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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

on the Guarantee Fund and the management thereof in 2010

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1. INTRODUCTION

Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009¹ (codified version) 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').

Under Article 8(2) of the Agreement, by 1 March of each year the EIB must send the Commission an annual status report on the Fund and the management thereof ('Statement of financial performance') and a financial statement for the Fund for the preceding year ('Statement of financial position of the Fund'). Further details of the report covering the year 2010 can be found in the Commission Staff Working Document.

In addition, 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.

¹ OJ L 145, 10.6.2009, p. 10 ('the Regulation').

2. POSITION OF THE FUND AT 31 DECEMBER 2010

The 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 position of the Fund is presented in accordance with International Financial Reporting Standards (IFRS) at the close of the 2010 financial year.

The Fund totalled EUR 1,347,330,925.77 (see Section 3 of the Staff Working Document: Statement of financial position of the Fund at 31 December 2010, as provided by the EIB). This is the sum of the flows since the Fund was established:

Guarantee Fund	Amount
Budget payments to the Fund	+ EUR 2,985,684,500.00
Successive yearly net results	+ EUR 760,201,245.08
Recoveries of payments made by the Fund for defaults	+ EUR 576,705,008.19
Accrued ² EIB management and audit fees in 2010 corresponding to the payments to be made in 2011	+ EUR 747,058.18
Commission received on late recovery in 2002	+ EUR 5,090,662.91
Adjustment due to application of the IFRS for the valuation of the Fund's portfolio (See item 'Reserves' in the liabilities on the Guarantee Fund balance sheet in Section 3 of the SWD)	- EUR 1,845,165.61
Minus calls on the Fund's resources	- EUR 477,860,856.19
Minus successive repayments of the surplus in the Fund to the general budget of the European Union and repayments following accession of candidate countries to the EU	- EUR 2,501,391,526.79
Accounting value of the Fund at 31 December 2010	EUR 1,347,330,925.77

² This amount of EUR 747,058.18 includes EUR 715,037.50 for EIB management fees plus external audit fees of EUR 32,020.67.00 in 2010 (see, 'Current liabilities', in the SWD).

Under Article 5 of the Regulation, 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 .

The Fund's net assets (i.e. the Fund's net cash resources) at 31 December 2010 totalled EUR 1,485,463,867.59. This is the sum of the accounting value of the Fund, i.e. EUR 1,347,330,925.77, minus accrued EIB and audit fees of EUR 747,058.18, of which EUR 715,037.50 were management fees (2010 EIB remuneration) and the transfer from the budget of EUR 138,880,000.00, as established in 2010 for the 2011 budget³.

Article 3 of the Regulation⁴ sets a target amount for the Fund of 9% of the total outstanding capital liabilities arising from each operation, plus any unpaid interest due.

Outstanding lending and loan guarantee operations for third countries plus accrued interest totalled EUR 19,395,882,340.31 at 31 December 2010, of which EUR 137,336,644.89 was accrued interest. The ratio between the Fund's net assets of EUR 1,485,463,867.59 and the outstanding capital liabilities referred to in the Regulation was 7.7%. Since this is lower than the target amount of 9% of the total guaranteed outstanding amount (rounded to EUR 1,745.63 million), a transfer has to be made from the general budget of the European Union to the Fund, as provided for in Article 5 of the Regulation. The amount included in 2011 as provisioning in the draft budget for 2012 is EUR 260,170,000.00.

2.2. Presentation of the accounts

Since the Commission decided to present its accounts in accordance with new accounting rules based on IPSAS⁵/IFRS principles, the pre-consolidated financial statements for the Fund have also been drawn up in accordance with these principles, as explained in the SWD.

2.3. Pre-consolidated financial statement for the Fund at 31 December 2010

A pre-consolidated financial statement of the Fund is prepared in order to include accounting operations which are not included in the Fund's financial statement prepared by the EIB (see Staff Working Document). The need to include such operations is due to the successive defaults occurred since the existence of the Fund. If the beneficiary of a loan operation guaranteed by the Fund defaults the pre-consolidated balance sheet should include any arrears due plus the interest accrued on late payments and other accounting accruals⁶ 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 31.12.2010, there is no default. So, the total amount indicated in the pre-consolidated balance sheet is EUR 1,347,330,925.77.

³ The amount of EUR 138,880,000.00 was paid to the Fund on 28 February 2011 from the general budget of the European Union.

⁴ 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.

⁵ IPSAS, International Public Sector Accounting Standards.

⁶ Other accounting accruals includes exchange rate difference if any, payable in other liabilities (mainly the recovery fees due to the EIB).

The major changes in the presentation of accounts are explained in the notes and reconcile the figures with the EIB financial statement presented in the SWD.

2.3.1. 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 accounts. The main changes are explained in the notes to the balance sheet.

<u>Balance sheet: Assets (EUR)</u>	2010	2009
Current assets		
Short-term receivables		
Others		3,626.09
Short-term investments	1,153,319,651.66	1,049,413,310.19
AFS ⁷ portfolio — cost	1,134,968,726.10	1,004,786,115.50
AFS portfolio — actuarial difference	-1,355,359.96	-3,096,484 .22
AFS portfolio — adjustment to fair value	-1,888,129.14	27,525,747.60
AFS portfolio — accruals	21,594,414.66	20,197,940.31
AFS portfolio — impairment		
Cash and cash equivalents	194,011,274.11	191,080,815.35
Current accounts	1,426,322.04	1,078,498.12
Short-term deposits — nominal	123,637,000.00	153,300,000.00
Accrued interest on short-term deposits	155,055.48	113,282.91
Other cash equivalents — cost	68,708,475.06	36,554,203.91
Accrued interest on other cash equivalents	84,421.53	34,830.41
Total current assets	1,347,330,925.77	1,240,497,760.63

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Available For Sale

TOTAL	1,347,330,925.77	1,240,497,760.63
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<u>Balance sheet: Liabilities (EUR)</u>	2010	2009
A. EQUITY		
Capital (Guarantee Fund)	484,292,973.21	390,482,973.21
<i>Payment from the budget</i>	484,292,973.21	390,482,973.21
<i>(surplus to be paid to the budget)</i>		
Reserves	-1,845,165.61	27,678,560.35
First-time application — fair value reserve	42,963.53	152,812.75
Change in fair value of AFS assets	-1,888,129.14	27,525,747.60
Accumulated surplus/deficit	821,618,687.47	780,668,814.11
Results brought forward	821,618,687.47	780,668,814.11
Economic result of the year	42,517,372.53	40,949,873.36
Total equity	1,346,583,867.60	1,239,780,221.03
B. CURRENT LIABILITIES		
Accounts payable	747,058.17	717,539.60
Others	747,058.17	717,539.60
Total current liabilities	747,058.17	717,539.60
TOTAL	1,347,330,925.77	1,240,497,760.63

Notes to the balance sheet:

- ‘Short-term receivables/others’ means the amount of calls on the Fund that is now receivable. This includes 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/others’ in 2010 include the EIB management commission, audit fees, and the accrual of the recovery fees due to the EIB following payment of the penalty fees due to the Fund.

2.3.2. *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 accounts of the EU. Main adjustments are explained in the note to the pre-consolidated economic outturn account.

Guarantee Fund — Pre-consolidated economic outturn account (EUR)	2010	2009
Financial operations revenue	43,367,717.93	41,753,692.10
Interest income		
Interest income on cash and cash equivalents	1,359,361.52	3,496,637.06
Interest income on AFS assets	40,351,233.09	38,180,007.32
Other interest income	80,574.54	77,047.72
Exchange gains		
Realised gains on sale of AFS assets	1,576,548.78	
Reversal of impairment losses on AFS assets		
Other financial income		
Financial operations expenses	-850,345.40	-803,818.74
Interest charges		
Interest charges on cash and cash equivalents		
Exchange losses		
Realised losses on sale of AFS assets		
Impairment losses on AFS assets		
Other financial charges	-850,345.40	-803,818.74
of which: Management fees	-715,037.50	-687,539.60
SURPLUS FROM NON-OPERATING ACTIVITIES	42,517,372.53	40,949,873.36
SURPLUS FROM ORDINARY ACTIVITIES		
Extraordinary gains		
Extraordinary losses		
SURPLUS FROM EXTRAORDINARY ITEMS		
ECONOMIC RESULT OF THE YEAR	42,517,372.53	40,949,873.36

Note to the pre-consolidated economic outturn account:

‘Other financial charges’ include the EIB management commission, audit fees, and accrual of the recovery fees due to the EIB following payment of the outstanding penalty fees due to the Fund.

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 2007⁸ to ensure a more efficient use of budgetary resources by provisioning the Fund on the basis of the observed amounts of guaranteed loans outstanding.

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 01040114 ‘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 01040114 ‘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 16,360.73 million as of 31.12.2009, an amount of EUR 138.88 million, corresponding to the 2009 provisioning, was inserted in budget line 01040114 ‘Provisioning of the Guarantee Fund’ for 2010 in the statement of expenditure in the general budget of the European Union for 2011. This amount was paid in one transaction from the budget to the Fund on 28 February 2011.

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 Community/EIB Agreement of 23/25 November 1994, as 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. 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. This is because

⁸ 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.

fixed-rate securities are reimbursable at 100% of their nominal value at the end of their life, while variable-rate securities can usually be sold at any time at a price close to 100%, whatever their remaining period to maturity. To maintain a balance between the various instruments providing the required liquidity, a minimum of EUR 100,000,000.00 is kept in money market instrument, particularly bank deposits.

The list of banks authorised to receive deposits is agreed by the Commission and the EIB. 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.

3.2.2.2. Performance

This performance was achieved against the background of the financial crisis and a very low interest rate environment.

Overall, market conditions in 2010 slightly improved compared to 2009, mainly due to the setting up of a rescue mechanism for euro area countries in difficulties and accompanying measures from the ECB which kept interest rates low and liquidity abundant.

The portfolio underperformed its benchmark by 13.26 basis points (see section 2.4. 'Performance' of the SWD for details). While the Fund's performance totalled 1.40 % during the first half of 2010, during the second half the performance deteriorated as the problems in Greece negatively impacted the Fund's holdings in bonds of other euro area Member States, mainly Ireland, Portugal, Spain, Italy and Belgium. The spread widening of these countries against the AAA euro area Member States contributed strongly to the observed performance of the Fund.

3.2.2.3. Interest income

In 2010, interest income on cash and cash equivalents, on the Fund's current accounts and on securities totalled EUR 43,367,717.93, broken down as follows:

- From deposits and current accounts: EUR 1,359,361.52; this reflects the situation at 31 December 2010, including interest received on bank deposits of EUR 1,253,213.48 and changes in accrued interest of +EUR 91,363.69 in 2010. Current accounts raised EUR 14,784.35 from interest.
- From securities: EUR 40,351,233.09; this includes EUR 39,633,686.93 of interest on securities and changes in accrued interest of +EUR 1,396,474.35 at 31 December 2010. The interest on securities is generated by investments placed in the form of securities in accordance with the investment principles laid down in the Agreement giving the EIB the mandate to manage the Fund's liquid assets. Of this amount, an adjustment of -EUR 678,928.19 must be made from the securities entered in the course of the year as the difference between the entry price and the redemption value divided *pro rata temporis* over the remaining life of the securities held (corresponding to the spread of the premium or discount entered in the profit-and-loss account).

The interest received is entered in the results for the financial year.

3.3. Recovery from defaulting debtors

The Fund has no amount to be recovered.

4. THE FUND'S LIABILITIES

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

4.1. Default payments

The Fund was not called on for default payments in 2010.

4.2. EIB remuneration

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 2010 was set at EUR 715,037.50 and was entered in the profit-and-loss account and as accruals (liabilities) on the balance sheet.