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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON THE GUARANTEE FUND AND ITS MANAGEMENT IN 2014

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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 2014

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 2 137 753 047.57 (see Annex of the SWD: Guarantee Fund Financial Statements as at 31 December 2014, as provided by the EIB). This is the sum of the flows since the Fund was established:

Guarantee Fund	**Amount at 31.12.2014**	**Amount at 31.12.2013**	**Change**
budget contributions to the Fund	3 743 236 312.00	3 598 826 794.00	144 409 518.00
successive yearly net results	908 051 618.54	878 284 248.11	29 767 370.43
recoveries of payments made by the Fund for defaults	578 854 353.78	578 854 353.78	-
other accounts payable (including called guarantees not yet paid and EIB management fees)	23 084 839.03	23 066 612.47	18 226.56
fees received on late recovery (in 2002)	5 090 662.91	5 090 662.91	-
calls on the Fund's resources (including called guarantees not yet paid)	-644 939 881.42	-584 704 389.46	-60 235 491.96
successive repayments to the budget (including exceptional repayment to the budget due to the accession of new Member States)	-2 531 726 712.72	-2 531 726 712.72	-
adjustment of portfolio valuation according to IFRS valuation	56 101 855.45	36 665 073.82	19 436 781.63
Accounting value of the Fund	**2 137 753 047.57**	**2 004 356 642.91**	**133 396 404.66**

The accounting value of the Fund increased by about EUR 133 million in 2014. This is explained by :

Increasing

- The contribution from the budget (provisioning amount) of EUR 144.4 million to adjust the Fund to the 9% target amount
- The net revenues on financial operations amounted to EUR 30 million
- The portfolio valuation increase by EUR 19 million due to the mark to market adjustment of its value.

Decreasing

- Intervention of the Fund to cover defaulted payments by Syria for a total amount of EUR 60 million thereof 22 million are still to be paid as at 31 December 2014 (other accounts payable).

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 21 calls on the EU Guarantee Fund up to 31 December 2014 for a total amount of EUR 165 million (see point 4.1 Default payments).

(2) In February 2014, 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.

To adjust the Fund to the 9% of the total outstanding capital liabilities, an amount of EUR 144.4 million was entered in the 2015 budget for the provisioning of the Fund. At 31.12.2013, the target amount was EUR 2 124.8 million corresponding to the 9% of the total outstanding guaranteed

[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.

operations (EUR 23 609 million). The difference between the target amount and the net assets of the Fund of EUR 1 980.4 million at 31.12.2013 was equal to EUR 144.4 million.

This amount was requested for the provisioning of the Fund in 2015 and was approved by the Council and the European Parliament as part of the approval of the 2015 budget in November 2014. It was subsequently recognised as a receivable of the Fund from the budget.

(3) In February 2014 an amount of EUR 58.43 million was transfered from the budget to the Fund corresponding to the provisioning amount for 2014 (see details in paragraph 3.2.1 provisioning of the Fund).

2.3. Significant transaction after the reporting date

In February 2015 an amount of EUR 144.4 million was transfered from the budget to the Fund corresponding to the provisioning for 2015.

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 2014

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), which implies a difference in the total assets value of the Fund in the financial statements prepared by the EIB (EUR 2 137 753 047,57) and the total assets value of the Fund in the pre-consolidated financial statements (EUR 2 016 490 714,57). The pre-consolidated financial statements 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 financial statements. The current assets in the pre-consolidated financial statements include a temporary receivable with the EIB of EUR 22 086 899 for guarantee calls 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 22 846 081 for guarantee calls not yet paid plus related amounts.

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

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 items are explained in the notes to the balance sheet.

Balance sheet – Assets

	31 December 2014	31 December 2013
NON-CURRENT ASSETS	1 499 128 901	1 432 206 953
Available for sale financial assets	1 499 128 901	1 432 206 953
CURRENT ASSETS	517 361 813	621 219 474
Available for sale financial assets	346 281 423	361 614 283
Receivables	23 147 185	107 502 078
Cash and cash equivalents	147 933 205	152 103 112
TOTAL ASSETS	2 016 490 714	2 053 426 427

Balance sheet - Liabilities

	31 December 2014	31 December 2013
CONTRIBUTOR'S RESOURCES	1 991 699 974	2 029 113 846
European Commission contribution	1 067 100 081	1 008 667 787
Fair value reserve	56 101 855	36 665 074
Retained earnings	868 498 038	983 780 985
NON-CURRENT LIABILITIES	-	-
CURRENT LIABILITIES	24 790 740	24 312 581
Payables	24 790 740	24 312 581
TOTAL CONTRIBUTOR'S RESOURCES + LIABILITIES	2 016 490 714	2 053 426 427

Notes to the balance sheet:

- ‘Current receivables’ includes amounts of loans that have been called but not yet paid (payment in January - March 2015), plus related amounts.

- The difference in ‘Retained earnings’ 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.

- ‘Current payables’ 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.

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.

	2014	2013
Revenue from operating activities	263 355	-
Expenses from operating activities	(1 516 968)	(1 671 934)
RESULT FROM OPERATING ACTIVITIES	(1 253 614)	(1 671 934)
Financial income	35 209 330	35 234 728
Financial costs	(149 238 663)	-
FINANCIAL RESULT	(114 029 333)	35 234 728
ECONOMIC RESULT OF THE YEAR	(115 282 947)	35 562 793

Notes to the economic outturn account:

- The ‘Financial costs’ consist in impairment losses on subrogated loans, related to defaulted payments (see section 4.1)

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

Council Regulation 480/2009 establishing the Guarantee Fund ensures an 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.

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.

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 23 099 million as of 31.12.2012, an amount of EUR 58.43 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 2014. This amount was paid in one transaction from the budget to the Fund in February 2014.

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

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[4]. 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 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.

[4] 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.

Up to 80% of the Fund can 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% of the total nominal amount of the portfolio.

Performance

The Fund delivered an absolute return of +2.55% during 2014, overperforming its benchmark by an excess return of 0.19%.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.

Initial growth and inflation expectations were lowered in the course of 2014, particularly in the euroarea. At the same time, ECB's accommodative monetary policy measures and communications aimed at bringing inflation expectations back to its target of below but close to 2 percentage points. In this environment, eurobenchmark rates decreased and reached negative levels until around the 5-year maturity point. The investment performance of the Fund in 2014 was supported by the decrease of the yields and the corresponding increase in the value of the fixed income securities held in the portfolio (see section 2.4.2 ‘Performance’ of the SWD for more details).

3.2.3. Financial operations revenues

In 2014, interest income on cash and cash equivalents, on securities and accrued income on subrogated loans totalled EUR 35 209 330, broken down as follows:

Description:	**2014**	**2013**
Interest income on cash and cash equivalent	**267 136.21**	**208 412.77**
Interests received on short-term deposits	266 031.63	205 694.91
Change in accrued interest on short-term deposits	-2 802.56	-10 794.39
Interest on current bank accounts	3 907.14	13 512.25
Interest income on AFS assets	**29 274 967.00**	**31 299 159.53**
Interest received - Available For Sale portfolio	32 894 240.86	36 599 210.68
Change in accrued interest – Available For Sale portfolio	-2 303 550.35	-2 642 922.24
Premium discount	-1 315 723.51	-2 657 128.91
Income from securities lending activities	**99 651.26**	**83 827.76**
Realized gain on sale of financial assets	**1 162 566.88**	**1 364 029.81**
Accrued interest on subrogated Loans	**4 405 009.00**	**2 279 297.84**

Interest from financial investment of the Fund's liquid assets	**35 209 330.35**	**35 234 727.71**

3.2.4. Revenues and expenses from operating activities

The result from operating activities amounted to EUR -1 253 614, which include the EIB management fees for EUR 844 873, other operating expenses for EUR 170 678, the external audit fees for EUR 39 500, unrealised exchange gain on subrogated Loans for EUR 263 355 and accrued EIB recovery fees for EUR 461 918.

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 past 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 21 calls on the EU Guarantee Fund up to 31 December 2014 for a total amount of EUR 165 million. Payment for the last 3 calls (EUR 22 million) are due in the first quarter 2015.

- Events after the reporting date

Until February 2015, an additional call for defaulting payments in Syria has been made for a total amount of EUR 7.9 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 2014 was set at EUR 844 873 and was entered in the economic outturn account and as accruals (liabilities) on the balance sheet.

The recovery fees due to EIB are calculated on the basis of the Recovery Agreement signed between the Commission and the Bank in July 2014. At the end of 2014 the cumulated accrued amount of the recovery fees was EUR 1 060 285.