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REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COURT OF
AUDITORS
ON THE GUARANTEE FUND FOR EXTERNAL ACTIONS AND ITS
MANAGEMENT IN 2019

{SWD(2020) 136 final}

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1. INTRODUCTION

Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 ('the Regulation')¹ established a Guarantee Fund for external actions ('the Fund') in order to repay the Union's creditors in the event of default by beneficiaries of loans granted or guaranteed by the European Union. In accordance with Article 7 of the Regulation, the Commission entrusted the financial management of the Fund to the European Investment Bank (EIB) under an agreement between the European Union and the EIB dated 25 November 1994, and subsequently amended on 23 September 1996, 8 May 2002, 25 February 2008 and 9 November 2010 and 28 September 2018² ('the Agreement').

Article 8 of the Regulation requires the Commission to send a report to the European Parliament, the Council and the Court of Auditors on the situation of the Fund and the management of the Fund at the end of the previous calendar year thereof for each financial year by 31 May of the following year.

This report, together with the Commission Staff Working Document (SWD), provides this information. It is based on data received from the EIB, in line with the agreement.

2. FINANCIAL POSITION AND SIGNIFICANT TRANSACTIONS OF THE GUARANTEE FUND

2.1. Financial Position of the Guarantee Fund at 31 December 2019

The Guarantee Fund totalled EUR 2,828,738,292.88 as of 31 December 2019 (EUR 2,609,881,747.51 as of 31 December 2018) (see Annex of the SWD: Guarantee Fund financial statements, as provided by the EIB).

The total balance sheet value of the Fund increased by about EUR 218.86 million in 2019. This is mainly explained by the following:

Increases:

- The contribution from the EU budget (provisioning amount) of EUR 240.15 million to adjust the Fund to its target amount of 9% of the total outstanding liabilities;
- The economic result on financial operations amounted to EUR 25.13 million;
- The portfolio valuation increased by EUR 8.6 million due to the mark-to-market adjustment of its value.

Decreases:

- Interventions of the Fund to cover defaulted payments for a total amount of EUR 54.9 million.

¹ OJ L 145, 10.6.2009, p. 10; the Regulation codified and repealed Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions. It has been amended on 14.3.2018 by Regulation (EU) 2018/409 of the EP and of the Council.

² Supplementary Agreement no 5 to the Agreement relating to the Management of the Guarantee Fund between the European Union and the European Investment Fund - Ref. Ares(2018)5207374 - 10/10/2018.

2.2. Significant Transactions of the Fund in 2019

2.2.1 Calls on the Guarantee Fund 2019

Syria

In 2019, the EIB has continued facing arrears on Syrian sovereign loans. As a consequence, and in line with the Guarantee Agreement between the EU and the EIB, the EIB has made 14 additional calls on the EU Guarantee Fund up to 31 December 2019 for a total amount of EUR 54.91million (see point 5).

2.2.2 Provisioning of the Guarantee Fund 2019

In February 2019 an amount of EUR 103.2 million was transferred from the budget to the Fund corresponding to the provisioning amount for 2018.

The calculation of the contribution from the EU budget to the Fund for 2020 was also calculated in February 2019 resulting in EUR 240.15 million to be transferred in February 2020. It was calculated following Article 3 and Article 5 of the Regulation:

Article 3 of the Regulation sets the target amount for the Fund at 9 % of the total outstanding capital liabilities arising from each operation, plus any accrued unpaid interest due.

Article 5 of the Regulation states that the amount to be transferred from the budget to the Fund in year $n + 1$ is calculated on the basis of the difference between the target amount and the value of the Fund's net assets at the end of year $n - 1$, calculated at the beginning of year n .

To adjust the Fund to 9% of the total outstanding capital liabilities, an amount of EUR 240.15 million was calculated based on guaranteed operations outstanding at 31 December 2018 and entered in the EU budget of 2020 for the provisioning of the Fund. The amount was approved by the Council and the European Parliament and recognised as an asset (receivable) of the Fund in the balance sheet at 31 December 2019.

2.3. Significant transactions after the reporting date (as of end March 2020)

In February 2020 the above mentioned provisioning amount of EUR 240.15 million was transferred from the EU budget to the Fund.

In January and March 2020, EUR 10.6 million in total were paid in two calls for defaulted payments of Syria (EUR 3.2 million and EUR 7.4 million including penalties applied by EIB).

3. PRE-CONSOLIDATED FINANCIAL STATEMENTS OF THE FUND

The pre-consolidated financial statements of the Fund are prepared in order to include accounting operations which are not included in the Fund's financial statements prepared by the EIB (see SWD). They are part of the EU's consolidated financial statements.

3.1. Pre-consolidated Financial Position at 31 December 2019

Balance Sheet – Assets

	31 December 2019	31 December 2018
NON-CURRENT ASSETS	2,312,151,734	2,275,342,664
Financial assets	2,312,151,734	2,275,342,664
CURRENT ASSETS	277,139,064	231,316,149
Financial assets	233,048,865	189,758,096
Receivables	1,290,863	-
Cash and cash equivalents	42,799,336	41,558,053
TOTAL ASSETS	2,589,290,798	2,506,658,813

Balance Sheet - Liabilities

	31 December 2019	31 December 2018
CONTRIBUTOR'S RESOURCES	2,407,419,308	2,295,687,144
European Commission contribution	1,950,195,297	1,846,972,362
Fair value reserve	20,859,023	12,227,192
Retained earnings	436,364,988	436,487,590
NON-CURRENT LIABILITIES	111,685,549	159,153,609
Financial provisions	111,685,549	159,153,609
CURRENT LIABILITIES	70,185,941	51,818,060
Financial provisions	49,709,547	50,777,871
Financial guarantee liability	19,590,000	
Payables	886,394	1,040,189
TOTAL CONTRIBUTOR'S RESOURCES + LIABILITIES	2,589,290,798	2,506,658,813

The difference of EUR 239.4 million between the total pre-consolidated balance sheet value of the Fund (EUR 2,589,290,798) and the value of the Fund in the financial statements prepared by the EIB (EUR 2,828,738,292.88) can be mainly explained by the following items:

- The pre-consolidated balance sheet (assets) includes:
 - all amounts subrogated to the EU as a result of the guarantee payments for EIB calls on defaulted loan instalments (arrears due plus the interest accrued on late payments). However, in view of the political situation of Syria and based on a decision of the Accounting Officer of the EC, these amounts have been fully impaired in the 2019 financial statements.
 - receivable of EUR 0.7 million from EIB for a partial recovery of loan to Enfidha Airport (Tunisia) which was collected by EIB in December 2019 and credited to the Guarantee Fund bank account in January 2020.
- The pre-consolidated balance sheet does not include EUR 240.2 million of contribution from the EU budget to the Fund transferred in 2020 as this receivable is offset by the corresponding payable in the consolidated accounts of the EU.
- The payments of calls from the Guarantee Fund to the EIB (and where applicable successive recoveries of the calls and late interests) are recognised as decreases (increases) of the Net Assets (EU Contribution) in the financial statements prepared by the EIB. In the pre-consolidated financial statements, the amounts paid for EIB calls are not deducted from the Net Assets as they become subrogated amounts. Related amounts are either accounted for as revenues (accruing late interest and penalties, foreign exchange gains) or as expenses (provisions, impairments, financial guarantee liability, foreign exchange losses). This leads into a permanent difference between the Net Assets items (EU Contribution and Retained earnings) recognised in the financial statements prepared by the EIB and the pre-consolidated financial statements prepared by the EC.

3.2. Pre-consolidated Statement of Financial Performance

In the same way as the balance sheet, the pre-consolidated Statement of Financial Performance is prepared for inclusion in the consolidated Financial Statements of the EU.

	2019	2018
Revenue from operating activities	266,252	2,928,446
Expenses from operating activities	(3,494,876)	(4,876,241)
RESULT FROM OPERATING ACTIVITIES	(3,228,615)	(1,947,795)
Financial income	42,681,966	30,241,834

Financial costs	(39,575,953)	(20,906,275)
FINANCIAL RESULT	3,106,013	9,335,559
ECONOMIC RESULT OF THE YEAR	(122,602)	7,387,764

- Revenues from operating activities include foreign exchange gains of EUR 0.3 million.
- Expenses from operating activities mainly include EIB asset management fees (EUR 0.8 million), external EIB recovery fees (EUR 0.2 million) and an addition to financial provisions on the outstanding future Syrian instalments (EUR 2.2 million).
- The Financial income mainly includes the interest income from the investment portfolio (EUR 7.7 million), realised gains on sale of financial assets (EUR 16.8 million), risk related remuneration from ERI private mandate operations (EUR 2.2 million) and accrued late payment interest on subrogated amounts (EUR 15.9 million).
- The Financial costs mainly include impairment losses (EUR 19.6 million) on amounts subrogated to the EU in 2019 (see point 5), realised losses on sale of financial assets (EUR 0.3 million) and recognised financial guarantee liability on ERI Private mandate operations (EUR 19.6 million).

4. GUARANTEE FUND TREASURY MANAGEMENT

4.1. Investment policy

The Fund's liquid assets are invested in accordance with the management principles laid down in the Annex to the Management Agreement, as amended³. Accordingly, sufficient assets shall be placed in monetary assets to cover the short term (less than one year) outflows, at a proportion to be set out in the annual investment strategy. The remaining assets may be allocated to medium and long term instruments, with a maximum maturity of 10 years and 6 months from the payment date (medium and long-term portfolio). As of end of 2019, the overall modified duration of the Fund portfolio was ca. 3 years.

4.2. Performance and market developments in 2019

The performance of the Fund portfolio was monitored on a mark-to-market basis. During 2019, the Fund portfolio delivered a healthy 1.3% return, supported by the continuation of lower yield environment and positive risk sentiment. The Fund

³ Amended by Supplementary Agreement No 1 of 23 September 1996, Supplementary Agreement No 2 of 8 May 2002, Supplementary Agreement No 3 of 25 February 2008, Supplementary Agreement No 4 of 9 November 2010 and Supplementary Agreement No 5 of September 2018.

portfolio underperformed its benchmark by -9.03 bps. The positive return translated into a positive contribution of EUR 33 million. As of end 2019, the market value of the Fund portfolio amounted to ca. EUR 2,580 million.

In the context of a weakening economy, subdued inflation and geopolitical downside risks, monetary policy turned accommodative. With three cuts of the Federal Funds rate throughout H2 2019, the Fed reversed the monetary tightening cycle initiated in 2015. In addition, the ECB delivered a stimulus package in September consisting of a 10 basis point deposit cut, an extended TLTRO, a tiering system for the banks and an open-ended quantitative easing programme.

The manufacturing sector in the US and Europe contracted because of global trade weakness. Services sector growth also slowed down, albeit remaining in expansionary territory. Eurozone inflation was below central banks' target whilst US inflation moved closer to target but the increase has not been considered satisfactory by the FED.

Geopolitical risks escalated in the course of August, with trade tensions intensifying between US and China while uncertainty over Brexit weighed on European investor sentiment. European and US rates moved to lower levels until September on the back of accommodative central banks policy, low expectations on growth and uncertainty regarding geopolitical risks.

Rates increased somewhat in Q4 in the context of easing geopolitical tensions and stabilization of economic data. Credit spreads, supported by accommodative central banks, trended downwards, with episodic reversals.

5. CALLS ON THE GUARANTEE FUND

Syria

Since November 2011, the EIB is facing arrears on Syrian sovereign loans. As a consequence, and in line with the guarantee agreements between the EU and the EIB, the EIB has made 77 calls on the EU Guarantee Fund up to 31 December 2019 for a total amount of EUR 475.96 million (including penalties applied by EIB and amounts recovered).

6. EIB REMUNERATION

The EIB remuneration is composed of the management fees and the recovery fees. The management fees cover the asset management of the Fund. The recovery fees cover the EIB's external recovery expenses regarding claims following defaults covered by the EU guarantee for EIB financing operations outside the Union.

The second Supplementary Agreement to the Agreement dated 8 May 2002 establishes that the Bank's management fees shall be calculated by applying degressive annual rates of fees to each tranche of the Fund's assets. This remuneration is calculated on the basis of the annual average assets of the Fund.

The Bank's management fees for 2019 were set at EUR 817,747 and were entered as expense in the Statement of Financial Performance and as accruals (liabilities) on the Balance Sheet.

The Recovery Agreement signed between the Commission and the Bank in December 2018 only envisages payment for EIB's external (and no longer internal) recovery expenses.