of the portfolio

The CPF portfolio at year-end is well diversified across the different asset classes in the eligible fixed income universe, including some limited exposure to non-euro denominated securities (USD) and cash or cash equivalents. Currency gains or losses on non-euro securities and transactions are largely offset by opposite changes in foreign exchange derivatives used as hedges.

The credit quality of the CPF portfolio is high, with an average rating of A, suggesting a negligible default probability ⁽²³⁾.

Over 35.7% of the portfolio's market value is invested in AAA securities ⁽²⁴⁾, with the rest distributed across the investment-grade scale.

USD-denominated investments represented 3.5% of the portfolio's market value as of December 2022 ⁽²⁵⁾, with currency risk hedged using forward contracts.

As of December 2022 about 18% of the portfolio consisted of short-term liquid assets ⁽²⁶⁾, providing for a buffer for liquidity risks ⁽²⁷⁾.

More information about the composition and characteristics of the portfolio is available in the staff working document accompanying this report.

2.3. Environmental, social and governance (ESG) footprint

The ESG footprint of the portfolio remains strong, with 14.0% share of ESG-labelled bonds ⁽²⁸⁾, compared to 13.4% in 2021. The proactive approach to ESG investing favours ESG-labelled bonds, provided they align with risk management criteria and overall investment strategy. The Commission continues to reinforce the ESG footprint in the CPF's new investment strategy, as explained in Section III.

⁽²²⁾ [EUR-Lex - 52022DC0213 - EN - EUR-Lex \(europa.eu\)](#)

⁽²³⁾ 0.04% default probability over a one year horizon.

⁽²⁴⁾ Compared to over 26.8% in 2021.

⁽²⁵⁾ Compared to 5.1% in 2021.

⁽²⁶⁾ Compared to 26% in 2021.

⁽²⁷⁾ On top of liquidity buffer described in Section 1.4.

⁽²⁸⁾ In assessing whether bonds are classified as ESG-labelled for the purposes of CPF allocation, the Commission relies on the published assessment of the 'use of proceeds' of the asset in question by the analytics and data providers which the Commission uses for its asset management function. 35.6% of the ESG-labelled assets had an AAA rating, while the lowest rated asset class (BBB-) corresponded to only 0.1%.

2.4. CPF performance in 2022

As stated above, the CPF is a liquid and well diversified bond portfolio. Investing exclusively in highly rated debt instruments has historically delivered positive returns for the Commission's portfolios. However, this strategy could not insulate the portfolios from the sharp rise of yields across the board that occurred in 2022, on the back of persistently higher inflation and a sharp tightening of monetary policy by the central banks. Bond prices fell, as they move inversely to the yields, significantly impacting the valuations. In fact, 2022 turned out to be the worst year for bond markets in more than forty years; global bond market indices and euro-denominated bond market indices declined respectively by 13.27% and 17.17% ⁽²⁹⁾. Consequently, the CPF performance was also negatively impacted, although remaining in line with its benchmark and faring better than the broader bond market. In particular, the CPF posted a negative annual absolute performance of -8.85%, which was 15bps better than the annual performance of the CPF benchmark (-9.00%) ⁽³⁰⁾.

The following box recaps the market environment in 2022 and its impacts on the bond market returns. The actions taken by the Commission as asset manager are described in Section III of this report.

⁽²⁹⁾ The Bloomberg Global Aggregate Bond Index (EUR hedged), a broad benchmark representing EUR 61 trillion worth of sovereign and corporate investment grade (IG) debt denominated in various currencies, lost 13.7% in 2022. The Bloomberg Euro-Aggregate Index, a EUR 13 trillion broad benchmark of euro denominated investment grade debt posted a record loss of 17.2% in 2022.

⁽³⁰⁾ The annual performance is calculated using market prices (mark-to-market) and a time-weighted basis in order not to be affected by any change in the size of the portfolio, due to inflows or outflows.

Market developments in 2022

Market developments in 2022 were dominated by the geopolitical instability and rising inflationary pressures. Fuelled by a steady increase in energy prices and widespread supply chain bottlenecks, headline inflation proved much stickier than previously expected and rose persistently through most of the year, peaking at multi-decade highs of 10.6% in Europe and 9.1% in the USA, before declining to close the year at 9.2% and 6.5% respectively. In response, major central banks ramped up interest rates at the fastest pace and biggest scale in decades. The magnitude of the move exceeded market expectations. As recently as December 2021, markets were pricing just 10bps of interest rate hikes for the entire 2022.

However, since July, the ECB raised interest rates by a total of 250bps in steps of 50-75bps, while in the USA rate hikes amounted to 425bps. The war of aggression against Ukraine in late February prompted a sharp rise in inflation, particularly in energy prices, erasing the possibility of “transitory” inflation, which was the most likely scenario of major central banks at the beginning of the year. The yield on the benchmark 10Yr German government bond started increasing and reached 1.76% in mid-June from -0.08% at the beginning of March.

By the end of the year, inflation pressures also began to slowly recede as energy prices declined from their peaks. However, inflation remained elevated in other components of consumer price indices. Consequently, interest rates continued to rise and the 10Y German government bond closed the year at 2.56%. During the course of 2022, interest rates had moved within a range of 275bps, whereas in 2021, the range amounted to 69bps.

3. SECTION III

3.1. Diversified investment universe

As announced in the CPF annual report for 2021, in 2022 the Commission took action to diversify the CPF investment universe. By the end of 2022 the Commission finalized the work on the operational framework allowing equity investments via Exchange-Traded Funds (ETFs), offering cost-efficient and diversified exposure to broad equity indexes through a basket of stocks. This approach mitigates the risk from investing in individual companies' stocks. The inclusion of equities as a new asset class in the CPF investment universe was based on a thorough analysis, with the objective of enhancing diversification and optimizing risk parameters and expected return of the portfolio over the longer-term.

The exposure to equity will be built progressively towards a level of about 7-8% of the CPF portfolio, starting from January 2023 and taking into account market conditions and valuation levels. This percentage has been identified as optimal in terms of risk/return profile and risk appetite. This choice is reflected in the updated CPF benchmark, as explained in the following section.

3.2. Enhanced, ESG-focused benchmark

The decision to update the CPF benchmark by including investment into equity ETFs was driven by the objective of enhancing the risk/return profile of the portfolio. The new benchmark, applicable as of January 2023, reflects the investment objective (i.e. capital preservation as primary objective), the investment horizon and the risk tolerance of the portfolio, as specified in the Asset Management Guidelines.

This benchmark update was also an opportunity to integrate Environmental Social and Governance factors, since ESG is an important consideration for the management of the CPF, in line with larger Commission commitments towards the green transition. Despite already including negative screening criteria in the AMGs, such as the exclusion of bonds related to activities involving gambling or tobacco, and holding a large exposure to ESG-labelled securities in the CPF portfolio, the Commission committed to putting the ESG considerations for the CPF on a firmer footing and to including the ESG characteristics in the updated version of the benchmark.

To achieve this objective, two dedicated ESG indices were included in the new CPF benchmark. The green-bond index sets an ambitious target for the proportion of assets to be invested in the ESG-labelled bonds (14.7%). This is in line with the existing ESG investment practice, where investments in ESG-labelled bonds are privileged over conventional bonds, when possible. The second ESG index, the Paris-aligned Benchmark (PAB) corporate bond index, guides the investments towards the Paris-aligned corporate issuers. Paris-aligned investing is also utilized by other institutional asset managers, such as European Investment Bank, and as such presents a welcome stakeholder response and further increased credibility. The inclusion of ESG indices in the benchmark further reinforces alignment of the Commission's asset management activities with the EU's climate goals and political priorities.

When setting up the CPF benchmark, the Commission followed a rigorous process, based on modern portfolio theory ⁽³¹⁾ and in line with market best practices.

⁽³¹⁾ Portfolio Selection, Harry Markowitz, *The Journal of Finance*, Vol. 7, No.1 (Mar., 1952), pp. 77-91.
The input parameters for the benchmark optimization exercise were derived by combining various

The new CPF benchmark was approved and validated in December 2022. The implementation of the benchmark began in January 2023. Alignment of the portfolio with the new benchmark will be implemented progressively up to end of 2023. The benchmark also sets a target of 14.7% allocation to ESG-labelled bonds, versus 14% in the CPF portfolio at the end of 2022.

CONCLUSIONS

The second year of CPF operation was marked by growth in absolute portfolio size due to new inflows, as well as increased complexity in terms of a number of compartments and contributing instruments feeding into the fund.

No operational risk events occurred in 2022, and all guarantee calls were met, with accounts finalised on schedule. The CPF, holding EUR 14.39 billion in assets at the end of 2022, continues to serve as a robust capital buffer for budgetary guarantees and provisioned loans to third countries.

Economic and market developments in 2022 made it one of the worst years for fixed-income portfolios for more than a generation, as yield levels moved significantly higher, against a backdrop of persistent inflation and tighter monetary policy. The unprecedented and unexpected steep increase in interest rates led to reduction of CPF portfolio's value in 2022 of around 8.8%, due to valuation losses. In the longer-term, higher interest rates provide the foundation for sustained positive performance. This is reflected in the portfolio's yield-to-maturity⁽³²⁾, which had reached 3% compared to 0% at the start of the year. The accrual of increased yields and reinvestment of maturities at higher rates provide important support and a cushion for future returns.

To further strengthen CPF's resilience, in 2022 the Commission continued work on asset diversification to incorporate some exposure to equity markets (through index-tracking funds), updated the CPF benchmark, and ensured stronger ESG alignment of the portfolio. While conditions in early 2023 have remained challenging, the CPF has weathered the market changes of 2022 and is now well-placed to recover lost value over the coming years.

market data, long-term views gathered from various investors and internal views on volatility and correlations in the coming years.

⁽³²⁾ The return on the portfolio that will be realised if all bonds are held to maturity (at which point they are redeemed at par).