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

**on the evaluation of the application of Decision No 466/2014/EU of the European
Parliament and of the Council of 16 April 2014 granting an EU guarantee to the
European Investment Bank against losses under financing operations supporting
investment projects outside the Union**

1. INTRODUCTION

This report summarises the Commission’s evaluation of the implementation in 2014-18 of the EU budgetary guarantee to the European Investment Bank (‘EIB’) against losses under EIB financing operations supporting investment projects outside the Union. The full evaluation was published in a Commission Staff Working Document in September 2019.¹

The EU’s budgetary guarantee as framed in consecutive decisions of the European Parliament and the Council is habitually referred to as the EIB’s External Lending Mandate (‘ELM’)². The Commission’s evaluation has an ex-post character, covering the period from mid-2014 until the end of 2018, the last year for which complete data is available. As requested by the European Parliament and the Council, the evaluation aims to provide input for a possible new decision on the coverage of the EIB financing operations by the EU guarantee post-2020.³

In particular, the evaluation aims to help design future EU budgetary guarantees in the context of the Neighbourhood, Development and International Cooperation Instrument (‘NDICI’), proposed by the Commission in June 2018. The trilogues on the legislative proposal have recently started.⁴ The evaluation represents one of the Commission’s inputs to the work of the High-Level Group of Wise Persons on the European financial architecture for development.⁵

As from 2021, the External Lending Mandate is envisaged to be replaced by a broader instrument, the European Fund for Sustainable Development Plus (‘EFSD+’), making EU budgetary guarantees available to the EIB as well as to other International Financial Institutions (‘IFIs’) or Development Finance Institutions (‘DFIs’) in the context of an ‘open financial architecture’.⁶

The evaluation examined the effectiveness, efficiency, relevance, coherence and EU added value of the budgetary guarantee underpinning the current ELM against the expectations originally expressed by the European Parliament and the Council in the ELM Decision.

External Lending Mandates to the European Investment Bank have been a feature of external policy of the European Economic Community and subsequently the European Union since 1977. The basic rationale of the EU budgetary guarantee is that it enhances the risk-bearing capacity of the EIB by significantly limiting the EIB’s risk exposure to a profile commensurate with the rules laid down by EIB’s governing bodies. In other words, the EU

¹ SWD(2019) 333 final.

² The legal basis is Decision No 466/2014/EU (‘the ELM Decision’), as amended by Decision (EU) 2018/412 following a mid-term review. The guarantee is provided through a guarantee agreement between the Commission and the EIB, the most recent version of which was concluded on 3 October 2018.

³ Article 20 of the ELM Decision.

⁴ COM(2018) 460 final.

⁵ The future of the European financial architecture for development: An independent report by the High-Level Group of Wise Persons on the European financial architecture for development, October 2019, https://www.consilium.europa.eu/media/40967/efad-report_final.pdf.

⁶ See also Commission communication ‘Towards a more efficient financial architecture for investment outside the European Union’, COM(2018) 644 final.

guarantee helps the EIB to undertake investment operations in riskier environments outside the EU based on the EIB's existing level of capital and reserves, while helping it maintain its AAA credit rating.

The EU guarantee has traditionally been provided to the EIB for a period coinciding with the EU's Multiannual Financial Framework. The 7-year character of the External Lending Mandate has been valuable in helping the EIB develop the human and material capacities necessary for undertaking investment operations outside the EU, operations which usually take more than a year to prepare. In return for the predictability and risk mitigation effect which the EU guarantee renders, the financing operations undertaken under the ELM are expected to address the objectives and fulfil the conditions established by the European Parliament and Council.

The scope of the EU guarantee underpinning the ELM differs depending on the nature of the financing operation: EIB financing operations with public sector counterparts (typically for infrastructure development) benefit from a comprehensive guarantee, covering operational as well as political risks. EIB loans to banks or corporations benefitting from a state guarantee and financing under the Economic Resilience Initiative private mandate, created following the mid-term review of the ELM in 2018, are also covered by the comprehensive guarantee. The comprehensive guarantee allows the EIB to waive the risk premium it would otherwise need to include in its interest rate⁷. Consequently, partner countries or their institutions/companies have been able to borrow from the EIB at a significantly lower cost.

By contrast, the EIB's private sector operations without a state guarantee benefit only from a political risk guarantee from the EU, covering certain situations further defined in the guarantee agreement with the EIB: non-payment due to non-transfer of currency, expropriation, war or civil disturbance or denial of justice upon breach of contract. The political risk guarantee provided by the EU does not translate in a reduction of the EIB's interest rate. However, the pricing of EIB loans remains attractive for the clients due to the EIB's low costs of borrowing from the financial markets.

The EU guarantee covers the first 65% of the EIB's outstanding exposure under ELM financing operations at portfolio level. This means that when a borrower defaults on an EIB loan and the EIB calls on the EU guarantee to make up for the missing repayment, the EU is obliged to honour fully each guarantee call up to the ceiling of 65% of the guaranteed portfolio. The EIB does not pay fees to the EU for the provision of the budgetary guarantee and the EIB does not receive any direct remuneration from the EU for the implementation of the mandate. The EIB's administrative costs in the context of the ELM are covered from the mark-up included in the EIB's interest rate, in line with its standard loan pricing policy.

⁷ By way of exception from the above rules, private sector projects falling under the Economic Resilience Initiative private mandate, created following the mid-term review of the ELM in 2018, benefit from the EU's comprehensive guarantee. However, the risk premium is not waived, but transferred by the EIB to the EU in consideration of the risk taken by the EU.

The ELM is one of the instruments used by the EU to implement EU external policy priorities. The ELM Decision refers to the ‘general EU interest’ and to principles guiding the Union’s external action as defined in the Treaty. It also spells out that ‘in developing countries [...], the EIB financing operations shall contribute [...] to the objectives of the Union's development cooperation policy, in particular towards reducing poverty through inclusive growth and sustainable economic, environmental and social development’. The current ELM Decision defines several objectives to be supported by the EU budgetary guarantee, namely local private sector development and development of socio-economic infrastructure, both of which can go hand in hand with promoting the objectives of climate change mitigation and adaptation, regional integration, or long-term economic resilience.

2. MAIN FINDINGS OF THE EVALUATION

A key limitation of the Commission’s evaluation is linked to the fact that the implementation of investment operations under the ELM takes a number of years, especially as regards infrastructure projects. Limited information is therefore available to date about the actual results and impacts of the operations financed. The EIB Results Measurement Framework relies, for the time being, heavily on upfront estimates and data on results achieved arrive with a long time lag. The Commission’s evaluation therefore worked mainly with currently available data on financing amounts signed and disbursed, with the findings of an external study completed in mid-2018⁸ and with observations brought forward by various stakeholders.

In accordance with the ELM Decision, 64 countries outside the EU are currently eligible for EIB financing operations under the EU budgetary guarantee. The EIB has entered into Framework Agreements with – and is thus currently able to undertake financing operations in – 57 of those countries. In the period under evaluation, the EIB signed financing operations under the ELM in 38 countries and under its own-risk facilities⁹ in six additional countries. The ELM enables the EIB to undertake financing operations in higher-risk countries than it could otherwise reach with its own-risk facilities.¹⁰

The overall ceiling of the EU budgetary guarantee for the EIB’s external operations in 2014-20 is EUR 32.3 billion. At the end of 2018, cumulative net signatures of EIB financing operations under the ELM 2014-20 amounted to EUR 17.6 billion, i.e. approximately 54% of the overall guarantee ceiling as revised during the mid-term review. By way of comparison (albeit only approximate due to a different market environment, geopolitical and regulatory context), at the end of 2011, i.e. at a similar time point of the previous external mandate, the

⁸ Ecorys and CEPS, 2018, ‘Final Report for the Evaluation of the application of the 2014-2020 External Lending Mandate’, published together with the Commission’s evaluation.

⁹ The EIB currently has four Own Risk Facilities in the ELM regions, namely the Pre-Accession Facility (PAF), the Neighbourhood Financing Facility (NFF), the Climate Action and Environment Facility (CAEF) and the Strategic Projects Facility (SPF). The latter two facilities also cover African, Caribbean and Pacific countries and Overseas Countries and Territories of EU Member States.

¹⁰ Commission Delegated Decision (EU) 2018/1102 of 6 June 2018 added Iran to the list of ELM-eligible countries, but no Framework Agreement is in place at this stage.

utilisation rate was 66%. During 2014-18, 189 operations were financed under the ELM, with an average size of approximately EUR 90 million.

The EIB's relatively limited utilisation of the ELM 2014-20 guarantee ceilings can be partly attributed to developments in Turkey since 2016 and the war in Eastern Ukraine since 2014.¹¹ Moreover, the guarantee ceilings allocated by the current ELM Decision to the EU Neighbourhood (Eastern and Southern) are altogether EUR 6 billion higher than the ceilings of the previous mandate, while absorption capacity has been reduced by the war in Syria and political volatility in several other countries. Taken together, these external factors largely explain why the EIB used the available guarantee ceilings by end-2018 to a lesser extent than at the same stage of the previous external mandate.

Another relevant quantitative indication of the **effectiveness** of the EU guarantee can be obtained from an analysis of disbursement rates under the ELM, i.e. the ratio between financing actually paid out by the EIB and amounts signed in the EIB's financing contracts with its counterparts (net of amounts subsequently cancelled). Like the analysis of guarantee utilisation rates, the analysis of disbursements needs to take into account intertemporal differences in the market environment and geopolitical and regulatory contexts.

The EIB disbursed EUR 5.8 billion under the ELM 2014-20 by the end of 2018, representing 33% of net signatures, whereas at the end of 2011, the EIB had disbursed EUR 8.5 billion or 44% of the net amounts signed under its external mandate for 2007-13.

The slower pace of disbursements under the ELM 2014-20 compared to the previous mandate appears to be explained mainly by external factors, such as weak regulatory frameworks, fragmented legislation, government instability, low institutional capacity, staff turnover and slow and inefficient procedures in recipient countries. Sovereign and municipal loans are particularly vulnerable to such factors given that a number of conditions need to be satisfied prior to disbursement of infrastructure loans, e.g. in terms of technical preparation and procurement. Moreover, in many countries, state borrowing from the EIB is subject to parliamentary ratification, which lengthens the timeline of project implementation.¹²

As for factors internal to the ELM's design or the EIB's implementation, high signature volumes are easier to communicate and typically receive more attention than disbursements. A discussion is also ongoing within the EIB's governing bodies about the appropriateness of

¹¹ The EIB has suspended signature of new financing operations in Russia upon request from the European Council on 16 July 2014 in view of the illegal annexation of Crimea and the military conflict in Eastern Ukraine.

¹² In some countries of the Neighbourhood, implementation capacity has somewhat worsened in 2014-18 compared to the previous mandate period. Moreover, large amounts of EIB financing for Ukraine were signed during a relatively short period of time in 2014-16. In addition, lower disbursement rates in Latin America under the ELM 2014-20 can be explained by a recent shift towards public sector infrastructure investments to support climate action, which tend to disburse more slowly than loans for private sector development.

the incentive system within the EIB, including as regards staff remuneration and the relative focus on volumes of commitments as opposed to disbursements and qualitative aspects.

A majority of ELM operations consists of loans to the public sector for infrastructure development. As of end-2018, these accounted for nearly EUR 11 billion of operations signed. Operations financing private sector development but benefitting from the comprehensive guarantee represented approximately one-quarter of signatures under the ELM in 2014-18. Finally, operations under the political risk guarantee made up about one-tenth of ELM volumes signed. The latter operations provide financing to commercial banks or corporates and demonstrate relatively fast disbursement rates.

Thanks to the EU guarantee, beneficiaries enjoy lower cost of EIB financing, provided for longer periods. This is highly beneficial for public sector investments, but raises concerns about putting at a disadvantage banks and companies that receive financing elsewhere on less favourable terms. The ELM Decision stipulates that financing operations under the ELM must have ‘added value on the basis of the EIB’s own assessment’, but there is no explicit requirement for their *additionality* in the sense of preventing the replacement of potential support and investment from other public or private sources. The latter requirement will apply to EIB financing operations covered by EU budgetary guarantee post-2020.¹³

The updated ELM Regional Technical Operational Guidelines issued by the Commission in April 2019 state that ‘in order to avoid as much as possible the risk of market distortion that could be potentially caused by EIB intervention covered by EU budgetary guarantee, the added value of the EIB’s intervention should receive the EIB’s careful attention. This is particularly important when studying possible operations in sectors and countries where there is strong competition and/or market or close-to-market conditions.’¹⁴ The risk of market distortion could be addressed notably through greater use of the option for upward modulation of EIB interest rates where appropriate in view of market conditions.

In geographical terms, the ELM’s implementation as of end-2018 varies per region:

- In the Pre-Accession region, the EIB has utilised about 41% of the guarantee ceiling for this region by end-2018. The EU guarantee has been indispensable for the EIB to finance operations in the Western Balkans. However, EIB activities in Turkey have been scaled down post-2016.
- In the Southern Neighbourhood, the EIB has used about half of the guarantee ceiling by end-2018. It has often relied on the *comprehensive guarantee* even for private sector operations (covered by a state guarantee), whereas they would be otherwise only covered

¹³ Article 209(2)(b) of 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.

¹⁴ C(2019) 2747 final, pp. 14, 24, 35 and 38.

by a political risk guarantee. Implementation of public infrastructure projects in this region has often incurred delays.

- In the Eastern Neighbourhood, the EIB has relied almost exclusively on the ELM to cover its financing operations, with almost no lending at its own risk. It has utilised most of the regional guarantee ceiling (78%), especially to support Ukraine in the context of Russia's illegal annexation of the Crimean peninsula in 2014 and on-going destabilising action. However, the implementation of many ELM operations is yet to start and the disbursement rate remains very low (23% of net signatures as of end-2018).
- ELM implementation is most advanced in Latin America and South Africa, which however account for only one-tenth of the ceiling of the EU budgetary guarantee. For Asia and Central Asia, the utilisation rate of the EU guarantee is high, but implementation in terms of disbursement levels is rather low.

The ELM exceeds the targets established by the EU legislator for supporting climate change mitigation and adaptation. Climate-related financing signed under the ELM in 2014-18 is at 34% of all financing volumes signed, above the target of 25%.

The **efficiency** and the **added value** of the EU guarantee correspond to the legislators' expectations. Compared to the budgetary amounts set aside in the guarantee fund, about 11 times more EIB financing is provided to beneficiaries at any given time, and more than 20 times as much total investment is mobilised.¹⁵ To date, no calls on the EU budgetary guarantee have occurred on operations under the ELM 2014-20. As described in the Commission's annual reports, the EIB has called on the EU guarantee in relation to a number of operations in Syria since 2012 as well as one operation in Tunisia (Aéroport Enfidha). All of these operations fall under previous external mandates and efforts are ongoing to recover the defaulted amounts. Amounts drawn from the Guarantee Fund for External Action in previous decades have been recovered.

The ELM incentivises the EIB to undertake relatively large volumes of lending on its own balance sheet, up to its 50% co-financing limit per project, since the EU guarantee underpinning the ELM covers only the EIB and not other co-investors. A different model of EU intervention was introduced in 2017 through the European Fund for Sustainable Development (EFSD) guarantee, where the EU guarantee can take the form of a first- or second-loss piece that shields not only the implementing financial institution but also (or mainly) other co-investors. The EFSD model requires a much higher provisioning rate (currently 50%) because of the expected higher financial risk of the EU intervention, also targeting clearly LDCs, but it may be more suitable for the financing of operations where crowding-in private sector investment is an important objective, also linked to the principle of remuneration under the EFSD guarantee.

The ELM plays a **relevant** role in supporting the EU's external policy objectives. However, most of the ELM guarantee is currently allocated in support of operations in Upper Middle

¹⁵ The provisioning rate is set at 9% of the amounts outstanding under the guarantee. EIB financing usually covers up to 50% of the project's total investment costs.

Income Countries, and only few operations have been financed by the EIB in Least Developed Countries. This can be perceived as a shortcoming in the ELM's relevance vis-à-vis EU development cooperation policy, to be addressed in the design of future EU guarantees, while taking into account limitations in terms of debt sustainability.

Coherence and alignment of ELM operations with EU policy and Member States' interventions could be improved, including by ensuring a stronger policy steer from the EU and greater sharing of information between the EIB and Commission services throughout the project cycle. The Commission provides opinions on envisaged EIB operations under a procedure set out in Article 19 of the EIB Statute. A positive opinion from the Commission implies that the envisaged operation can be included under the ELM and covered by the EU guarantee. However, this consultation is undertaken at a relatively early stage and the level of information shared during the Article 19 process is often insufficient.

Through years of dialogue, non-binding arrangements have been put in place between the EIB and Commission services to improve, inter alia, upstream coordination concerning potential financing operations identified by the EIB. In November 2018, the EIB and the Commission's Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR) signed a joint note expressing mutual commitment to enhance information exchange on potential EIB operations under the ELM. Moreover, the Commission and the EEAS increasingly provide early feedback on indicative overviews of newly identified potential operations that the EIB submits to the Commission on a quarterly basis.

Stakeholder complaints related to ELM operations represent 45% of all complaints registered under the EIB Complaints Mechanism over the period 2014-18. This indicates that operations in ELM countries represent significant reputational risk for the EIB compared to the less than 10% share they represent in the EIB's overall business volume, although many of these complaints are found by the EIB not to have solid grounds. A key systemic suggestion emerging from civil society criticisms of individual ELM operations is to broaden and strengthen clauses in the EIB's financing contracts that enable to suspend disbursements in case of breaches of human rights and environmental and social standards throughout the implementation phase. Information sharing between the EIB and the Commission on the application of such clauses could also be improved.

3. CONCLUSIONS AND RECOMMENDATIONS

In order to maximise the additionality of EU budgetary guarantees under the NDICI Regulation post-2020, several lessons can be learned from the ELM 2014-20:

- For the purpose of policy design, it is useful to distinguish more clearly between the desired impact of the EU guarantee on the financial advantage transferred to beneficiaries (i) in the public sector, and (ii) in the private sector. While there may be policy reasons to minimise the costs of financing operations with certain types of public sector counterparts, this is not necessarily the case for private sector financing.

- Consistent attention to reducing the risks of market distortion is warranted and a more explicit policy could be formulated for the use of key mitigating measures, such as upward modulation of interest rates in order to reflect local market conditions in private sector financing.
- The rationale for the use of comprehensive guarantees in the financing of private sector development deserves careful scrutiny.
- Provision of local currency financing could be further encouraged.

More broadly, the evaluation has identified the following key recommendations for improvements in the implementation of the ELM, also relevant for the design of post-2020 EU budgetary guarantees in the context of the NDICI Regulation:

- To explore options for timelier reporting and evaluation of actual results achieved, and greater analysis of actual impacts.
- For the EIB to share more information with the Commission on the effective application of contractual clauses enabling the EIB to suspend disbursements in cases of projects' non-compliance with environmental, social, human rights, tax and transparency standards.
- For the EIB, Commission services and the EEAS to work better together in defining the optimal sizes of envisaged investment operations, tailored to the beneficiary countries (also to ensure debt sustainability), and to help beneficiary countries make faster use of approved ELM financing.
- To pay consistent attention to minimising the risks of market distortion in the financing of private sector companies. In particular, to envisage stricter constraints for the use of the EU comprehensive guarantee, for instance by limiting its scope to public sector investments only and/or requiring appropriate remuneration of the EU guarantee. To ensure the effective implementation of the recently agreed *Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations*.
- To strengthen alignment of ELM operations with EU policies through stronger policy steer from the EU and closer coordination between the EIB, the Commission and the EEAS. The latter includes early-stage coordination, more substantial information to be provided by the EIB in 'Article 19 consultations' before financing operations are approved, and joint monitoring of project implementation.
- To adapt the geographical coverage of possible EU external investment windows post-2020 and the allocation of the EU guarantee across the various regions based on the EU's external policy priorities post-2020 and the needs of partner countries.
- To seek stronger synergies between the strengths of the EIB in terms of low borrowing costs, and other financial institutions' strengths in terms of ground presence, sectoral expertise and development impact.

The strengths and weaknesses of the current ELM are relevant for the broader debate on the post-2020 European financial architecture for development. High-volume, low-cost financing of public sector infrastructure investments could continue to be supported through an EU budgetary guarantee dedicated to this specific type of operations but with stronger policy steer from the EU institutions. For private sector financing, increased preference for attracting

private co-investment may warrant a differently designed guarantee, less focused on volumes provided directly by the EIB (or other IFI involved), and with pricing closer to market levels.