EUROPEAN
COMMISSION

Brussels, 5.8.2019
COM(2019) 363 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON THE GUARANTEE FUND FOR EXTERNAL ACTION AND ITS MANAGEMENT IN 2018

{SWD(2019) 314 final}

Table of Contents

1. INTRODUCTION

Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 (codified version) ('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 2018[2] ('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.

1 OJ L 145, 10.6.2009, p. 10; the Regulation codified and repealed Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions.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. FINANCIAL POSITION AND SIGNIFICANT TRANSACTIONS OF THE GUARANTEE FUND

2.1. Financial Position of the Guarantee Fund at 31 December 2018

The Guarantee Fund totalled EUR 2,609,881,747.51 as of 31 December 2018 (EUR 2,560,761,844.63 as of 31 December 2017) (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 49.1 million in 2018. This is mainly explained by the following:

<u>Increases:</u>

- The contribution from the EU budget (provisioning amount) of EUR 103.2 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 12.0 million.

<u>Decreases:</u>

- Interventions of the Fund to cover defaulted payments for a total amount of EUR 55.7 million.
- The portfolio valuation decreased by EUR 10.5 million due to the mark-to-market adjustment of its value.

2.2. Significant Transactions of the Fund in 2018

2.2.1 Calls on the Guarantee Fund 2018

Syria

In 2018, the EIB has continued 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 9 additional calls on the EU Guarantee Fund up to 31 December 2018 for a total amount of EUR 55.73 million (see point 5).

Enfidha Airport (Tunisia)

In 2018, the EIB recovered EUR 136,092.88 from the loan to Enfidha Airport (Tunisia) which were credited to the Guarantee Fund bank account with the value date 15 January 2018 (see point 5).

2.2.2 Provisioning of the Guarantee Fund 2018

In February 2018 an amount of EUR 137.8 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 2019 was also calculated in February 2018 resulting in EUR 103.2 million to be transferred in February 2019. It was 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 103.22 million was calculated based on guaranteed operations outstanding at 31 December 2017 and entered in the EU budget of 2019 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 2018.

2.3. Significant transactions after the reporting date (as of end March 2019)

In February 2019 the above mentioned provisioning amount of EUR 103.2 million was transferred from the EU budget to the Fund.

In January and March 2019, 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 2018

Balance Sheet – Assets

	31 December 2018	31 December 2017
NON-CURRENT ASSETS	2,275,342,664	2,077,970,486
Financial assets	2,275,342,664	2,077,970,486
CURRENT ASSETS	231,316,149	344,990,638
Financial assets	189,758,096	120,771,792
Receivables	-	136,093
Cash and cash equivalents	41,558,053	224,082,753
TOTAL ASSETS	2,506,658,813	2,422,961,124

Balance Sheet - Liabilities

	31 December 2018	31 December 2017
CONTRIBUTOR'S RESOURCES	2,295,687,144	2,160,971,521
European Commission contribution	1,846,972,362	1,709,171,640
Fair value reserve	12,227,192	22,700,055
Retained earnings	436,487,590	429,099,826
NON-CURRENT LIABILITIES	159,153,609	208,033,976
Financial provisions	159,153,609	208,033,976
CURRENT LIABILITIES	51,818,060	53,955,627
Financial provisions	50,777,871	50,408,230
Payables	1,040,189	3,547,397
TOTAL CONTRIBUTOR'S RESOURCES + LIABILITIES	2,506,658,813	2,422,961,124

The difference of EUR 103.2 million between the total pre-consolidated balance sheet value of the Fund (EUR 2,506,658,813) and the value of the Fund in the financial statements prepared by the EIB (EUR 2,609,881,748) can be mainly explained by the following items:

- The pre-consolidated financial statements include 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 2018 financial statements.
- The pre-consolidated financial statements do not include EUR 103.2 million of contribution from the EU budget to the Fund transferred in 2019 as this receivable is offset by the corresponding payable in the consolidated accounts of the EU.
- Financial provisions of EUR 209.9 million relating to future instalments of the remaining outstanding Syrian loans have been recognised in the pre-consolidated balance sheet in 2018.
- 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 (accruing EIB recovery fees, impairments, 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.

	2018	2017
Revenue from operating activities	2,928,446	939,062
Expenses from operating activities	(4,876,241)	(3,834,219)
RESULT FROM OPERATING ACTIVITIES	(1,947,795)	(2,895,157)
Financial income	30,241,834	29,913,694
Financial costs	(20,906,275)	(51,793,999)
FINANCIAL RESULT	9,335,559	(21,880,305)
ECONOMIC RESULT OF THE YEAR	7,387,764	(24,775,462)

- Revenues from operating activities include foreign exchange gains and reversed 2017 balance of accrued EIB recovery fees, resulting from the requirements of the new Recovery Agreement, signed in 2018. The new Agreement no longer envisages payment for fees for EIB internal recovery costs.
- Expenses from operating activities mainly include EIB asset management fees (EUR 0.9 million), external EIB recovery fees (EUR 1.9 million) and an addition to financial provisions on the outstanding future Syrian instalments (EUR 1.9 million)
- The Financial income mainly includes the interest income from the investment portfolio (EUR 6.3 million), realised gains on sale of financial assets (EUR 10.0 million) and accrued late payment interest on subrogated amounts (EUR 13.9 million)
- The Financial costs mainly include impairment losses (EUR 19.6 million) on amounts subrogated to the EU in 2018 (see point 5), interest expenses on cash and cash equivalents (EUR 0.9 million) and realised losses on sale of financial assets (EUR 0.5 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 amended[3]. 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).

4.2. Performance and market developments in 2018

The year was characterized by volatile yield movements on European fixed income markets with rates moving higher in Q1 due to expectations relating to the end of the ECB's quantitative easing policy (QE). Rates then moved to annual lows at the end of the year due to softening economic growth. Credit spreads edged higher during the year and the move accelerated in December on falling equity markets and expectation of tighter monetary policies.

Throughout the year, financial markets were affected by the following risk factors. The imposition of trade tariffs by president Trump slowed economic growth, and inflation remained below the central bank targets due to low commodity prices and globalization factors. The uncertain outlook of Brexit negotiations weighed on UK financials and corporates. The ramifications of the March Italian elections were felt in May, as Italian spreads widened out to more than 250 basis points vs Germany.

Monetary policy of major global central banks became tighter in 2018. The US FED continued its rate hike cycle every quarter by 25 basis points raising the FED funds target rate to 2.50-2.75% by year-end. The ECB has reduced the monthly net asset purchases as part of its QE policy from EUR 30 billion to EUR 15 billion in September and terminated the net purchases at the end of 2018. The reinvestments of the maturing bonds on the ECB balance sheet will continue to support the markets. However, more recently, the monetary policy on both sides of the Atlantic has turned more dovish with increasing uncertainties. The market no longer expects further FED hikes and the first interest rate increase of the ECB has been postponed to 2020. Economic growth is expected to slow down from 2.9% in 2018 to 2.5% in 2019 for US, and from 1.9% to 1.4% for the Euro area.

Going forward, in 2019 it is expected that market volatility will remain, as uncertainty around Brexit and growth slowdown will affect market rates being currently close to historical lows. At the same time credit spreads tend to move wider as the economic cycle matures in the US and central bank asset purchases have been terminated in the EU.

[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.

The performance of the Fund portfolio was monitored on a mark-to-market (MTM) basis (fair value). During 2018, the portfolio delivered a 0.1005% MTM yearly return, outperforming its benchmark by +13.5 basis points.

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 63 calls on the EU Guarantee Fund up to 31 December 2018 for a total amount of EUR 421.05 million (including penalties applied by EIB and amounts recovered).

Enfidha Airport (Tunisia).

In January 2018, the EIB recovered EUR 136,092.88 from the loan to Enfidha Airport (Tunisia) which was credited to the bank account of the Guarantee Fund for external Actions.

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 expensesregarding 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 2018 were set at EUR 894,626 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’ external (and no longer internal) recovery expenses.