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

**On operations conducted under the External Lending Mandates of the EIB and future
outlook**

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Table of contents

1.	Introduction	3
2.	Achievements	3
2.1.	Lending volumes	4
2.2.	EIB's regional presence compared to other IFIs.....	5
2.3.	Co-operation with Community programmes and other financial institutions.....	6
2.4.	Progress towards the risk-sharing objective.....	7
2.5.	Value added of the EIB	8
3.	Orientations of future activities.....	9
3.1.	Regional ceilings	9
3.2.	Reserve mandate	11
3.3.	Guarantee coverage	11
3.4.	Country coverage	12
3.5.	Linkage with EU policies	12
3.6.	Cooperation with other IFIs	13
3.7.	Reporting and accounting.....	13

1. INTRODUCTION

This report is submitted to the European Parliament and the Council in accordance with Article 2 of Council Decision 2000/24/EC adopted on 22 December 1999, as amended (the "Decision") which states that: *"The Commission shall report on the application of this Decision by 31 July 2006 at the latest."*

The guarantees granted by the Community under the Decision are backed by a Guarantee Fund for external actions established by Council Regulation 2728/94 of 31 October 1994, as amended ("Guarantee Fund"). On 5 April 2005, the Commission issued a proposal for amending the above Council Regulation.

This report is presented in two sections: the first section provides an overview of the achievements of the European Investment Bank ("EIB" or the "Bank") under the existing mandate; the second section details the orientations of future activities. Two Staff Working Papers, one reviewing regional outlook (SEC (2006) 790, Annex 1) and the other providing a detailed assessment of the existing mandate (SEC (2006) 789, Annex 2), are annexed to this report.

Alongside this report, the Commission is presenting a proposal for a Council Decision for the renewal of the EIB external mandates (COM (2006) 324) reflecting the orientations outlined in this report.

2. ACHIEVEMENTS

The EIB mandate, as laid down in the Decision, is to support the Community's policy objectives through the financing of selected investment projects. The Bank was called upon to enhance coordination with the Community's other financial instruments, and to consult regularly with the Commission to ensure coordination of priorities and activities in the countries concerned. The Bank was also invited to aim to cover the commercial risk on 30% of its lending under risk-sharing arrangements from third-party guarantees or other security. This section summarizes how the Bank fulfilled these objectives; detailing in particular the volume of lending, coordination with Community instruments and with other IFI's and progress towards the risk-sharing objective. It also examines the value added of the Bank's activities. As mentioned above, a detailed evaluation is included in Annex 2.

2.1. Lending volumes

As regards the existing external lending mandates, Table 1 below shows that loan signatures as at 31 December 2005 - i.e. around 85% of the duration of the lending mandates - represent 87% of the overall lending ceiling of EUR 20 660 m, but there are significant differences by region. The table includes operations under the "General Mandate"¹, the "Northern Dimension Environmental Projects/Russia Mandate"² (NDEP), and the "Russia, Ukraine, Moldova and Belarus Mandate"³ (Russia/WNIS).

Table 1: Loans signed as at 31 December 2005

Mandate		Signatures			
Region	Ceiling EUR m	Total EUR m	% of ceiling	Number of loans	Average loan size EUR m
South Eastern Neighbours (SEN)	9 185	7 817	85	120	65
Mediterranean countries (MED)	6 520	6 272 ⁴	96	89	70
Latin America and Asia (ALA)	2 480	1 942	78	44	44
Republic of South Africa (RSA)	825	757	92	14	54
Turkey Earthquake Reconstruction and Rehabilitation Action (TERRA)	600	600	100	5	120
EC/Turkey Customs Union Special Action Programme (SAP)	450	450	100	5	90
Northern Dimension/Russia (NDEP)	100	85	85	3	28
Russia, Ukraine, Moldova and Belarus (Russia/WNIS)	500	0	0	0	0
Total	20.660	17.923	87	280	64

The EIB expects to sign the balance of the amounts available under the different regional ceilings in 2006, except under the NDEP mandate which expired in May 2005 and in the Russia/WNIS mandate, where it forecasts to commit EUR 225 m in 2006 and the remainder in the first half of 2007.

The sectoral breakdown detailed in Annex 2 shows that the Communications sector (Transport and Telecoms) accounted for 35% of total lending. Over half of the loans in this sector were granted in the SEN region. The Water and Miscellaneous sector (including areas

¹ Council Decision 2000/24/EC of 22 December 1999 as amended by Council Decision 2000/688/EC of 7 November 2000, Council Decision 2000/788/EC of 4 December 2000, Council Decision 2001/778/EC of 6 November 2001, Council Decision 2005/47/EC of 22 December 2004 and Council Decision 2006/174/EC of 27 February 2006. Council Decision 199/786/EC of 29 November 1999 is also included in the General Mandate.

² Council Decision 2001/777/EC of 6 November 2001.

³ Council Decision 2005/48/EC of 22 December 2004. To date, only Russia and Ukraine have been confirmed by the Commission to have fulfilled the appropriate conditionality for EIB to start operations under this mandate.

⁴ The cancellation of all un-disbursed EIB public sector loans by the Algerian Government will free up EUR 407 m for new operations.

such as urban rehabilitation) absorbed 20% of total lending, with lending distributed evenly between the SEN and MED regions. The Energy sector accounted for 19% of loans granted during the period under review with a major part of this going to the MED region.

2.2. EIB's regional presence compared to other IFIs

The following table compares the 2005 overall EIB lending activity in the different regions, including at the Bank's own risk outside the Community mandates, with the lending activity of other IFIs.

Table 2: EIB and other IFIs loan commitments in 2005 (EUR bn)⁵

Region	EIB	World Bank ⁶	IFC	EBRD	AfDB	ADB	IADB
Turkey	0.9	1.4	0.3	-	-	-	-
Western Balkans	0.5	0.3	0.2	0.4	-	-	-
Mediterranean countries	1.3	0.5	0.1	-	0.7	-	-
Eastern Europe, Southern Caucasus and Russia	0.1	0.5	0.7	2.0	-	<0.1	-
Central Asia	-	0.2	<0.1	0.3	-	0.1	-
Asia (without Central Asia and Middle East) ⁷	0.6 ⁸	6.3	1.2	-	-	4.5	-
Latin America	0.1	3.9	1.2	-	-	-	5.5
South Africa	0.1	-	<0.1	-	-	-	-

IFC = International Finance Corporation; EBRD = European Bank for Reconstruction and Development; AfDB = African Development Bank; ADB = Asian Development Bank; IADB = Inter-American Development Bank

As shown above, the EIB was the main player in the Mediterranean region and in the Western Balkans in 2005 and, together with the World Bank, it was the most active IFI in Turkey. As compared to the activity of other IFIs, the role of the EIB in the Eastern Neighbour countries, Asia and Latin America was marginal, due to the limited size of the respective mandates.

⁵ The EUR/\$ exchange rate adopted is the 2005 average exchange rate published by the ECB. Figures refer to the respective 2005 Fiscal Years of the various IFIs, which in some cases run from 1/7 to 30/6.

⁶ World Bank figures include IBRD (International Bank for Reconstruction and Development) loans and IDA (International Development Association) concessional financing.

⁷ World Bank and ADB figures refer to Asia (without Central Asia and Middle East) and Pacific.

⁸ This includes the EUR 0.5 bn loan outside the Community mandate for the Beijing airport.

2.3. Co-operation with Community programmes and other financial institutions

Given the type of projects which the Bank supports, co-financing is a regular feature, and is usually a necessity, as EIB funding will not cover more than 50% of the project amount. Table 3 below provides information on the projects financed under the mandate where Community programmes or other financial institutions, in addition to promoters, contributed to the financing of the project.

Table 3: Cofinancings as at 31 December 2005 (EUR m)

Region	Cost	EIB	PHARE/ ISPA	Multilateral Institutions	Bilateral and national inst.	Others
SEN	9 344	3 214	1 122	1 330	881	2 797
MED	9 041	2 787	-	1 292	1 182	3 780
ALA	12 423	1 338	-	718	2 398	7 969
RSA ⁹	798	50	-	-	148	600
Turkey SAP	96	40	-	51	-	5
TERRA	1 286	450	-	308	-	528
TOTAL	32 988	7 879	1 122	3 699	4 609	15 679

The Bank is managing EU budgetary resources for different types of activities in Pre-Accession countries, in the MED region and in South Africa. All members of the Economic and Financial Committee have clearly recognized the value of a "*closer link-up between EIB lending and EU budget resources in the form of grant support and technical assistance*"¹⁰. Furthermore, in the context of cooperation with the other IFIs, the EIB has signed several Memoranda of Understanding (MoUs) or letters of intent setting a framework for cooperation to exchange information and to coordinate activities either in specific regions or in particular projects. The following table lists the EU budgetary instruments managed by the Bank and the MoUs with the Commission and IFIs currently signed or under negotiation.

⁹ Excluding EUR 130 m lines of credit directly to bilateral/regional institutions (European EDFIs and South African development institutions).

¹⁰ EFC report to the ECOFIN Council of March 2006.

Table 4: List of EU-funded instruments and MoUs

Region	EU-funded instruments	MoUs/letter of intent and other parties involved
Pre-Accession countries	- SME Finance Facility, Municipal Infrastructure Facility and Municipal Finance Facility. These instruments combine EIB lending and EU grants to encourage financial institutions to increase their lending activity for SMEs and municipal investment projects. - Interest rates subsidies for selected projects. - Technical assistance via the European Agency for Reconstruction.	- MoU with Commission, EBRD, World Bank, IFC, Nordic Investment Bank, Nordic Environment Finance Corporation, Council of Europe Development Bank and the Black Sea Trade and Development Bank.
Mediterranean countries	- Technical assistance for the preparation and implementation of projects. - risk capital investments supporting local companies and the development of local equity markets. - interest rate subsidies for environmental projects. - The FEMIP Trust Fund, including mainly resources from Member States, focuses on upstream technical assistance and risk capital.	- MoU with Commission and World Bank. - Mou with Commission and AfDB. - Letter of intent with European Development Finance Institutions. - Letter of intent with Agence Française de Développement and Kreditanstalt für Wiederaufbau.
Eastern Europe, Southern Caucasus and Russia	-	- Commission, EBRD, World Bank, Nordic Investment Bank, Black Sea Trade and Dev. Bank. - Commission, EBRD (also covering Central Asia - under negotiation).
Asia	-	- ADB (under negotiation)
Latin America	-	- IADB. - Corp. Andina de Fomento (under neg.). - Central American Bank for Economic Integration (under neg.). - Banco Nacional de Desenvolvimento Econômico e Social (under neg.).
South Africa	- Risk capital investments supporting local companies	-

2.4. Progress towards the risk-sharing objective

The existing Community Guarantee covers all credit risks, unless the risk-sharing arrangements apply, in which case the Community Guarantee covers only specific political risks whereas non-political risks are borne and mitigated by the EIB. 30% of the EIB's loan portfolio was expected to avail itself of risk sharing under the current mandate.

Table 5 shows that the Bank had achieved at the end of December 2005 16.7% in terms of risk-sharing loans as a proportion of total loans signed under the mandate. The proportions differ greatly between the various regional headings of the mandate. The target of 30% for mandate operations has been substantially exceeded in ALA, but is unlikely to be attained individually in SEN, MED or RSA. In MED, this essentially reflects the difficulty for local promoters to gain access to external (including European) banks willing to provide guarantee

acceptable to the EIB under its current guidelines. No call on the EU guarantee has been made for political risk coverage under risk sharing.

Most of the lending operations in the new Member States before accession, however, were carried out without EU guarantee under the Pre-Accession Facility, adopted by the Bank after the Decision came into force. The Bank has, in the meantime, also established its Mediterranean Partnership Facility, with a lending envelope of EUR 1 bn, for lending in the Mediterranean countries, and has extended a EUR 500 m loan for the Beijing airport, both again without EU guarantee. In analysing fully the sharing of risk between the EU budget and the EIB in external lending operations, non-guaranteed lending must also be considered. Table 5 below shows the effect of classifying lending under the Pre-Accession Facility, the Mediterranean Partnership Facility and with the specific Article 18 authorisation, together with risk-sharing lending under the mandate.

Table 5: Risk-sharing achieved as at 31 December 2005

Mandate		Signatures			
Region	Ceiling EUR m	Total EUR m	Risk Sharing EUR m	Risk Sharing % achieved on mandate alone	Risk Sharing % achieved on mandate and non-mandate
SEN	9 185	7 817	830	10.6	65.3
MED	6 520	6 272	601	9.6	14.6
ALA	2 480	1 942	1 463	75.3	80.4
RSA	825	757	80	10.6	10.6
TERRA	600	600			
Turkey SAP	450	450			
EU Mandate Total	20 060	17 838	2 974	16.7	52.1
Pre-Accession Facility II	14 000	12 304	12 304		
Med Partnership Facility	1 000	364	364		
Article 18 project		500	500		
Outside Mandate Total	15 000	13 168	13 168		
Overall Total	35 060	31 006	16 142		

2.5. Value added of the EIB

The EIB does not have a general mission outside the EU under its Statute but operates under specific mandates to act in support of EU policy as established under strategy documents of the Commission or the Council. As compared to other IFIs, the EIB operates its external lending mandates with fewer staff and is perceived by potential borrowers as a streamlined and efficient lending institution with a closely defined focus.

The EIB's expertise and comparative advantage lie in particular in fields such as infrastructure, environment and SMEs, where it seeks to pass on to project promoters its technical and economic know-how. Furthermore, the Bank performs a rigorous appraisal of

project conditionality, notably ensuring the application of EU environmental and procurement standards¹¹.

The EIB's project conditions also cover other important issues such as pricing and tariff policies, improvements in management capacity, cessation of non-profitable activities, productivity targets and asset disposal, etc. Such conditions form part of the finance contracts and are monitored throughout project implementation. In case of non-compliance, disbursements of the loan may be withheld or suspended. In the Mediterranean region, the EIB has placed growing weight on sectoral support and reforms, also thanks to the availability of technical assistance funds for project preparation and implementation. It should be noted that, at an EU level, macro-economic assistance and conditionality are dealt with by the Commission.

In addition to the above benefits, the EIB has passed on in full the financial advantages resulting from the Community guarantee and the attractive funding costs of the Bank to the final beneficiaries in the form of competitive interest rates. Moreover, the EIB has extended loans with very long maturities, which are generally not readily available in these countries. In many cases, EIB's support for a project also had a catalytic effect on the participation of other financial partners. The EIB has also been developing its local currency fund raising and lending capacity in some countries, which has contributed to the development of local capital and financial markets.

3. ORIENTATIONS OF FUTURE ACTIVITIES

3.1. Regional ceilings

The new mandate will build upon the existing achievements of the Bank, broadening the geographical and sectoral focus of activity in line with the new political priorities of the EU. Foreseeable future needs and potential absorption capacities vary across the different regions. Annex 1 to this report reviews the future outlook in the various regions of the mandate and analyses the orientations of the Bank's future activities in response to these needs, thus supporting the Commission's proposals for the new EIB external mandate.

Table 6 below compares the ceilings of the mandates during 2000-2006 and the ceilings proposed by the Commission for the period 2007-2013.

¹¹ In this respect, it is worth mentioning the recently launched 'European Principles of the Environment', a joint initiative between the EIB, the EBRD, the Council of Europe Development Bank, the The Nordic Environment Finance Corporation and the Nordic Investment Bank, aimed at the harmonisation of environmental principles, practices and standards associated with the financing of projects. Regarding procurement, the EIB seeks to ensure that the fundamental EU principles regarding public procurement, such as the principles of equal treatment, non-discrimination and transparency, are respected.

Table 6: Comparison of current and proposed EIB mandates

EU POLICY / MANDATE	2000-2006		2007-2013	
	€ bn	%	€ bn	%
Pre-accession				
<i>Pre-accession countries</i>	10,2	49,5%	9,0	28,6%
- of which pre-accession countries 2007-2013	5,2	25,2%		
Sub-total	10,2	49,5%	9,0	28,6%
Neighbourhood				
<i>Mediterranean countries (*)</i>	6,5	31,6%	10,0	31,7%
<i>Eastern Europe, Southern Caucasus and Russia</i>	0,6	2,9%	5,0	15,9%
Sub-total	7,1	34,5%	15,0	47,6%
Development Cooperation/Economic Cooperation				
Asia and Latin America				
<i>Asia</i>			2,0	6,3%
<i>Latin America</i>			4,0	12,7%
Sub-total	2,5	12,0%	6,0	19,0%
ACP - South Africa				
<i>South Africa</i>	0,8	4,0%	1,5	4,8%
Sub-total	0,8	4,0%	1,5	4,8%
Total regional mandates	20,7	100,0%	31,5	100,0%
Reserve mandate	0,0		1,5	
TOTAL	20,7		33,0	

(*) Following the restructuring of the mandates after the mid-term review of 2003, the ceiling for Mediterranean countries was de facto increased, since Turkey was excluded from the Mediterranean mandate and included in the South Eastern Neighbours' one.

The EUR 31.5 bn would represent in real terms a 7-year increase of around 16%¹² (or slightly more than 2% annually). As detailed in Annex 1, the regional ceilings have been considered with regard to political EU priorities as well as absorption capacity perceived by the EIB.

It should be noted that, while the current mandates have a fragmented geographical coverage, the new mandate will offer a global coverage, by supporting the three circles of the EU external policy (Pre-accession, Neighbourhood and Development Cooperation and Economic Cooperation). The level of the amounts devoted to the different regions will depend on the relative importance of such regions within the EU's external policy. The estimated allocation per capita implied by the proposed ceilings under the different mandates is as follows: Pre-Accession ± € 100; Neighbourhood and Partnership ± € 40; Development Cooperation and Economic Cooperation ± € 2.

¹² Figures deflated on the basis of the ENR International Construction Cost index.

3.2. Reserve mandate

Reconstruction after natural disasters or conflicts as well as developments in politically/strategically important countries may result in large additional financing needs where EIB guaranteed loans can usefully complement or be combined with EC budget support to ensure timely and visible EU action. In addition, the nature of the EU response may need to be targeted to selected sectors and conditions. Over the last few years, the swift mobilisation of significant EIB resources in support of such types of activities has proved to be very difficult (e.g. Tsunami and Gaza-West Bank). Therefore, to ensure that such developments do not put a burden on existing regional ceilings and can, where appropriate, be swiftly combined with budget resources, it is suggested to introduce a “Reserve Mandate” within the general lending mandate in order to facilitate the planning for, and increase the speed of, an EU response.

The main triggers for the Reserve Mandate will be natural disasters (commonly floods, fires, earthquakes, hurricanes/typhoons, tsunamis) or post-conflict reconstruction. The Reserve Mandate can also be activated for prompting EIB lending in certain countries or regions politically/strategically important to the EU, which do not fulfil the necessary conditions for immediate EIB activity but with viable perspectives in the medium term, including those countries with prospects for conclusion of cooperation agreements. Given past experience, it would be appropriate to reserve amounts for two/three major events during the lifetime of the mandate, which justifies the proposed ceiling of EUR 1.5 bn.

Potentially eligible countries for the Reserve Mandate will be those listed in the Council decision under the regional mandates. The activation of the Reserve Mandate will be subject to a joint Commission/EIB decision, following consultation with the Economic and Financial Committee through a comitology procedure, which foresees parallel information to the European Parliament.

3.3. Guarantee coverage

The EIB will continue to extend the volume and the scope of its operations without Community guarantee wherever appropriate. In particular, over the period 2007-2013, financing in Croatia, Turkey and the Former Yugoslav Republic of Macedonia would increasingly take place under the Pre-Accession Facility made available by the EIB, which should be extended over time to cover the rest of the Western Balkans, in line with progress of their accession process. The EIB indicative lending without Community guarantee in this region would amount to around EUR 4 bn over the period 2007-2013. The Bank would also increase its lending in Mediterranean countries without EU guarantee coverage, building upon the already existing ‘Nice’ Facility, to an indicative amount of around EUR 2 bn over the period 2007-2013. In light of past experiences (Beijing airport project), the Bank could also foster the practice of financing at its own risk strategic *ad hoc* projects in investment grade countries, notably in Asia and Latin America.

The Commission's proposal clarifies the nature of the guarantee coverage which will be limited to risks of a sovereign or political nature. The Community guarantee will provide a full coverage for financing operations entered into with or guaranteed by the State. Also operations entered into with local authorities or government-owned and/or -controlled entities can be fully covered, where such operations have an appropriate EIB credit risk assessment taking into account the credit risk situation of the country concerned.

The political risks covered under the Community guarantee will be those established under the current mandate, i.e. non-transfer of currency, expropriation, war or civil disturbance and denial of justice upon breach of contract. In order to align the implementing provisions for the coverage of these risks, notably denial of justice upon breach of contract, with MIGA provisions, some technical adjustment will be introduced in the guarantee agreement between the Commission and the EIB.

Finally, the Commission proposes to extend the guarantee coverage to both types of financing operations mentioned in the EIB Statute, i.e. loans and guarantees. Under the existing mandates only loans are covered. This extension will not imply any material change in the types of projects to be financed by the EIB. For both loans and guarantees, the Community guarantee will cover sovereign or political risks and thus the risk borne by the Community budget will be equivalent for both types of operations (under equivalent conditions). A technical modification of the Guarantee Fund Regulation is necessary to accommodate this extension.

3.4. Country coverage

In line with the practice established under the existing mandate for Russia, Ukraine, Moldova and Belarus, selected individual countries covered by the Neighbourhood policy and the Development Cooperation and Economic Cooperation policy will become eligible as and when they fulfil appropriate conditionality consistent with EU high level agreements with the country in question on political and macro-economic aspects. The Commission, following consultation with the EIB, will determine when an individual country has fulfilled the appropriate conditionality. The list of the relevant countries is included in the proposed legal act. This approach will ensure that the EIB activity in the selected countries can be triggered on a sound political and macro-economic basis, in full coherence with EU action in the relevant countries. EIB operations in a given country can then take place once the relevant Framework Agreement between the EIB and the relevant country is signed, ratified and has entered into force.

The proposal foresees that, in view of serious concerns about the subsequent evolution of the political or economic situation in a specific country, the Commission and the EIB might decide to suspend EIB's financing operations in such a country.

3.5. Linkage with EU policies

In order to further increase support for EU external policies in each specific region, the linkage between EIB priorities and EU policies in the respective area has to be strengthened. This can be achieved through a stronger framework for dialogue and cooperation between the Bank and the Commission, in the definition of regional policies, country strategies, and at a project level. Furthermore, the effectiveness and visibility of financial support to EU policy may benefit in many circumstances from the synergies and leverage achieved by combining EU budget and lending capacities (risk capital, technical assistance, co-financing, targeted interest subsidies). The extent of this cooperation will progress on a regionally differentiated basis, taking into consideration the EIB's importance in the region but also the scope for linkage with EU's policies in the framework of the Pre-Accession Policy, the European Neighbourhood Policy and the Development and Economic Cooperation Policy.

The Commission envisages covering EIB activities in its regional or country strategy papers and action plans, setting out priorities and expected outcome. The preparation of these reports

will be carried out in close collaboration with the EIB. The EIB will also be invited to participate in the various regional committees set up under the aegis of the Commission

Furthermore, the Commission envisages upstream consultation by the EIB on individual projects. An EIB financing operation will not be included under the cover of the Community guarantee in case the Commission delivers a negative opinion on such operation within the framework of the procedure provided for in Article 21 of the Statutes of the EIB.

Finally, a yearly reporting process is foreseen to assess the contribution of the EIB financing operations to the fulfilment of the EU's external policy objectives.

3.6. Cooperation with other IFIs

The Commission's proposal reflects the need for the EIB to further strengthen co-ordination, co-operation and, where appropriate co-financing, with IFIs and with European bilateral institutions. The intention is to, where necessary, develop an enhanced framework for operational cooperation, building on the existing MoUs.

In this context, a tripartite agreement, in the form of a MoU, between the Commission, the EIB and the EBRD, will set out cooperation patterns concerning operations in Eastern Europe, Southern Caucasus, Russia and Central Asia. The modalities of cooperation envisaged in the tripartite agreement foresee intervention by the EIB and the EBRD in these regions with, in general, agreed 'joint offers' to borrowers, each of them bringing in most cases half of the financing. The final beneficiary would thus in general benefit from a blended package and pricing. A steering committee composed of high-level officials of the three institutions will oversee the application of the tripartite agreement.

3.7. Reporting and accounting

The Commission proposes enhancing its reporting to the European Parliament and Council to allow them to better monitor the external mandate of the EIB. Furthermore, the accounting rules stemming from the new Financial Regulation require that the EIB provide the Commission in a timely manner with more detailed financial, accounting and, where necessary, risk valuation data in order for the latter to prepare its annual accounts and answer to requests of the Court of Auditors.

A mid-term review of the mandate would be carried out by the Commission in 2010, which would allow, where necessary, for a refocusing of the priorities set out in the legal basis. It would be prepared by the Commission drawing inter alia upon an activity report from the EIB as well as an evaluation provided by the independent evaluation department of the EIB.