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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON THE GUARANTEE FUND AND ITS MANAGEMENT IN 2012

{SWD(2013) 344 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.

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 2012 can be found in the Commission Staff Working Document (SWD).

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. FINANCIAL POSITION OF THE FUND AT 31 DECEMBER 2012

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 2,021,926,202.00 (see Section 3 of the Staff Working Document: Statement of financial position of the Fund at 31 December 2012, as provided by the EIB). This is the sum of the flows since the Fund was established:

Guarantee Fund	**Amount at 31.12.2012**	**Amount at 31.12.2011**	**Change**
budget contributions to the Fund	3,540,394,500.00	3,384,734,500.00	155,660,000.00
successive yearly net results	846,343,661.55	802,354,046.04	43,989,615.51
recoveries of payments made by the Fund for defaults	578,854,353.78	576,705,008.19	2,149,345.59
other accounts payable (including called guarantee not yet paid and EIB management fees)	18,819,492.23	770,809.98	18,048,682.25
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)	(519,866,214.55)	(477,860,856.19)	(42,005,358.36)
successive repayments to the budget (including exceptional repayment to the budget due to the accession of new Member States)	(2,501,391,526.79)	(2,501,391,526.79)	0.00
adjustment of portfolio valuation according to IFRS valuation	53,681,272.87	(34,197,488.08)	87,878,760.95
Accounting value of the Fund	**2,021,926,202.00**	**1,756,205,156.06**	**265,721,045.94**

The accounting value of the Fund increased by about EUR 266 million in 2012. This is explained by :

Increasing

- The contribution from the budget (provisioning amount) of EUR 156 million to adjust the Fund to the 9% target amount
- The net revenues on financial operations amounted to EUR 44 million
- The recovery of payments made by the Fund for defaults of EUR 2 million
- A payable of EUR 18 million consisting mainly of guarantee calls to the Fund (payment occurred early 2013)
- The portfolio valuation increase by EUR 88 million due to price volatility in the context of the financial crisis.

Decreasing

- Intervention of the Fund to cover defaulted payments by Syria for a total amount of EUR 42 millions thereof 18 million are still to be paid as at 31 December 2012 (other accounts payable).

2.2. Significant transactions

(1) In January 2012, the contribution from the budget to the Fund was calculated following the article 3 and the 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 155.66 million was inserted to the budget 2013 for the contribution into the Fund. At 31.12.2011, the target amount was EUR 1,911.09 million corresponding to the 9% of the total outstanding guaranteed operations (EUR 21,234.34 million). The difference between the target amount and the net assets of the Fund EUR 1,755.43 at 31.12.2011 was equal to EUR 155.66 million.

This amount was requested for the provisioning of the Fund in 2013 and was approved by the Council and the European Parliament in November 2012. It was subsequently recognised as a receivable of the Fund from the budget.

(2) On 20.02.2012 an amount of EUR 260.17 million was transfered from the budget to the Fund corresponding to the provisioning amount 2012 (see details in paragraph 3.2.1 provisioning of the Fund).

(3) Since November 2011, the EIB is facing arrears on Syrian sovereign loans[3]. 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 (see point 4.1 Default payments).

2.3. Significant transaction after the reporting date

On 20 February 2013 an amount of EUR 155.66 million was transfered from the budget to the Fund corresponding to the provisioning for 2013.

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

[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.

[3] Due partly to the fact that transfers of funds to the EIB from Syria are being blocked by correspondent banks as a result of a number of different sanctions regimes.

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 2012

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 Staff Working Document). 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 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 accruals[4] 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 31.12.2012, 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 21,873,627.24, as well as a call of guarantee for the same defaulting debtor for a total amount of EUR 17,982,385.53 recorded in the pre-consolidated financial statements as other receivables and the counterparty as liabilities (as the payment occurred in January/February 2013). So, the total amount indicated in the pre-consolidated balance sheet is EUR 2,061,782,214.77.

It should be noted that pre-consolidated accounts reflect the decision of the Accounting Officer of the Commission (AO) on 31 January 2013, effective as from financial periods beginning on or after 1 January 2012, to show the available-for-sale financial assets of the European Institutions as current/non-current according to their remaining maturity and no longer as current. For comparative purpose, the distinction between current/non current has been applied as well to the 2011 figures. However, the balance sheet presented in the SWD[5]does not mirror the decision of the AO. The decision was effectively adopted too late to be incorporated in the accounts of the Guarantee Fund for External Action as provided by the EIB to the SWD.

[4] Other accounting accruals include exchange rate differences if any, payable in other liabilities (mainly the recovery fees due to the EIB).

[5] SWD section 3: Statement of financial position of the fund as at 31 December 2012

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	**2012**	**2011**
NON-CURRENT ASSETS		
Long-term Investments	**1,347,503,201.55**	**994,147,018.00**
AFS Portfolio - cost	1,277,457,029.68	986,847,999.50
AFS Portfolio – actuarial difference	1,937,127.51	1,281,526.63
AFS Portfolio – adjustment to fair value	52,128,946.59	(11,104,971.28)
AFS Portfolio - accruals	15,980,097.77	17,122,463.15
Total Non-current Assets	**1,347,503,201.55**	**994,147,018.00**
CURRENT ASSETS		
Short-term Investments	**268,067,766.99**	**200,405,636.14**
AFS Portfolio - cost	265,916,314.50	220,037,760.00
AFS Portfolio – actuarial difference	(2,383,541.31)	(368,459.65)
AFS Portfolio – adjustment to fair value	1,540,460.39	(23,084,885.85)
AFS Portfolio - accruals	2,994,533.41	3,821,221.64
Short-term receivables	**196,117,402.09**	**260,170,000.00**
Contributions from EU Budget	155,660,000.00	260,170,000.00
Subrogated loans	21,873,627.24	-
Other receivables: called guarantee	17,982,385.53	-
Other receivables: coupon	601,389.32	-
Cash and Cash Equivalents	**250,093,844.14**	**301,482,501.92**

Current accounts	8,074,235.40	1,340,446.23
Short-term deposits – nominal	242,000,000.00	299,600,000.00
Accrued interests on short-term deposits	19,608.74	542,055.69
Total Current Assets	**714,279,013.22**	**762,058,138.06**
TOTAL	**2,061,782,214.77**	**1,756,205,156.06**

Balance Sheet: Liabilities in EUR	**2012**	**2011**[6]
A. EQUITY		
Capital (Guarantee Fund)	**1,039,002,973.21**	**883,342,973.21**
Contributions paid in	883,342,973.21	623,172,973.21
Contributions allocated but not yet paid in	155,660,000.00	260,170,000.00
Reserves	**53,681,272.87**	**(34,197,488.08)**
First Time application – Fair value reserve	11,865.89	(7,630.95)
Change in fair value of AFS assets	53,669,406.98	(34,189,857.13)
Accumulated surplus / deficit	**906,288,860.95**	**864,136,059.99**
Results brought forward	906,288,860.95	864,136,059.99
Economic result of the year	**43,929,330.40**	**42,152,800.96**
Total Equity	**2,042,902,437.43**	**1,755,434,346.08**
CURRENT LIABILITIES		
Accounts Payables	**18,879,777.34**	**770,809.98**
Guarantee call payable	17,982,385.53	

[6] A reporting error occurred in the report 2011 at the level of the capital and the accumulated surplus, with no impact on the total amount to be reported. The comparative figures for 2011 have been rectified accordingly.

Others	837,106.70	770,809.98
Others (handling fees)	60,285.11	-
Total Current Liabilities	**18,879,777.34**	**770,809.98**
TOTAL	**2,061,782,214.77**	**1,756,205,156.06**

Notes to the balance sheet:

- 'Short-term receivables' contains the provisioning amount for 2013 due to be paid by the EU budget to the Fund in early 2013. It also includes the subrogated loans for which the Fund have already paid as guarantor, as well as the amounts that have been called but not yet paid (payment in January/February 2013). These amounts include the capital, interest and penalties due to the budget of the European Union following release of the Fund guarantee. Other receivables represent coupons due but not paid at balance sheet date.

- 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 2012 include the calls to guarantees unpaid at the balance sheet date, the accrual of the recovery fees due to the EIB following payment of the penalty fees due to the Fund, EIB management commission and audit fees.

- In 2012 and 2011, the Commission did not record any impairments in respect of 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.

2.4.2.2. 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 financial statements of the EU. Main adjustments are explained in the note to the pre-consolidated economic outturn account

Consolidated Economic Outturn Account in EUR	**2012**	**2011**
Financial operations revenues	**47,722,795.64**	**44,976,268.71**
Interest income		
Interest income on cash and cash equivalents	2,152,817.58	4,118,369.38
Interest income on AFS assets	36,869,194.02	40,771,673.71
Other Interest income	104,765.51	86,225.62
Realised gains on sale of AFS assets	8,596,018.53	
Financial operations expenses	**(3,793,465.24)**	**(2,823,467.75)**
Realised losses on sale of AFS assets	(2,781,347.56)	(1,940,019.61)
Other financial charges	(1,012,117.68)	(883,448.14)
Thereof: Management fees	(805,306.70)	(739,809.98)
Thereof: Handling fees	(60,285.11)	
Surplus from non operating activities	**43,929,330.40**	**42,152,800.96**
Economic result of the year	**43,929,330.40**	**42,152,800.96**

Notes 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 2007[7] 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). In this context it is worth noting that the Commission issued in 2013 a legislative proposal for the 2014-2020 External Mandate for the EIB which is currently being discussed at the Council and Parliament. The result of these discussions will have an important impact on the amounts needed to fund the Guarantee Fund as its size is directly related to the outstanding amounts covered.

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 31.12.2010, an amount of EUR 260.17 million, was inserted in budget line 01040114 ‘Provisioning of the Guarantee Fund’ in the statement of expenditure in the general budget of the European Union for 2012. This amount was paid in one transaction from the budget to the Fund on 20 February 2012.

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[8]. Accordingly, 20 % of the Fund must be invested in short-term investments (up to one year). These investments

[7] 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.

[8] 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

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 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 time to maturity, as long as their credit spread reflect their credit characteristics. To maintain a balance between the various instruments providing the required liquidity, a minimum of EUR 100 million 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

The Fund delivered an absolute return of +7.7963% in the year.

In 2012, the combination of weak growth and portfolio reallocations driven by concerns about sovereign risk in the peripheral countries pushed yields on the debt of highly rated sovereigns to unprecedented lows. Financial fragmentation between core and peripheral countries was at its height in terms of capital flight from the periphery.

In this context, the ECB played a vital role for sovereign bonds in 2012. In the first quarter, its unlimited liquidity injections and the two 3-year LTROs alleviated financing problems on the part of banks and facilitated the placement of securities of certain States, particularly Spain and Italy. Then, with the announcement of the sovereign debt purchase programme (Outright Monetary Transactions or OMT), the ECB triggered a substantial tightening of spreads of the more vulnerable euro-area Member States towards year-end.

The performance of the Fund was positively impacted by these developments, as well as other measures taken in response to the crisis (see section 1.4. ‘Performance’ of the SWD for details).

3.2.2.3. Financial operations revenues

In 2012, interest income on cash and cash equivalents and on securities totalled EUR 47,722,795.64, broken down as follows:

Description:	**2012**	**2011**
Interest income on cash and cash equivalent	**2,152,817.58**	**4,118,369.38**
interests received on short-term deposits	2,660,950.98	3,797,877.59
change in accrued interest on short-term deposits	(522,446.95)	302,578.68
Interest on current bank accounts	14,313.55	17,913.11
Interest income on AFS assets	**36,869,194.02**	**40,771,673.71**
interest received - Available For Sale portfolio	38,824,106.90	41,853,323.85
change in accrued interest – Available For Sale portfolio	(1,367,664.30)	(650,729.87)
premium discount	(587,248.58)	(430,920.27)
Income from securities lending activities	**104,765.51**	**86,225.62**
Realized gain on sale of financial assets	**8,596,018.53**	**-**
Interest from financial investment of the Fund's liquid assets	**47,722,795.64**	**44,976,268.71**

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

3.2.2.4. Financial operations expenses

The financial operations expenses amounted to (EUR 3,793,465.24) of which (EUR 2,781,347.56) relate to realised losses on sales of available for sale assets. The rest includes the EIB management fees for (EUR 805,306.70), other financial charges for EUR (114,725.87), the external audit fees for (EUR 31,800.00) and the handling fees (EUR 60,285.11).

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[9]. 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. Two payments were made in 2012 (EUR 24 million) and EUR 2.1 million were recovered. Payment for the 2 other calls (EUR 17.9 million) are due in the first quarter 2013.

- Events after the reporting date

Until 30 April 2013, three additional calls for defaulting payments in Syria have been made for a total amount of EUR 16.2 million.

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 2012 was set at EUR 805,306.70 and was entered in the economic outturn account and as accruals (liabilities) on the balance sheet.

[9] Due partly to the fact that transfers of funds to the EIB from Syria are being blocked by correspondent banks as a result of a number of different sanctions regimes.