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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 2020

{SWD(2021) 209 final}

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1. INTRODUCTION

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 (the EFSI Regulation) has established the Guarantee Fund of the EFSI whose resources are to be managed by the Commission.[1]

By Regulation (EU) 2017/2396 of the European Parliament and Council of 13 December 2017, the EFSI Regulation was further amended to extend the duration of the European Fund for Strategic Investments and to introduce a number of technical enhancements to the Fund and the European Investment Advisory Hub[2] (the EFSI 2.0 Amendment). The EFSI 2.0 Amendment increased, *inter alia*, the size of the EU Guarantee and also adjusted the target amount for the provisioning of the Fund. On 22 July 2015, the European Commission and the European Investment Bank (the EIB) signed the agreement on the management of EFSI and on the granting of the EU Guarantee (the EFSI Agreement).[3]

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[4] on the management of the EFSI Guarantee Fund (the EFSI GF) in the preceding calendar year, including an assessment of the adequacy of the target amount and the level of the EFSI GF and of its potential replenishment need. This annual report shall describe the financial position of the EFSI GF at the end of the preceding calendar year, the financial flows during the preceding calendar year as well as a list of the significant transactions and any relevant information on the financial accounts. The report shall also include information on the financial management, the performance and the risk of the EFSI GF at the end of the preceding calendar year.

The Financial Regulation 2018/1046[5] has established the Common Provisioning Fund (CPF) to hold the provisions assigned to cover the financial liabilities arising from budgetary guarantees and financial assistance programmes from the date of application of the 2021-2027 Multi-Annual Financial Framework (MFF)[6] onward. These provisions entered into force on January 1, 2021, as of which date the EFSI Guarantee Fund constitutes a separate compartment within the CPF.

2. OPERATIONAL CONTEXT

The EU Guarantee[7] covers financing and investment operations:

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[1] Amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 — the European Fund for Strategic Investments (the EFSI Regulation). OJ L 169, 1.7.2015, p. 1.
[2] OJ L 345, 27.12.2017, p. 34
[3] The EFSI Agreement was later amended and restated, more precisely on 21 July 2016, 21 November 2017, 9 March 2018, 20 December 2018, 27 March 2020 and 27 April 2020.
[4] This report is the sixth report on the EFSI GF. For previous reports, see COM(2016)353 final, COM(2017)326 final, COM(2018)345 final, COM(2019)244 final and COM (2020)385 final.
[5] Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, OJ L 193, 30.7.2018, p. 1 (the Financial Regulation).
[6] Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027, OJ L 433I, 22.12.2020.
[7] The size of the EU Guarantee has been increased from EUR 16 billion to EUR 26 billion by the EFSI 2.0

- signed by the EIB under the main part of the Infrastructure and Innovation Window (IIW), and;
- signed by the European Investment Fund (EIF) under the SME Window (SMEW) and the SME / MidCap fund investment sub-window of IIW.

Part of the overall EFSI operations are covered by the EU Guarantee, while a part is carried out at the EIB Group's own risk[8].

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 the called amounts are 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 to collect the EU revenues and recovered amounts resulting from EFSI operations under the EU Guarantee and, to the extent that the available balance allows, to pay calls under the EU Guarantee.

The EFSI GF has been provisioned progressively, but this provisioning will cease in 2022. 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 and 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 and for reporting to the Commission, in line with Article 16 of the EFSI Regulation. On the basis of this reporting and making 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.

Furthermore, pursuant to Article 16(2) of the EFSI Regulation, the EIB submits to the European Parliament and Council an annual report containing 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 2020

Financial information concerning EFSI is presented below, broken down in four sections:

(1) the financial situation of the EFSI GF as at 31 December 2020;

(2) the EFSI operations under the EU Guarantee carried out by the EIB Group as at 31 December 2020;

(3) the provisioning of the EFSI GF and;

(4) the calls and use of the EU Guarantee.

Amendment.

[8] The size of EIB Group's own resources contribution has been increased from EUR 5 billion to EUR 7.5 billion by the EFSI 2.0 Amendment.

3.1. Financial situation of the EFSI GF as at 31 December 2020

The total assets of the EFSI GF[9] stood at EUR 8 028 million as at 31 December 2020. The assets comprised the investment securities portfolio, classified as available-for-sale (EUR 7 526 million), an FX forward sale of USD with positive net present value, classified as financial assets at fair value through surplus and deficit (EUR 6 million), and cash equivalents (EUR 496 million).

As to the 2020 financial performance[10], the EFSI GF ended the year with an economic result of EUR 21.6 million. The main contribution came from positive net interest revenue of EUR 17.0 million and net gains from sales of available-for-sale securities[11] (EUR 11.1 million). This was offset by a negative foreign exchange revaluation result of EUR -5.7 million[12]. The remaining net expense of EUR -0.8 million mainly consisted of custodian fees.

3.2. EFSI operations under the EU Guarantee

The EU guarantee exposure in relation to disbursed outstanding EFSI operations by the EIB Group amounted to EUR 18.9 billion as at 31 December 2020, out of the net available EU guarantee[13] of EUR 25.8 billion[14]. The amount of EUR 18.6 billion is recorded as a contingent liability in the notes to the 2020 financial statements of the EU, while a provision has been recognised for the remaining amount.

In 2020, EFSI operations under the Infrastructure and Innovation Window generated net revenue of EUR 243.4 million for the EU[15]. Of this amount, a net receivable of the Commission from the EIB of EUR 76.8 million as at 31 December 2020 was recorded in the 2020 EU financial statements.

For the EFSI operations under the SME Window, the EU incurred a net cost of EUR 295.2 million in 2020[16].

3.3. Provisioning of the EFSI GF

A total budgetary appropriation of EUR 301 million relating to the provisioning of the EFSI GF was committed in 2020. Of this amount, a budgetary appropriation of EUR 153 million was committed in compliance with Commission Decision C(2020)451. Additional commitment appropriations for an amount of EUR 148 million were committed as assigned

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[9] The audited financial statements of the EFSI Guarantee Fund are disclosed in the staff working document accompanying the EFSI GF report.

[10] See Section 3 "EFSI GF FINANCIAL STATEMENTS" of the staff working document accompanying the EFSI GF report.

[11] The net figure is composed of gains of EUR 12.7 million and losses of EUR 1.6 million.

[12] After hedging the currency risk of the USD-denominated portion of the portfolio, presented as fair value changes of derivatives in the financial statements.

[13] According to Article 11 of the EFSI 2.0 Amendment, the EU Guarantee shall not, at any time, exceed EUR 26 billion. 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.

[14] In the notes to the EU 2020 annual accounts this figure is presented net of the financial provisions of 0,3 billion.

[15] This amount includes EUR 18.4 million of unrealized revenue derived from upward movement of the IIW equity portfolios fair value at 31 December 2020 compared to 31 December 2019.

[16] This amount includes EUR 216.5 million of financial provisions in respect of the SMEW debt portfolios, as well as unrealized revenue of EUR 23.4 million derived from upward movement of the SMEW equity portfolios' fair value at 31 December 2020 compared to 31 December 2019.

revenues[17].

A total amount of EUR 1 249 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 156 million was recovered as assigned revenue from the EFSI, and an amount of EUR 5 million was transferred as additional payment appropriations at the end of the budgetary year.

3.4. Calls and use of the EU Guarantee

During 2020, there were no guarantee calls due to defaulted operations. However, the EU Guarantee was called as follows:

- EUR 33.1 million for value adjustments[18] under the IIW;
- EUR 2.3 million for EIB funding costs[19] under the IIW;
- EUR 2.1 million for recovery costs[20] under the IIW;
- EUR 37.5 million for non-euro hedging under the SMEW.

All calls were paid from funds available on the EFSI Account, except for one SMEW call that was partially paid from the EFSI GF (EUR 0.5 million).

4. Management of the EFSI GF in 2020

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 the market outlook. The investment approach aimed to enhance diversification across various fixed income asset classes.

4.2. Market developments in 2020

Market developments in 2020 were dominated by the Covid-19 virus, its devastating impact on public health and the global economy and the quick and strong policy response by governments and central banks.

Fixed income markets started the year on an optimistic note, courtesy of progress in the US-China trade relationship and a generally positive economic sentiment. The 10-year German government bond (Bund) yield reached a high of -0.16% in mid-January, which would prove

[17] Assigned revenues refer here to what is commonly termed 'reflows'. They are, for example, composed of EFSI remuneration, dividends, capital gains or annual repayments including capital repayments, guarantees released, and repayments of the principal of loans recovered from the EIB.
[18] See Article 8.1(b) of the EFSI Agreement.
[19] See Article 8.1(d) of the EFSI Agreement.
[20] See Articles 8.1(d) and 11.7 of the EFSI Agreement.

to be the peak level for the whole year.

Around March, more than half the world's population was effectively put in confinement when the threat of the virus became increasingly clear. This created a global shock to both supply and demand, particularly in face-to-face services.

Financial markets worldwide experienced a sudden shock, which went hand in hand with an important spike in risk aversion and volatility. The ensuing 'dash for cash' led to the fire sale of assets, causing dislocations and threatening the stability of financial markets.

Equity markets plummeted and investors turned to safe assets, such as the Bund, whose yield quickly dropped to its year low of -0.86% by mid-March. US Treasuries yields dropped even further, fuelled by two emergency rate cuts by the US Federal Reserve, for a total of 150bps, at the beginning of March. Safe-haven yields then reversed and, in tandem with the rest of the fixed income universe, moved higher in the midst of market uncertainty and limited liquidity. The Bund moved back towards -0.20% ten days after reaching its year low. Spreads of other European government bonds to the Bund widened substantially, as did spreads of all other fixed income asset classes.

To restore confidence, governments implemented rescue packages and central banks provided monetary accommodation (e.g. policy rate cuts and/or asset purchases) at an unprecedented scale. This helped markets to calm and overall asset valuations to rebound. Following a volatile March, spreads stabilized from April onwards, moving to a generally downward trajectory. The announcement of unprecedented fiscal packages worldwide and in Europe, notably the EUR 750 billion Next Generation EU, nudged the overall yield levels higher in June, but central banks continued to ensure favourable financing conditions amidst lingering downside risks. Overall, for the rest of the year, euro-area yields and spreads were gradually decreasing, while investor confidence kept improving on the back of advances on the front of vaccination and the prospect of further stimulus following the US elections in November. The Bund finished the year at -0.57%.

Overall, fixed income markets, although characterized by very high volatility, provided attractive investment opportunities, which in turn contributed to the positive return of the EFSI GF at year-end.

4.3. COMPOSITION AND KEY RISK CHARACTERISTICS OF THE PORTFOLIO

The year-end figures of the EFSI GF portfolio show that the portfolio is well diversified in terms of asset classes and rating categories. In addition, there is also diversification in non-euro denominated securities (USD) in the form of an allocation to US Treasuries and other US issuers (e.g. Supranational, other Sovereigns or Agencies) and cash for about 6% of the portfolio. The currency risk is hedged.

The proportion of bonds complying with environmental, social and governance criteria was 9.5% at the end of 2020 compared with 6.9% at the end of 2019. The portfolio duration[21] at the end of 2020 was 3.19 years, while its average credit rating was BBB+.

About 33% of the portfolio consisted of bonds with a maturity below 1-year, floating rate notes and short-term money market instruments which provide a further liquidity buffer for the portfolio.

[21] 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.

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 so as not to be affected by the size of the portfolio, which continued to grow during the year.

In a market environment characterised by health-related volatility and historically low yields, the Fund delivered an annual absolute performance of 1.246 % in 2020. This return is in line with the annual performance of the EFSI benchmark (1.23 %). However, the 2020 performance of both the benchmark and the portfolio were largely driven by positive curve returns. Considering the historically low levels reached by EU and US yields, the portfolio and the benchmark could be negatively impacted in the coming years by opposite curve movements (i.e. rising yields).

5. Assessment of the adequacy of the target amount and the level of the EFSI GF

As of 31 December 2020, total cumulated signatures under EFSI amounted to EUR 82.7 billion covering all Member States, of which EUR 57.2 billion was signed under the IIW (629 operations) and EUR 25.5 billion was signed under the SMEW (792 operations). Overall, this represents a significant increase compared to 31 December 2019, when total signatures amounted to EUR 68.7 billion. The above figures represent total amounts signed by the EIB Group from the inception of EFSI, whereas the outstanding exposure is only partially covered by the EU Guarantee under the EFSI. The latter is further detailed in the subsequent paragraphs of this section, as well as in section 3 above. As of 31 December 2020, the overall outstanding disbursed exposure covered by the EU Guarantee amounted to EUR 18.9 billion (16.5 and EUR 2.4 billion for respectively IIW and SMEW), up from EUR 18.4 billion in 2019.

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 24.1 billion (18.5 billion for IIW and for 5.6 billion for SMEW).

Under the IIW, the outstanding disbursed exposure covered by the EU Guarantee was EUR 16.5 billion, of which EUR 15.2 billion was for debt operations and EUR 1.3 billion was 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 the same amount at its own risk on a pari passu basis.

As of 31 December 2020, under SMEW, the total outstanding disbursed exposure covered by the EU Guarantee was EUR 2.4 billion, of which EUR 1.7 billion was for guarantee operations and EUR 0.7 billion was for equity operations[22].

[22] As evidenced in the financial statements of the EU as at 31 December 2020, not including guarantee contracts

Should there be any losses due to the SMEW guarantee operations, they would be primarily covered by the contributions of the InnovFin SME Guarantee Facility, the COSME Loan Guarantee Facility, the Cultural and Creative Sectors Guarantee Facility and the EaSI Guarantee Financial Instrument. EFSI SMEW provides a senior coverage for losses above the EU contribution. Under EFSI Combination Product, EFSI covers the Second Loss Piece tranche of the operations after the Member State or Managing Authority, while the EIF provides the complementary senior risk coverage. Under SMEW Skills and Education Product, EFSI provides a guarantee up to 80% of each signed operation.

In the case of SMEW Equity Product Sub-windows, any losses would be covered pro-rata by the EU Guarantee under the EFSI and by the EIF, depending on their contributions specified in the EFSI Guarantee Agreement. In the case of Equity Product Sub-window 2, the InnovFin Equity Financial Instrument will cover the First Loss Piece. Under the SMEW Private Credit Product, EFSI povides a First Loss Piece tranche coverage, and under the SMEW Scale-Up Action for Risk capital it provides a full guarantee.

The target amount of the EFSI GF has been set at 35% of the total EU Guarantee obligations[23]. The risk assessment of the different products supported by the EU Guarantee shows that - with this target rate - the Union budget would overall be adequately shielded from potential calls under the EU Guarantee, taking into consideration recoveries, revenues and reflows from EIB operations. Therefore, the target rate of 35% is considered adequate.

As the EFSI GF - as part of the CPF compartment since January 2021 - is still in the build-up phase until 2022, the need for replenishment will only be assessed at a later stage.

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whose availability period starts in 2021.

[23] See Article 12(5) of the EFSI Regulation.