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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON THE GUARANTEE FUND AND ITS MANAGEMENT IN 2013

{SWD(2014) 241 final}

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1. INTRODUCTION

Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009[1] (codified version) ('the Regulation') 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 signed between the Community and the EIB on 23 November 1994 in Brussels and on 25 November 1994 in Luxembourg ('the Agreement'), and subsequently amended on 17/23 September 1996, 8 May 2002, 25 February 2008, 20 October 2010 and 9 November 2010.

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 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

2. FINANCIAL POSITION OF THE FUND AT 31 DECEMBER 2013

The financial position of the Fund is the sum of all the financial flows since the setting up of the Fund in 1994.

2.1. Financial flows of the Fund

The Fund totalled EUR 2,004,356,642.91 (see Section 3 of the SWD: Fund Financial Statements as at 31 December 2013, as provided by the EIB). This is the sum of the flows since the Fund was established:

Guarantee Fund	**Amount at 31.12.2013**	**Amount at 31.12.2012**	**Change**
budget contributions to the Fund	3,598,826,794.00	3,540,394,500.00	58,432,294.00
successive yearly net results	878,284,248.11	846,343,661.55	31,940,586.56
recoveries of payments made by the Fund for defaults	578,854,353.78	578,854,353.78	0.00
other accounts payable (including called guarantee not yet paid and EIB management fees)	23,066,612.47	18,819,492.23	4,247,120.24
fees received on late recovery (in 2002)	5,090,662.91	5,090,662.91	0.00
calls on the Fund's resources (including called guarantee not yet paid)	(584,704,389.46)	(519,866,214.55)	(64,838,174.91)
successive repayments to the budget (including exceptional repayment to the budget due to the accession of new Member States)	(2,531,726,712.72)	(2,501,391,526.79)	(30,335,185.93)
adjustment of portfolio valuation according to IFRS valuation	36,665,073.82	53,681,272.87	(17,016,199.05)
Accounting value of the Fund	**2,004,356,642.91**	**2,021,926,202.00**	**(17,569,559.09)**

The accounting value of the Fund decreased by about EUR 18 million in 2013. This is explained by :

Increasing

- The contribution from the budget (provisioning amount) of EUR 58 million to adjust the Fund to the 9% target amount
- The net revenues on financial operations amounted to EUR 32 million
- A change of EUR 4 million consisting mainly of the payable for the guarantee calls to the Fund (payment occurred early 2014)

Decreasing

- Intervention of the Fund to cover defaulted payments by Syria for a total amount of EUR 65 millions thereof 22 million are still to be paid as at 31 December 2013 (other accounts payable).
- Repayment to the budget of EUR 30 millions due to the accession of a new Member State (Croatia)
- The portfolio valuation decrease by EUR 17 million due to the mark to market adjustment of its value.

2.2. Significant transactions

(1) Since November 2011, the EIB is 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 4 calls on the EU Guarantee Fund in 2012 for a total amount of EUR 42 million (from which EUR 2.15 million have been recovered) and 9 calls in 2013 for an amount of EUR 64.83 million (see point 4.1 Default payments).

(2) In February 2013, the contribution from the budget to the Fund was calculated following Article 3 and Article 5 of the Regulation:

Article 3 of the Regulation[2] sets a target amount for the Fund of 9 % of the total outstanding capital liabilities arising from each operation, plus any 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.

[2] The Regulation stipulates that operations concerning accession countries covered by the Fund remain covered by the EU guarantee after the date of accession. However, from that date they cease to be external actions of the EU and are covered directly by the general budget of the European Union and no longer by the Fund.

To adjust the Fund to the 9% of the total outstanding capital liabilities, an amount of EUR 58.43 million was entered in the 2014 budget for the provisioning of the Fund. At 31.12.2012, the target amount was EUR 2,078.92 million corresponding to the 9% of the total outstanding guaranteed operations (EUR 23,099.15 million). The difference between the target amount and the net assets of the Fund of EUR 2,020.49 million at 31.12.2012 was equal to EUR 58.43 million.

This amount was requested for the provisioning of the Fund in 2014 and was approved by the Council and the European Parliament as part of the approval of the 2014 budget in November 2013. It was subsequently recognised as a receivable of the Fund from the budget.

(3) On 20.02.2013 an amount of EUR 155.66 million was transfered from the budget to the Fund corresponding to the provisioning amount for 2013 (see details in paragraph 3.2.1 provisioning of the Fund).

2.3. Significant transaction after the reporting date

On 27 February 2014 an amount of EUR 58.43 million was transfered from the budget to the Fund corresponding to the provisioning for 2014.

2.4. Presentation of the accounts

2.4.1. Basis of preparation

The Fund's financial statements (as well as the pre-consolidated financial statements) have been prepared in accordance with the accounting rules adopted by the Accounting Officer of the European Commission, in particular "Accounting rule 11 - Financial instruments" as explained in the SWD.

2.4.2. Pre-consolidated financial statements for the Fund at 31 December 2013

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). The need to include such operations is due to the successive defaults which occurred since the existence of the Fund. If the beneficiary of a loan operation covered by the Fund defaults, the pre-consolidated balance sheet should include any arrears due plus the interest accrued on late payments and other accounting accruals[3] until the full repayments of amounts due to the Fund. Thus, there will be a full set of financial statements for the Fund at the end of the year to be consolidated in the EU consolidated balance sheet. At 31.12.2013, there are defaulted payments for Syrian loans which have been covered by the Fund and are recorded in the pre-consolidated financial statements as current assets (subrogated loans) for a total amount of EUR 85,462,796.16. The current assets also include a temporary receivable with the EIB of EUR 22,039,281.70 for calls of guarantee not yet paid plus related amounts, where the EIB remains creditor of Syria until the payment of the call. The current liabilitites include a payable to the EIB of EUR 22,839,314.22 for calls of guarantee not yet paid plus related amounts. The total amount indicated in the pre-consolidated balance sheet is EUR 2,111,858,720.77.

It should be noted that pre-consolidated accounts reflect a recommendation of the Court of Auditors, to show the accrued interest related to the available-for-sale (AFS) financial assets

[3] Other accounting accruals include exchange rate differences and recovery fees due to the EIB.

of the European Institutions as it is expected to be paid within the next twelve months of the reporting date. For comparative purpose, this categorisation has been applied as well to the 2012 figures.

2.4.2.1. Guarantee Fund: Pre-consolidated balance sheet

The pre-consolidated balance sheet is the preparation of the balance sheet for its consolidation in the EU's consolidated financial statements. The main changes are explained in the notes to the balance sheet.

Balance sheet: Assets in EUR	31.12.2013	31.12.2012
NON-CURRENT ASSETS		
Long-term Investments	**1,432,206,953.14**	**1,331,523,103.78**
AFS Portfolio - cost	1,394,349,787.68	1,277,457,029.68
AFS Portfolio – actuarial difference	2,830,052.94	1,937,127.51
AFS Portfolio – adjustment to fair value	35,027,112.52	52,128,946.59
AFS Portfolio – impairment	-	-
Total Non-Current Assets	**1,432,206,953.14**	**1,331,523,103.78**
CURRENT ASSETS		
Short-term Investments	**361,614,283.35**	**284,047,864.76**
AFS Portfolio - cost	345,762,688.23	265,916,314.50
AFS Portfolio – actuarial difference	-2,717,150.48	-2,383,541.31
AFS Portfolio – adjustment to fair value	1,635,647.34	1,540,460.39
AFS Portfolio - accruals	16,933,098.26	18,974,631.18
AFS Portfolio – impairment	-	-
Short-term receivables	**165,934,371.86**	**196,117,402.09**
Other: Contributions receivable from EU Budget	58,432,294.00	155,660,000.00
Other: Coupon receivables	-	601,389.32
Other: Guarantee calls (EIB receivable)	22,039,281.70	17,982,385.53
Other: Subrogated loans (Syria receivable)	85,462,796.16	21,873,627.24
Cash and Cash Equivalents	**152,103,112.42**	**250,093,844.14**
Current accounts	1,222,298.07	8,074,235.40
Short-term deposits – nominal	150,872,000.00	242,000,000.00
Accrued interests on short-term deposits	8,814.35	19,608.74
Total Current Assets	**679,651,767.63**	**730,259,110.99**
TOTAL ASSETS	**2,111,858,720.77**	**2,061,782,214.77**

Balance sheet: Liabilities in EUR	31.12.2013	31.12.2012
EQUITY		
Capital (Guarantee Fund)	**1,067,100,081.26**	**1,039,002,973.21**
Contributions allocated but not yet paid in	58,432,294.00	155,660,000.00
Payment from the budget	1,008,667,787.26	883,342,973.21
Reserves	**36,665,073.82**	**53,681,272.87**
First Time application – FV reserve	2,313.96	11,865.89
Change in fair value of AFS assets	36,662,759.86	53,669,406.98
Accumulated surplus / deficit	**950,218,191.35**	**906,288,860.95**
Results brought forward	950,218,191.35	906,288,860.95
Economic result of the year	**33,562,793.32**	**43,929,330.40**
Total Equity	**2,087,546,139.75**	**2,042,902,437.43**
CURRENT LIABILITIES		
Accounts Payables	**24,312,581.02**	**18,879,777.34**
Other: Guarantee calls (EIB payable)	22,839,314.22	17,982,385.53
Other: Handling fees (EIB payable)	598,367.37	60,285.11
Others	874,899.43	837,106.70
Total Current Liabilities	**24,312,581.02**	**18,879,777.34**
TOTAL LIABILITIES	**2,111,858,720.77**	**2,061,782,214.77**

Notes to the balance sheet:

- 'Short-term receivables' contains the provisioning amount for 2014 due to be paid by the EU budget to the Fund in early 2014. It also includes the subrogated loans plus related amounts, as well as amounts of loans that have been called but not yet paid (payment in January/February 2014), plus related amounts. These amounts include the capital, interest and penalties due to the budget of the European Union following release of the Fund guarantee. The difference in 'accumulated surplus' in equity compared with the financial position of the Fund presented in the SWD is explained by the successive repayments of calls and penalties to the Fund.

- 'Accounts payables' in 2013 include the calls to guarantees unpaid at the balance sheet date plus related amounts, the accrual of the recovery fees due to the EIB, EIB management commission and audit fees.

- In 2013 and 2012, the Commission did not record any impairments in respect of the subrogated loans and of the EU sovereign and sovereign guaranteed bond holdings in the Fund portfolio.

- The Fund exposure against EU sovereign risk per country can be found in the SWD. At 31/12/2013, the top 3 countries in terms of sovereign risk exposure were France, Germany and Belgium with a weight of about 21%, 20% and respectively 12%.

- Guarantee Fund: Pre-consolidated economic outturn account

In the same way as the balance sheet, the pre-consolidated economic outturn account is prepared for inclusion in the consolidated financial statements of the EU. Main adjustments are explained in the note to the pre-consolidated economic outturn account

	2013	2012
Financial operations revenues	**35,234,727.71**	**47,722,795.64**
Interest income		
Interest income on cash and cash equivalents	208,412.77	2,152,817.58
Interest income on AFS assets	31,299,159.53	36,869,194.02
Other Interest income (securities' lending)	83,827.76	104,765.51
Realised gains on sale of AFS assets	1,364,029.81	8,596,018.53
Other: sub-rogated loans (accrued interest income)	2,279,297.84	-
Financial operations expenses	**-1,671,934.39**	**-3,793,465.24**
Interest charges		
Realised losses on sale of AFS assets	-	-2,781,347.56
Other financial charges	**-1,671,934.39**	**-1,012,117.68**
Other: GF Audit fees	-33,600.00	-31,800.00
Other: GF Management & handling fees	-841,299.43	-805,306.70
Other: Other financial charges	-139,943.88	-114,725.87
Other: Unrealised exchange loss on sub-rog loans	-119,008.82	-
Other: Recovery Management & handling fees	-538,082.26	-60,285.11
ECONOMIC RESULT OF THE YEAR	**33,562,793.32**	**43,929,330.40**

Notes to the pre-consolidated economic outturn account:

‘Other financial charges’ include the EIB management fees, audit fees, unrealised exchange losses on the subrogated loans and accrual of the EIB recovery fees.

3. PAYMENTS TO OR FROM THE FUND

This section explains the financial flows going to or out of the Fund.

3.1. Legal basis for payments to the Fund from the general budget

The Regulation was amended in 2007[4] to ensure a more efficient use of budgetary resources by provisioning the Fund on the basis of the observed amounts of guaranteed loans outstanding. As the amount of outstanding liabilities increases, the Eu budget contribution required to maintain the target amount for the Fund will also increase. Therefore EIB need to use the guarantee only when it's absolutely necessary and make adequate use of the possibility of own risk operations.

The target amount is 9% of the loans and guaranteed loans outstanding, including all types of operations covered (EIB, MFA and Euratom loans) outside the EU. The difference between the target amount and the value of the Fund's net assets will result in provisioning from budget line 01.03.06 'Provisioning of the Guarantee Fund' to the Fund or in payment from the Fund to the budget in the event of a surplus.

The amount available for financing the Fund is provided from budget line 01.03.06 'Provisioning of the Guarantee Fund' under Heading 4 (External Relations).

3.2. Payments to or from the general budget in the course of the financial year

3.2.1. Provisioning of the Fund

On the basis of the outstanding guaranteed operations of EUR 21,234.34 million as of 31.12.2011, an amount of EUR 155.66 million, was inserted in budget line 01.03.06 'Provisioning of the Guarantee Fund' in the statement of expenditure in the general budget of the European Union for 2013. This amount was paid in one transaction from the budget to the Fund on 20 February 2013.

3.2.2. Interest from the investment of the Fund's liquid assets

3.2.2.1. Investment policy

The Fund's liquid assets are invested in accordance with the management principles laid down in the Annex to the Agreement, as amended[5]. Accordingly, 20% of the Fund must be invested in short-term investments (up to one year). These investments include variable-rate securities, irrespective of their maturity dates, and fixed-rate

[4] Council Regulation (EC, Euratom) No 89/2007 of 30 January 2007 amending Council Regulation (EC, Euratom) No 2728/94 establishing a Guarantee Fund for external actions, (OJ L 22, 31.1.2007, p. 1).

[5] Amended by Supplementary Agreement No 1 of 17/23 September 1996, Supplementary Agreement No 2 of 26 April/8 May 2002, Supplementary Agreement No 3 of 25 February 2008 and Supplementary Agreement No 4 of 9 November 2010.

securities with a maximum of one year remaining to maturity, irrespective of their initial maturity period. To maintain a balance between the various instruments providing the required liquidity, a minimum of EUR 100 million is kept in money market instruments, particularly bank deposits.

The list of banks authorised to receive deposits is proposed by the EIB and agreed by the Commission. The list has been regularly revised in the light of the changes in bank ratings. All banks have a Moody's rating of at least 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 competitive return and to avoid any concentration of risk.

About 80% of the Fund will be placed in a portfolio of bonds with a remaining maturity of no more than 10 years and 6 months from the date of payment. The average duration of the placements of all Fund assets may not exceed 5 years. The investments in bonds should respect some specific criteria such as liquidity, credit ratings, eligibility of the counterparties and concentration limits. In order to ensure a good risk diversification, the total amount invested in the bonds per single issuer must not exceed 10% ofthe total nominal amount of the portfolio.

3.2.2.2. Performance

The Fund delivered an absolute return of +0.7914% during 2013, underperforming its benchmark by 33.71 bps. During the last 3 years, the Fund had an absolute return of 9.3% overperforming its benchmark by 2.2%. The benchmark of the Fund is a composite mainly built from iBoxx indices (in particular EUR Eurozone Sovereign and EUR Collateralized Covered indices) and Euribid for the short-term exposure.

The whole year 2013 was in general characterized by excess liquidity in the system to alleviate market pressures on sluggish growth, a situation which kept short-term rates at extremely low levels. While positive, the performance of the Fund in 2013 was in line with this low-rate environnement (see section 2.4.2 'Performance' of the SWD for more details).

3.2.2.3. Financial operations revenues

In 2013, interest income on cash and cash equivalents and on securities totalled EUR 35,234,727.71 , broken down as follows:

Description:	2013	2012
Interest income on cash and cash equivalent	**208,412.77**	**2,152,817.58**
Interests received on short-term deposits	205,694.91	2,660,950.98
Change in accrued interest on short-term deposits	-10,794.39	-522,446.95
Interest on current bank accounts	13,512.25	14,313.55
Interest income on AFS assets	**31,299,159.53**	**36,869,194.02**
Interest received - Available For Sale portfolio	36,599,210.68	38,824,106.90
Change in accrued interest – Available For Sale portfolio	-2,642,922.24	-1,367,664.30
Premium discount	-2,657,128.91	-587,248.58
Income from securities lending activities	**83,827.76**	**104,765.51**
Realized gain on sale of financial assets	**1,364,029.81**	**8,596,018.53**
Accrued interest on subrogated Loans	**2,279,297.84**	**-**
Interest from financial investment of the Fund's liquid assets	**35,234,727.71**	**47,722,795.64**

3.2.2.4. Financial operations expenses

The financial operations expenses amounted to EUR 1,671,934.39, which include the EIB management fees for EUR 841,299.43, other financial charges for EUR 139,943.88, the external audit fees for EUR 33,600.00, unrealised exchange loss on subrogated Loans for EUR 119,008.82 and the handling fees for EUR 538.082,26.

4. THE FUND’S LIABILITIES

The Fund's liabilities correspond to all the financial commitments due by the Fund.

4.1. Default payments

- Calls on the Guarantee Fund following defaulted payments

In the wake of the deteriorating situation in Syria, the Foreign Affairs Council, the European Parliament and the Council had taken some decisions in 2011 towards the country. In particular, they prohibited disbursements by the EIB in connection with existing loan agreements as well as they supended EIB technical assistance contracts for sovereign projects in Syria. This Decision has been thereafter consolidated in Council Decision 2011/782/CFSP of 1st December 2011 and Council Regulation (EU) N° 36/2012 of 18 January 2012.

As a consequence, no new financing operation has been pursued by the EIB since May 2011 and all on-going disbursements and technical assistance services to the Syrian Arab Republic have been suspended since November 2011 until further notice.

Whereas in recent years Syria had fully and timely serviced its loans to the Bank, since November 2011, the EIB is 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 13 calls on the EU Guarantee Fund in 2012 and 2013 for a total amount of EUR 107 million. Two payments were made in 2012 (EUR 24 million out of which EUR 2.1 million were recovered), 8 payments were made in 2013 (EUR 61 million). Payment for the 3 other calls (EUR 22 million) are due in the first quarter 2014.

- Events after the reporting date

Until April 2014, two additional calls for defaulting payments in Syria have been made for a total amount of EUR 12.1 million.

4.2. EIB remuneration

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

The management fees

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 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 remuneration for 2013 was set at EUR 841,299.43 and was entered in the economic outturn account and as accruals (liabilities) on the balance sheet. The increase of EURO 35,992.73 compared to 2012 was caused by the growth of the annual average value of the Fund's assets in 2013.

The recovery fees due to EIB are calculated on the basis of the existing Recovery Agreement signed between the Commission and the Bank in November 2010. At the end of 2013 the accrued amount of the recovery fees was EUR 658,652.48.