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signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
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THE COUNCIL AND THE COURT OF AUDITORS ON THE  
MANAGEMENT OF THE GUARANTEE FUND OF THE EUROPEAN  
FUND FOR STRATEGIC INVESTMENTS IN 2018

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Delegations will find attached document COM(2019) 244 final.

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**REPORT FROM THE COMMISSION**

**TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COURT OF  
AUDITORS**

**ON THE MANAGEMENT OF THE GUARANTEE FUND OF THE EUROPEAN  
FUND FOR STRATEGIC INVESTMENTS IN 2018**

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## 1. INTRODUCTION

The legal basis for this report is Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 — the European Fund for Strategic Investments<sup>1</sup> (the "EFSI Regulation"). The EFSI Regulation was amended by Regulation (EU) 2017/2396 of the European Parliament and Council of 13 December 2017 as regards the extension of the duration of the European Fund for Strategic Investments as well as the introduction of technical enhancements for that Fund and the European Investment Advisory Hub<sup>2</sup> (the "EFSI 2.0 Amendment"). The EFSI 2.0 Amendment increased, *inter alia*, the size of the EU Guarantee and adjusted the target amount. The agreement on the management of the EFSI and on the granting of the EU Guarantee (the "EFSI Agreement") was signed by the European Commission and the European Investment Bank (the "EIB") on 22 July 2015 and was amended and restated on 21 July 2016, 21 November 2017, 9 March 2018 and 20 December 2018.

Article 16(6) of the EFSI Regulation provides that the Commission shall, by 31 May of each year, submit to the European Parliament, to the Council and to the Court of Auditors an annual report<sup>3</sup> on the management of the EFSI Guarantee Fund (the "EFSI GF") in the previous calendar year, including an assessment of the adequacy of the target amount and the level of the EFSI GF and of the need for its replenishment. This annual report shall contain the presentation of the financial position of the EFSI GF at the end of the previous calendar year, the financial flows during the previous calendar year as well as the significant transactions and any relevant information on the financial accounts. The report shall also include information about the financial management, the performance and the risk of the EFSI GF at the end of the previous calendar year.

## 2. OPERATIONAL CONTEXT

The EU Guarantee<sup>4</sup> covers financing and investment operations signed by the EIB under the main part of the Infrastructure and Innovation Window ("IIW"), and by the EIF under the SME Window ("SMEW") and the SME / MidCap fund investment sub-window of IIW. Part of the overall EFSI operations is covered by the EU Guarantee while a part is carried out at the own risk of the EIB Group<sup>5</sup>.

According to Article 12 of the EFSI Regulation, the EFSI GF shall constitute a liquidity cushion from which the EIB shall be paid in the event of a call on the EU Guarantee. In accordance with the EFSI Agreement between the EU and the EIB, calls are paid by the EFSI GF if their amount is in excess of the funds at the disposal of the EIB on the EFSI Account. The EFSI Account, managed by the EIB, has been established for the purposes of collecting the EU revenues and recovered amounts resulting from EFSI operations under the EU Guarantee and, to the extent of the available balance, for the payment of calls under the EU Guarantee.

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<sup>1</sup> OJ L 169, 1.7.2015, p. 1.

<sup>2</sup> OJ L 345, 27.12.2017, p. 34.

<sup>3</sup> This report is the fourth report on the EFSI GF. For previous reports, see COM(2016)353 final, COM(2017)326 final and COM(2018)345 final.

<sup>4</sup> The size of the EU Guarantee has been increased from EUR 16 billion to EUR 26 billion by the EFSI 2.0 Amendment.

<sup>5</sup> The size of EIB Group Guarantee has been increased from EUR 5 billion to EUR 7.5 billion by the EFSI 2.0 Amendment.

The EFSI GF is provisioned progressively taking into account the increase in exposure borne by the EU Guarantee.

According to Article 12(4), the resources of the EFSI GF are directly managed by the Commission and invested in accordance with the principle of sound financial management following appropriate prudential rules.

The EIB and the EIF are responsible for assessing and monitoring the risk of the individual operations backed by the EU Guarantee. On the basis of this reporting and of coherent and prudent assumptions on future activity, the Commission ensures the adequacy of the target amount and the level of the EFSI GF under review. In line with Article 16(3) of the EFSI Regulation, the EIB and the EIF reported back to the Commission and the European Court of Auditors in March 2019.

Pursuant to Article 16(2) of the EFSI Regulation, the annual report of the EIB to the European Parliament and Council shall contain specific information on the aggregate risk associated with the financing and investment operations carried out under the EFSI as well as on the guarantee calls.

### **3. FINANCIAL ACCOUNTS AND SIGNIFICANT BUDGETARY TRANSACTIONS IN 2018**

Financial information concerning EFSI is presented below, broken down in four sections: (1) the financial situation of the EFSI GF as at 31 December 2018, (2) the EFSI operations under the EU Guarantee carried out by the EIB Group as at 31 December 2018, (3) the provisioning of the EFSI GF and (4) the calls and use of the EU Guarantee.

#### **3.1. FINANCIAL STATEMENTS OF THE EFSI GF AS AT 31 DECEMBER 2018**

The total assets of the EFSI GF<sup>6</sup> stood at EUR 5 452 million as at 31 December 2018. The assets comprised the investment securities portfolio, classified as available-for-sale (EUR 5 000 million), an FX forward sale of USD with positive net present value, classified as financial assets at fair value through surplus and deficit (EUR 2 million), and cash and cash equivalents (EUR 450 million).

In terms of the 2018 statement of financial performance<sup>7</sup>, the EFSI GF ended the year with an economic result of EUR -13.9 million. A net loss of EUR -34.5 million from positive (EUR 28.4 million) and negative (EUR -62.9 million) fair value changes of derivatives, used for hedging the currency risk of the USD-denominated portion of the portfolio, was offset by net gains (EUR 17.0 million) from positive (EUR 103.7 million) and negative (EUR -86.7 million) foreign exchange revaluation of financial assets and interest revenue (EUR 17.5 million). The remaining loss mainly consisted of net losses from sales of available-for-sale securities<sup>8</sup> (EUR -13.3 million) and custodian fees (EUR -0.6 million).

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<sup>6</sup> The audited financial statements of the EFSI Guarantee Fund are disclosed in the staff working document accompanying the EFSI GF report.

<sup>7</sup> See page 6 of the staff working document accompanying the EFSI GF report.

<sup>8</sup> The net figure is composed of gains of EUR 4.3 million and losses of EUR 17.6 million.

### 3.2. EFSI OPERATIONS UNDER THE EU GUARANTEE

The guarantee exposure of the EU in relation to disbursed outstanding EFSI operations by the EIB Group amounted to EUR 15.8 billion, as at 31 December 2018, out of the net available legal commitment<sup>9</sup> of EUR 25.9 billion guaranteed by the EU. The amount of EUR 15.8 billion is recorded as a contingent liability in the notes to the 2018 financial statements of the EU.

In 2018, EFSI operations managed by the EIB under the Infrastructure and Innovation Window generated a net revenue of EUR 112.7 million for the EU. Of this amount, a net receivable of the Commission from the EIB as at 31 December 2018 of EUR 38.9 million<sup>10</sup> was recorded in the 2018 EU financial statements. The EFSI operations related to a call under the Infrastructure and Innovation Window are described in the section 3.4.

For the EFSI operations under the SME Window, the EU incurred cost of EUR 30.3 million in 2018. Out of this, EIF administrative fees of EUR 21.9 million recorded in the 2018 EU financial statements are payable to the EIF on or after 30 June 2019.

### 3.3. PROVISIONING OF THE EFSI GF

A total budgetary appropriation of EUR 2 069 million was committed in 2018 relating to the provisioning of the EFSI GF. Of this amount, a budgetary appropriation of EUR 1 905 million was committed in compliance with Commission Decision C(2018)307. Additional commitment appropriations for an amount of EUR 105 million were made available from the budget line "Reserves for Financial Interventions". Finally, an amount of EUR 59 million was committed as assigned revenue.

A total amount of EUR 2 014 million was effectively paid into the EFSI GF during the year. Of this, the bulk came from payment appropriations of the general budget of the EU, while an amount of EUR 59 million was recovered as assigned revenue (EUR 53.4 million from EFSI revenues and EUR 5.6 million from Marguerite Fund revenues) and an amount of EUR 154.9 million was transferred as additional payment appropriations at the end of the budgetary year.

### 3.4. CALLS AND USE OF THE EU GUARANTEE

In accordance with Article 8.1(a) of the EFSI Agreement, the EU Guarantee was called for an amount of EUR 97.1 million related to a defaulted operation under the Infrastructure and Innovation Window. In accordance with the Article 11 of the EFSI Agreement, the EIB recovered initially the amount of EUR 18.6 million, reducing the amount to be paid to EUR 78.5 million. The call was paid from the EFSI Account (EUR 17.7 million) and from the EFSI GF (EUR 60.8 million). Subsequently, the amount of EUR 1.6 million was recovered. In relation to this defaulted operation, an amount of EUR 1.0 million for recovery costs and EUR 0.6 million for recoverable administrative costs were called by the EIB.

In 2018, an amount of EUR 0.6 million was paid to the EIB for funding costs<sup>11</sup> and EUR 10.7 million for value adjustments<sup>12</sup>.

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<sup>9</sup> According to Article 11 of the EFSI 2.0 Amendment, the EU Guarantee shall not, at any time, exceed EUR 26 billion and not exceed EUR 16 billion before 6 July 2018. Calls and uses of the EU Guarantee, and provisions for portfolio guarantee products under SME Window, are deducted from the maximum amount of the EU Guarantee.

<sup>10</sup> Net of outstanding recovery costs of EUR 0.5 million payable to the EIB in 2019 in relation to a defaulted operation.

<sup>11</sup> See Article 8.1(d) of the EFSI Agreement. This amount does not include the EUR 1.6 million of costs related to the call mentioned above.

<sup>12</sup> See Article 8.1(b) of the EFSI Agreement.

## **4. MANAGEMENT OF THE EFSI GF IN 2018**

### **4.1. FINANCIAL MANAGEMENT**

The EFSI GF's investment portfolio is invested in accordance with the management principles laid down in Commission Decision C(2016)165 of 21 January 2016 approving the asset management guidelines of the EFSI GF.

These guidelines foresee that the assets in the investment portfolio shall provide sufficient liquidity in relation to the potential guarantee calls, while still aiming at optimising the return and risk level that is compatible with maintaining a high degree of security and stability.

Investment and risk management strategies were adopted reflecting the investment objectives and outlook of market conditions. The investment approach aimed at enhanced diversification across various fixed income asset classes.

### **4.2. MARKET DEVELOPMENTS IN 2018**

The year 2018 was challenging for investors, being characterised by overall negative or historically low yields coupled with significant market volatility and uncertainties. Some key factors that contributed to this volatile environment were the gradual tightening of monetary policy in the euro-area and US on the back of expectations of continued growth and rising inflation, the trade war, the developments in Italy and the darkening economic outlook that took hold towards the end of the year. In terms of monetary policy, in particular, the ECB reduced the monthly net asset purchases under the so-called quantitative easing policy from EUR 30 billion to EUR 15 billion in September and then terminated the net purchases at the end of 2018. The US Federal Reserve delivered four hikes of 25 basis points over the year raising the Fed Funds target rate range to 2.25-2.5 by year-end.

In this context, after moving significantly higher in the beginning of 2018, the European fixed income yields generally registered annual lows at the end of the year due to softening economic growth and outlook, declining oil prices and lower expectations regarding the medium-term path of the monetary policy rates. Credit spreads edged higher during the year and the move accelerated in December on falling equity markets and the end of net asset purchases by the European Central Bank (ECB). Short-term euro-area bond yields also declined, but less markedly, resulting in flattening of the relevant yield curves across the board. Euro-area economic sentiment index – which covers the mood among both households and companies – dropped more than analysts predicted, to its lowest level in almost two years. The decline was broad-based across industry groups and countries. Peripheral spreads to the German Bund decreased in December across the board. The spreads for Italy tightened over 30 basis points finishing the month at 250 basis points supported by the understanding reached with the European Commission on the Italian budget.

### **4.3. COMPOSITION AND KEY RISK CHARACTERISTICS OF THE PORTFOLIO**

On 31 December 2018, the investment portfolio was made predominantly of securities issued by Sovereigns (27% of market value against 46% for the benchmark) as well as by Sub-sovereigns, supnationals and agencies (SSA) and foreign governments (18% of market value against 12% for the benchmark) and covered bonds (25% of market value against 20% for the benchmark). The remainder was mainly allocated to unsecured bonds issued by corporates and financial institutions. About 9% of the portfolio was invested in liquid and highly-rated (AA/AAA) USD denominated investments. The currency risk exposure of these investments has been hedged. At the end of 2018, the exposure of the portfolio to bonds

complying with environmental, social and governance criteria was more than 3 times higher when compared to its benchmark.

The portfolio duration<sup>13</sup> at the end of 2018 was 2.41 years. Average credit rating is A-.

The bulk of the portfolio is invested in liquid securities and an adequate part (21% of the total portfolio value) matures in less than 12 months.

The profile of the portfolio, in terms of duration, credit risk and liquidity, has been calibrated in line with the forecasted cash-flows arising from the EFSI operations under the EU Guarantee (e.g. projected calls, revenues).

#### 4.4. PERFORMANCE

The annual performance is calculated on a time-weighted basis in order not to be affected by the size of the portfolio, which grew considerably during the year.

In a very challenging market environment characterised by overall negative or historically low yields coupled with significant market volatility and uncertainties, the Fund delivered a annual absolute performance of -0.312 % in 2018. This return is in line with the annual performance of the EFSI benchmark (-0.305 %) and was achieved against a background of negative rates in the euro-area (especially for what is perceived by the markets as "credit risk free" and liquid exposures in Europe) and several hikes of interest rates in the United States.

### 5. ASSESSMENT OF THE ADEQUACY OF THE TARGET AMOUNT AND THE LEVEL OF THE EFSI GF

As of 31 December 2018, total cumulated signatures under EFSI amounted to EUR 53.6 billion covering 28 Member States, of which EUR 39.1 billion was signed under the IIW (407 operations) and EUR 14.5 billion was signed under the SMEW (470 operations). Overall, this represents a significant increase compared to 2017, at the end of which total signatures amounted to EUR 37.4 billion.

As of 31 December 2018, the overall outstanding disbursed exposure covered by the EU Guarantee amounted to nearly EUR 15.8 billion up from EUR 10.1 billion in 2017.

The exposure of the EU budget to possible future payments under the EU Guarantee in terms of signed operations (disbursed and undisbursed) amounted to EUR 19.8 billion.

Under the IIW, the outstanding disbursed exposure covered by the EU Guarantee was EUR 14.8 billion, of which EUR 14.2 billion for debt operations and EUR 0.6 billion for equity-type operations.

Should there be any losses due to these IIW operations, those will be covered by the EU Guarantee in accordance with the terms set out in the EFSI Agreement. In particular, the EU Guarantee under the IIW is granted in the form of a Portfolio First Loss Piece coverage for operations under the IIW Debt Portfolios and IIW NPB Equity Portfolio. Under the IIW Standard Equity Portfolio, the EU Guarantee is in the form of a full guarantee provided that the EIB invests at its own risk on a pari passu basis the same amount of resources.

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<sup>13</sup> The duration figure refers to 'modified duration' which measures the price sensitivity of a bond to interest rate movements. This figure is based on the concept that a security price and interest rates are inversely related.



As of 31 December 2018, under SMEW, the total outstanding exposure covered by the EU Guarantee was EUR 0.995 billion, of which EUR 0.880 billion for guarantee operations and EUR 0.115 billion for equity operations<sup>14</sup>.

Should there be any losses due to these SMEW operations, those would be covered primarily by the contributions of the InnovFin SME Guarantee Facility, the COSME Loan Guarantee Facility, Cultural and Creative Sectors Guarantee Facility and the EaSI Guarantee Financial Instrument. In the case of the SMEW Equity Product, any losses would be covered by the EU Guarantee under the EFSI and the InnovFin Equity First Loss Piece (in the case of Sub-window 2).

The target amount of the EFSI GF has been set at 35% of the total EU Guarantee obligations<sup>15</sup>. The risk assessment of the different products supported by the EU Guarantee shows that overall the Union budget would be adequately shielded from potential calls under the EU Guarantee with this target rate, taking into consideration recoveries, revenues and reflows from EIB operations. Therefore, the target rate of 35% is considered adequate.

The EFSI GF is in the building-up phase until 2022 thus the need for replenishment will be assessed in a later stage.

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<sup>14</sup> As evidenced in the financial statements of the EU as at 31 December 2018, not including guarantee contracts whose availability period starts in 2019, amounts committed and undisbursed for guarantee operations under COSME, and those committed and undisbursed for equity operations. Including all the latter categories would imply a total outstanding (disbursed and undisbursed) exposure to be potentially covered by the EU Guarantee of EUR 2.3 billion.

<sup>15</sup> See Article 12(5) of the EFSI Regulation.