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**REPORT FROM THE COMMISSION**

**Annual Report from the Commission  
on the Guarantee Fund and its Management in 2004**

**{SEC(2005) 807}**

## TABLE OF CONTENTS

|      |                                                                            |   |
|------|----------------------------------------------------------------------------|---|
| 1.   | Legal bases .....                                                          | 3 |
| 2.   | Position of the Fund at 31 December 2004 .....                             | 3 |
| 3.   | Payments into the Fund .....                                               | 4 |
| 3.1. | Payments from the general budget in the course of the financial year ..... | 4 |
| 3.2. | Interest from financial investment of the Fund's liquid assets .....       | 5 |
| 3.3. | Recovery from defaulting debtors .....                                     | 6 |
| 4.   | The Fund's liabilities .....                                               | 6 |
| 4.1. | Default payments .....                                                     | 6 |
| 4.2. | EIB remuneration .....                                                     | 7 |
| 4.3. | Foreign exchange losses .....                                              | 7 |

## **1. LEGAL BASES**

Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 (“the Regulation”) set up a Guarantee Fund for external actions in order to repay the Community's creditors in the event of default by beneficiaries of loans granted or guaranteed by the Community (OJ L 293, 12.11.1994, p. 1). The Regulation was amended by the Council Regulation (EC, Euratom) No 1149/99 of 25 May 1999 (OJ L 139, 2.6.1999, p. 1) and the Council Regulation (EC, Euratom) No 2273/2004 of 22 December 2004 (OJ L 396, 31.12.2004, p. 28) (“the amended Regulation”).

In accordance with Article 6 of the Regulation, the Commission entrusted financial management of the Fund to the European Investment Bank (EIB) under an Agreement signed between the Community and the EIB on 23 November 1994 in Brussels and on 25 November 1994 in Luxembourg (“the Agreement”).

Under Article 8.2 of the Agreement, by 1 March of each year the Bank must send the Commission a status report on the Fund and its management, the revenue and expenditure account and the financial statement for the Fund for the preceding year. An extract from the report covering the year 2004 can be found in section 2 of the Commission Staff Working Paper (“the Annex”)<sup>1</sup>.

In addition, Article 7 of the amended Regulation requires the Commission to send the European Parliament, the Council and the Court of Auditors a report on the situation of the Fund and its management for each financial year by 31 May of the following year.

## **2. POSITION OF THE FUND AT 31 DECEMBER 2004**

At the close of the 2004 financial year, the Fund totalled EUR 1,612,856,213.44 (see section 3 of the Annex). This is the sum, since the Fund was established, of all:

- budget payments to the Fund (EUR 2,532,164,500.00);
- successive yearly net results (EUR 473,032,495.02);
- late repayments from non-member countries (EUR 575,673,913.77);
- debts corresponding to the repayments not made to the EIB (EUR 765,497.93);
- commission received on late recovery in 2002 (EUR 5,090,662.91);
- less calls on the Fund's resources (EUR 477,860,856.19) and successive repayments to the budget of the surplus in the Fund (EUR 1,496,010,000.00).

After the deduction of accruals (EIB's remuneration), the Fund total at 31 December 2004 amounts to EUR 1,612,090,715.51.

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<sup>1</sup> SEC(2005) 807

The total amount of the consolidated balance sheet is EUR 1,614,117,863.19. This includes the total amount of the Fund plus the arrears covered by the Fund and the accruals of interests on late payments (for details see section 5 of the Annex).

Article 3 of the Regulation requires that the amount of the Fund has to reach an appropriate level (target amount) set at 9% of the total outstanding capital liabilities arising from each operation, plus unpaid interest due.

The amended Regulation stipulates that operations towards accession countries covered by the Guarantee Fund remain covered by the Communities guarantee after the date of accession. However, from that date, they cease to be external actions of the Communities and are covered directly by the general budget of the European Union and no longer by the Guarantee Fund.

Therefore, outstanding lending and loan guarantee operations for third countries plus unpaid interest due totalled EUR 12,068,132,585.66 at 31 December 2004, of which EUR 144,107,751.62 was accounted for by interest due but not yet paid.

Consequently, an amount of EUR 338,831,402.07 was repaid to the budget on 10 January 2005, representing 9% of the outstanding operations granted to the new Member States at 1 May 2004 (EUR 3,764,793,356.32).

The ratio between the Fund's resources (EUR 1,612,090,715.51 - EUR 338,831,402.07) and outstanding capital liabilities within the meaning of the amended Regulation was 10.55%. Since this is higher than the target amount of 9%, a repayment from the Fund to the general budget of the European Union had to be made, as provided for in the third paragraph of Article 3 of the Regulation. The amount to be repaid to the budget in 2005 came to EUR 187,130,000.00.

### **3. PAYMENTS INTO THE FUND**

#### **3.1. Payments from the general budget in the course of the financial year**

The legal bases for the provisioning arrangements are described in section 1 of the Annex.

The Council Regulation (EC) No 2040/2000 of 26 September 2000 (OJ L 244, 29.9.2000, p. 27) concerning budgetary discipline authorised the entry in the general budget of a reserve for loan and loan guarantee operations. This item, which was allocated appropriations of EUR 221 million in 2004, is used for endowing the Fund by transferring amounts into the budget item for payments into the Fund.

In line with the legal bases, two transfers totalling EUR 181,875,000.00 to endow the Guarantee Fund were adopted by the budgetary authority in 2004.

- Transfer DEC 34/2004<sup>2</sup>: EUR 161,760,000.00: this first transfer was for payments into the Fund in respect of the Council Decisions of

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<sup>2</sup>

SEC(2004) 716 final.

22 December 1999, 6 November 2001 and 29 April 2004 in accordance with the arrangements set out in the Annex to the Regulation.

- Transfer DEC 35/2004<sup>3</sup>: EUR 20,115,000.00: this second transfer was for a payment into the Fund in respect of a loan operation adopted by the Commission on 30 March 2004.

The decisions covered by these transfers are given in section 1 of the Annex.

Both transfers were paid under the mechanism for offsetting against the repayment of the Fund's surplus which took place on 10 August 2004.

In line with the needs identified in the Comprehensive Report on the functioning of the Guarantee Fund<sup>4</sup>, the Commission adopted an amendment to the Regulation of the Guarantee Fund to improve the rules of the provisioning mechanism, i.e. the rules that determine how the Fund's assets are brought in line with the target amount of the Fund<sup>5</sup>.

### **3.2. Interest from financial investment of the Fund's liquid assets**

The Fund's liquid assets are invested in accordance with the management principles laid down in the Annex to the Community/EIB Agreement of 23/25 November 1994, amended by Supplementary Agreement No 1 of 17/23 September 1996 and Supplementary Agreement No 2 of 26 April/8 May 2002. By Supplementary Agreement No 2, the investment principles were changed in 2002 in order to correct the excess liquidity which had risen to over 50% of the Fund's assets and was restricting the yield of the Fund. While retaining the limit whereby at least one third of the Fund must be invested in short-term investments (up to one year), the instruments eligible for short-term liquidity were extended. They now include variable-rate securities, irrespective of their maturity dates, and fixed-rate securities with a maximum of one year remaining to maturity, irrespective of their initial maturity period. This is because fixed-rate securities are reimbursable at 100% of their nominal value at the end of their life (i.e. after a maximum of one year), while variable-rate securities can be sold at any time at a price approaching 100%, whatever their remaining period to maturity. To maintain a balance between the various instruments for which liquidity is monitored, a minimum of 18% (corresponding to double the provisioning rate of the Fund) is kept in monetary investments, particularly bank deposits. This new structure helped to improve the Fund's yield while maintaining a prudent liquidity level.

In 2004, the new portfolio structure decided in 2002 was fully implemented and an additional liquidity reserve was set aside in order to cover an important extraordinary payment to the budget expected to take place in the second half of 2004 or very early in 2005 (EUR 338,831,402.07, related to the accession of the ten new Member States).

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<sup>3</sup> SEC(2004) 717 final.

<sup>4</sup> COM(2003) 604 final.

<sup>5</sup> COM(2005) 130 final.

The list of banks authorised to receive deposits is agreed by the Commission and the EIB. The original list has been regularly revised in the light of the latest changes in bank ratings. Most of the banks are members of the euro clearing system. They all have a Moody's rating of at least A1 for long-term and P1 for short-term investments, or an equivalent Standard & Poor's or Fitch rating. The investments made with them are governed by rules to ensure a good spread and to avoid the concentration of risk.

In 2004, interest on deposits, the Guarantee Fund current accounts, and securities totalled EUR 61,950,402.49, broken down as follows:

- deposits: EUR 10,855,766.08; this represents the situation at 31 December 2004 including interest received on bank deposits (EUR 11,318,130.39) and changes in accrued interest (-EUR 462,364.31) in 2004. The accrued interest corresponds to interest which has not been received by the Fund at the end of the year but will be paid at the dates fixed for maturity of the investments. The interest accrued at 31 December 2004 (EUR 738,069.03) is reduced by the accrued interest entered in the accounts for 2003 but received in 2004 (EUR 1,200,433.34).
- current accounts: EUR 53,933.68 comprising interest recorded on the current account.
- securities portfolio: EUR 51,040,702.73; this amount includes EUR 50,411,967.55 of interest on securities, EUR 628,735.18 of interest received on Commercial Paper, and EUR 26,102,214.88 of accrued interest at 31 December 2004. The interest on securities is generated by investments placed in the form of securities in accordance with the investment principles laid down in the Agreement giving the EIB the task of managing the Fund's liquid assets. From this figure must, however, be subtracted the EUR 2,845,532.15 entered in the course of the year as the difference between the entry price and the redemption value divided *pro rata temporis* over the remaining life of the securities held (corresponding to the spread of the premium or discount entered in the profit-and-loss account).

The interest received is entered in the results for the financial year.

### **3.3. Recovery from defaulting debtors**

Late repayments by defaulting countries on operations where the Fund has honoured the guarantees have been paid into the Fund. The running total is now amounted to EUR 575,673,913.77 at 31 December 2004 as one net repayment of EUR 7,456,334.33 has been received during the year.

## **4. THE FUND'S LIABILITIES**

### **4.1. Default payments**

Two calls on the Fund took place in 2004, for a total amount of EUR 4,370,582.17 (see section 2.2.1 of the Annex).

#### **4.2. EIB remuneration**

The second Supplementary Agreement to the Agreement signed on 26 April and 8 May 2002, lays down that the Bank's remuneration is to be determined by applying to each of the tranches of the Fund's assets the degressive annual rates of commission which relate to them respectively. This remuneration is calculated on the basis of the average assets of the Fund.

The Bank's remuneration for 2004 was fixed at EUR 765,497.93 and was entered in the profit-and-loss account and as accruals (liabilities) on the balance sheet. The remuneration will be paid to the EIB in the first quarter of 2005.

#### **4.3. Foreign exchange losses**

The Guarantee Fund realized a loss of EUR 1,260,433.70 further to a foreign exchange transaction of USD 10,117,515.47 (see section 3.3) in the context of a recovery from a defaulted loan.