



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 28.6.2007  
SEC(2007) 869

**COMMISSION STAFF WORKING DOCUMENT**

**Annex to the**

**REPORT FROM THE COMMISSION**

**Annual Report from the Commission  
on the Guarantee Fund and its Management in 2006**

{COM(2007) 362 final}

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## **1. LEGAL BASE FOR PAYMENTS TO THE GUARANTEE FUND FROM THE GENERAL BUDGET**

In line with Regulation No 2728/94, the provisioning of the Guarantee Fund (the “Fund”) follows different rules according to the type of operation covered. In the case of EIB loans, the provisioning of the Fund applicable in 2006 takes place at the beginning of each year, based on the forecast provided by the EIB of total loans to be signed in the respective year. The difference between forecast and realisation is balanced at the end of each year when the Fund is aligned to its target amount. Euratom loans are provisioned on a forecast basis and are fully provisioned at the latest at the time of the signature of the loans.

In the case of macro-financial assistance loans, the provisioning takes place as soon as the Council has adopted the decision to grant macro-financial assistance, for the maximum amount decided by the Council. This applies independently of the disbursement of the loan, i.e. if the loan is paid out in several tranches over a period of more than one year.

One transfer to the Fund of EUR 127,640,000.00 was made from the guarantee reserve under this procedure in 2006.

Decisions covered by Transfer DEC20/2006:

- Council Decision of 22 December 1999 (2000/24/EC) as amended granting a Community guarantee to the European Investment Bank against losses under loans for projects outside the Community subject to an overall loan ceiling of EUR 19,460 million granted for a period of seven years beginning on 1 February 2000 for Central and Eastern Europe, the Mediterranean countries, Latin America and Asia and on 1 July 2000 for the Republic of South Africa and ending on 31 January 2007 for all regions (OJ L 9, 13.1.2000, p. 24).
- Council Decision of 6 November 2001 (2001/777/EC) granting a Community guarantee to the European Investment Bank against losses under a special lending action for selected environmental projects in the Baltic Sea basin of Russia under the Northern Dimension. The overall ceiling of credits is EUR 100 million (OJ L 292, 09.11.2001, p. 41).
- Council Decision of 22 December 2004 (2005/48/EC) granting a Community guarantee to the European Investment Bank against losses under loans for certain types of projects in Russia, Ukraine, Moldova and Belarus. The overall ceiling of credits is EUR 500 million (OJ L 21, 25.01.2005, p. 11).

## 2. GUARANTEE FUND - MANAGEMENT REPORT AT 31 DECEMBER 2006<sup>1</sup>

### 2.1. Development of the Fund in 2006

The total market value of the Guarantee Fund's (the "Fund") holdings (excluding accrued interest) stood at EUR 1,354.7 million at 31 December 2006 as against EUR 1,299.5 million at 31 December 2005, an increase of EUR 55.2 million.

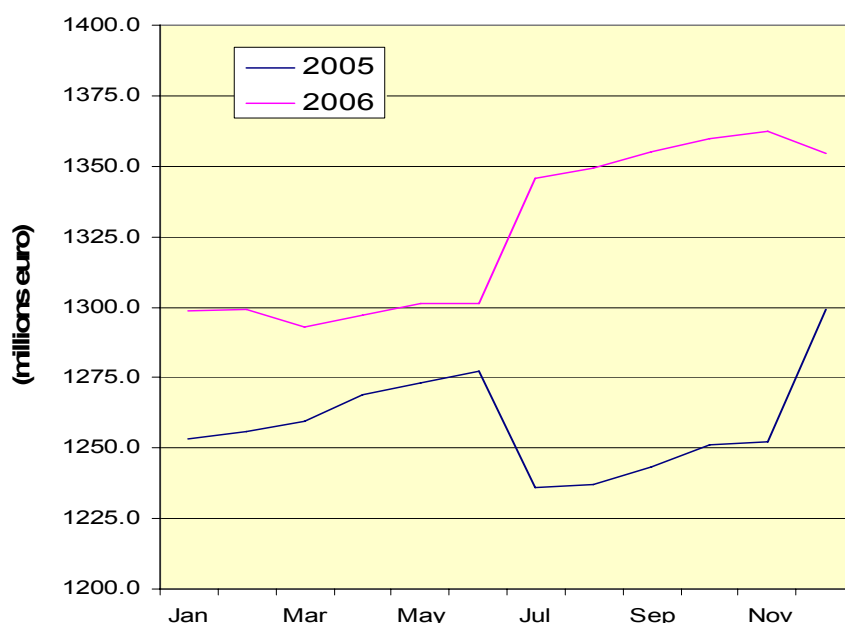


Figure 1: Development of holdings in 2006

The Fund had a surplus of EUR 92.73 million at 31 December 2005. Subsequently, an allocation of EUR 127.64 million was entered on 31 July 2006 with the Commission paying the Fund the difference, EUR 34.91 million. Total provisioning to 31 December 2006 amounted to EUR 127.64 million.

Income in each segment was proportional to the breakdown of assets allocated to the bond and money market segments, as agreed between the EIB and the Commission. The net operating result amounted to EUR 52.1 million at 31 December 2006 compared with EUR 50.7 million at 31 December 2005. Interest income on AFS (Available For Sale) assets (net of the premium / discount spread) amounted to EUR 41.5 million, representing 80% of the income recorded at 31 December 2006. Interest income on cash & cash equivalents amounted to EUR 11.5 million, or 22% of the total result (see Section 3 of this Annex), the rest (-2%) being commission and financial charges.

<sup>1</sup> Report prepared by the EIB.

## 2.2. Situation of the Fund

### 2.2.1. The Fund's resources at 31 December 2006

The Fund balance increased by EUR 34.9 million, or 4.6% from EUR 753.2 at 31 December 2005 to EUR 788.1 at 31 December 2006.

This is explained by the movements shown in the following table:

<b>Resources</b>		Situation at 31/12/2005	Movements in 2006	Situation at 31/12/2006
Provisioning	+	2,677,365,162.91	127,640,000.00	2,805,005,162.91
Repayment of surplus	-	(1,683,140,000.00)	(92,730,000.00)	(1,775,870,000.00)
Activation of guarantee	-	(477,860,856.19)	0.00	(477,860,856.19)
Recovery of amounts guaranteed	+	575,673,913.77	0.00	575,673,913.77
Repayment of Funds (9%)	-	(338,831,402.07)	0.00	(338,831,402.07)
<b>Balance</b>		<b>753,206,818.42</b>	<b>34,910,000.00</b>	<b>788,116,818.42</b>

### 2.2.2. The Fund's assets at 31 December 2006

The Fund's holdings at 31 December 2006 totalled EUR 1,354.7 million as detailed below. The Fund operates in one currency only, the Euro:

EUR 436.5 million in the monetary portfolio (interbank term deposits);

EUR 1.2 million in the current accounts;

EUR 917.0 million in the Available For Sale (AFS) investment portfolio (the market value of fixed rate and variable rate securities (excluding accrued interest), see table in section 3.1).

## 2.3. General and segmental analysis of the Fund

### 2.3.1. Liquidity analysis

The distribution of the Fund's holdings at 31 December 2006 (market value excluding accrued interest) was as follows:

Segments	Fixed rate investments			Variable rate securities	TOTAL
	Less than 3 months	3 months to 1 year	1 to 10 years		
Current accounts	1,158,007.44				1,158,007.44
Fixed term deposits	436,500,000.00				436,500,000.00
Securities portfolio	56,535,900.00	51,292,050.00	732,804,128.15	76,355,536.00	916,987,614.15
TOTAL	494,193,907.44	51,292,050.00	732,804,128.15	76,355,536.00	1,354,645,621.59
Percentage	36.5%	3.8%	54.1%	5.6%	100.0%

### 2.3.2. General analysis of the results of the Fund

Overall, the Fund produced EUR 52.1 million in net revenue.

Investment income at 31 December 2006 was as follows:

	January – December 2006 (EUR million)
Interest income on cash & cash equivalents	11.5
Interest income on AFS assets	41.5
Commission and financial charges	(0.9)
Total	52.1

The performance of the Fund portfolio was monitored on a marked to market basis. Over 2006, the portfolio has delivered a 1.603% marked-to-market (MTM) return, outperforming its benchmark by 6.5bps.

## 2.4. Analysis by segment

### 2.4.1. Analysis of money markets operations

Money-market investments amounted to EUR 436.5 million at 31 December 2006, to be compared with EUR 313.5 million a year before.

The EUR 123 million increase results from the necessity to maintain a liquidity cushion to be able to repay to the Budget the amount of reflow due to EU enlargement to Bulgaria and Romania. This repayment occurred in early 2007.

- **Evolution of money-market rates in 2006**

The constant increase of the short term money market rates benefited mostly to the money market portfolio of the Fund which was invested with maturities at 1 and 3 months rolling periods. The table below shows the positive evolution of the one- and three-month Euribid reference rates (i.e. Euribor – 12.5bp).

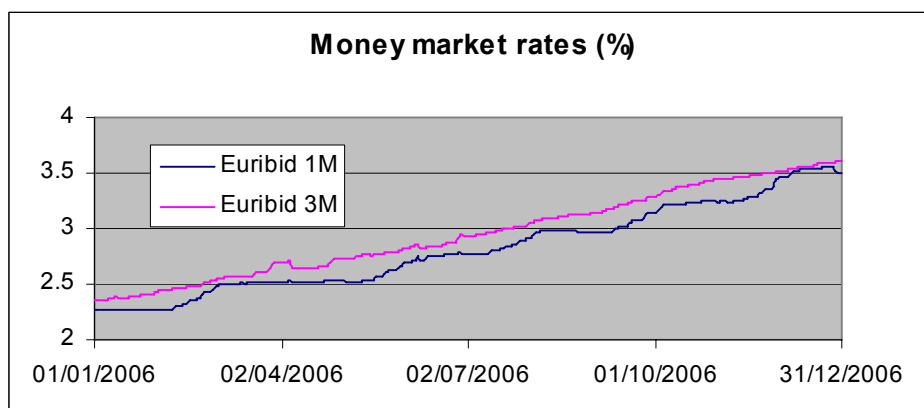


Figure 2: Evolution of Money Market rates during 2006

- **Profile of counterparties**

In accordance with the agreement between the Community and the EIB on the management of the Fund, all the interbank investments should have a minimum credit rating of A1. The breakdown, including accrued interest, is as follows:

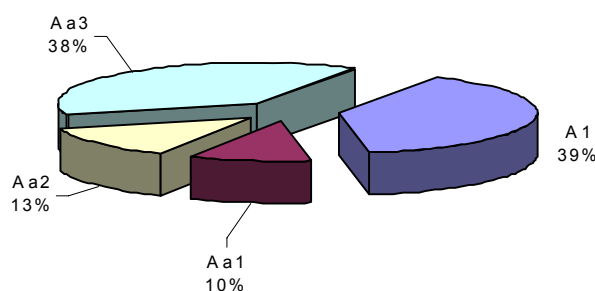
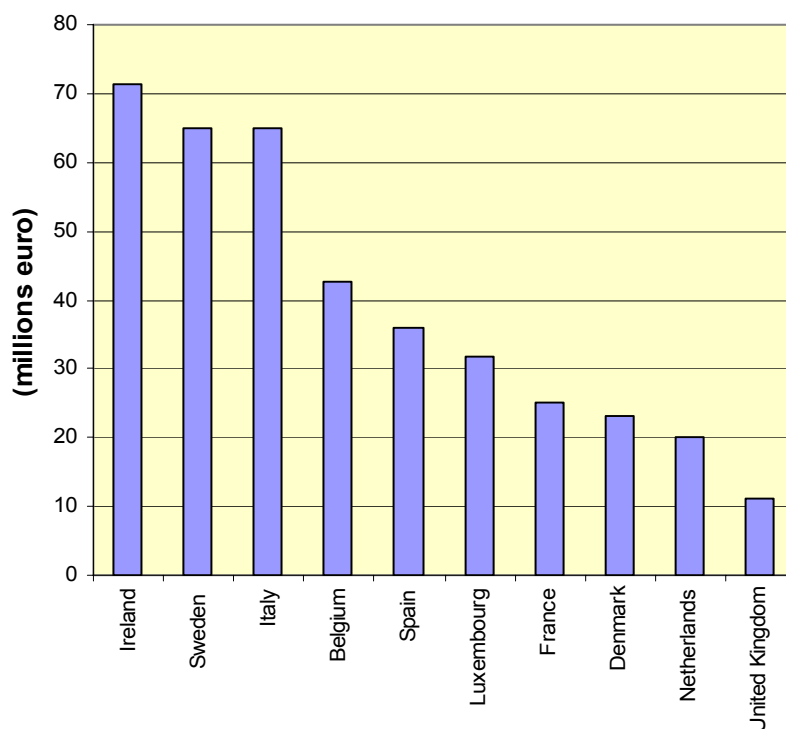


Figure 3: Short term interbank investments by type of counterparty at 31 December 2006

- **Geographical breakdown**

The geographical breakdown of the Fund's short-term interbank investments (in terms of average capital) in 2006 is as follows:





**Figure 4: Short-term interbank investments: geographical distribution of average capital**

The EIB is pursuing its objective of a better geographical distribution throughout the countries of the European Union while at the same time maintaining the competitiveness of the yield obtained.

#### 2.4.2. Analysis of bond portfolio results

The bond portfolio, seen as a long-term investment portfolio, is made up of euro-denominated securities initially acquired with the intention of holding them until maturity. Under IFRS (IAS), these securities are classified in the Financial Statements as Available For Sale (AFS). At 31 December 2006, the market value (excluding accrued interest) of fixed rate securities with a residual period to maturity of less than three months amounted to EUR 56.5 million, between three months and one year EUR 51.3 million and between one and 10 years EUR 732.8 million.

The starting value of the securities in this portfolio is the acquisition cost. The difference between the entry price and the redemption value is the premium/discount spread, which is divided *pro rata temporis* over the remaining life of each of the securities using the effective interest rate method as specified under IFRS.

At 31 December 2006, the nominal value of the investment portfolio was EUR 899.2 million, against a market value of EUR 917.0 million.

The global (modified) duration of the bond portfolio decreased over 2006 to reach 3.1 years at the end of the year. As of 31 December 2006 the market value (excluding accrued interest) of the investment portfolio came to EUR 917.0 million compared with a book value of EUR 902.3 million (including premiums/discounts), which gives an unrealised gain of EUR 14.7 million, compared with an unrealised gain of

EUR 46.6 million and a market value (excluding accrued interest) of EUR 984.4 million at 31 December 2005.

During 2006 the euro area 1- to 10-year yield curve flattened by 50 basis points from 59 basis points to 9 basis points. The movement occurred as a result of short-term yields increasing more than long-term yields as shown in Figure 5.

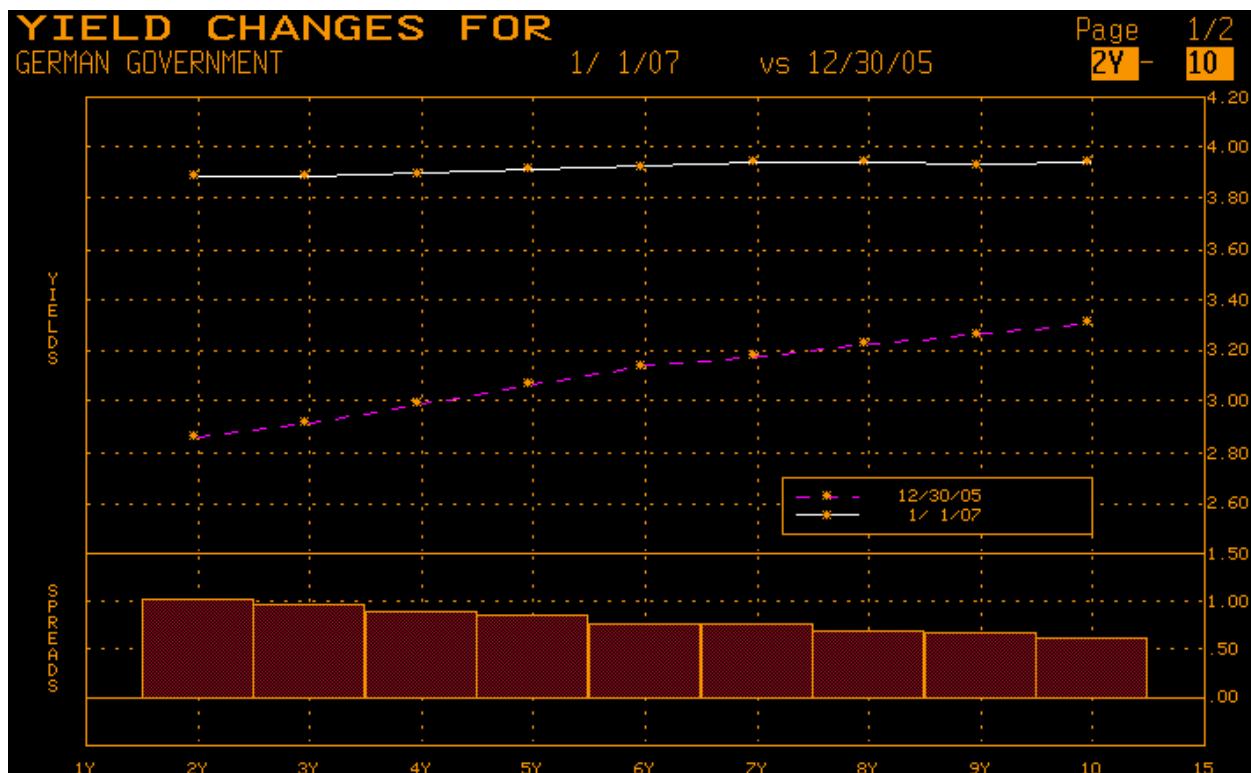


Figure 5: Euro area yield curve flattening during 2006 using German government benchmark bonds (source Bloomberg)

The 2006 investment strategy for the fixed coupon bond segment was based on reinvestment interest rate triggers with the enhancement of dynamic reinvestment levels. This hybrid strategy retains the advantages of avoiding exposure to underinvestment should market yields not develop as expected. In accordance with this investment strategy a total nominal amount of EUR 84 million was invested in 7, 8, 9 and 10 year fixed coupon bonds. This occurred in response to the first trigger point for reinvestment of 3.80% being reached end of March 2006 and the second trigger point of 3.90% reached in the middle of April 2006. The inflow of EUR 34.91 million in on 31<sup>st</sup> July 2006 was invested in line with the strategy in 7- to 10-year fixed coupon bonds as all trigger points were reached at this time so that equal outstanding amounts were achieved for these years. The highest yield of the 10-year bund reached 4.13% on 5<sup>th</sup> July 2006.



Figure 6: 2006 Graph of 10-year Bund YTD yield evolution with investment dates (source Bloomberg)

For the FRN subgroup, a total of EUR 20 million matured and a total of EUR 33 million were reinvested in November 2006. The shortfall (investments – redemptions) was taken from the money market subgroup.

At 1 January 2006, a total of EUR 148.63 million of reimbursements (nominal value) on the securities portfolio were scheduled for the year, split as follows:

EUR 107.40 million for the fixed rate, and

EUR 41.23 million for the variable rate.

- Breakdown of the investment portfolio between fixed rate and variable rate securities

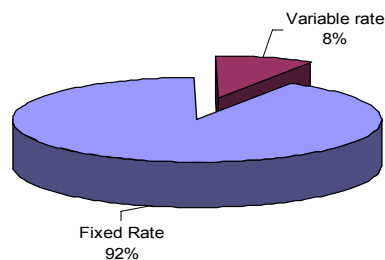


Figure 7: Breakdown of the investment portfolio between fixed and variable rate securities at 31 December 2006

- **Redemption profile of investment portfolio (nominal value)**

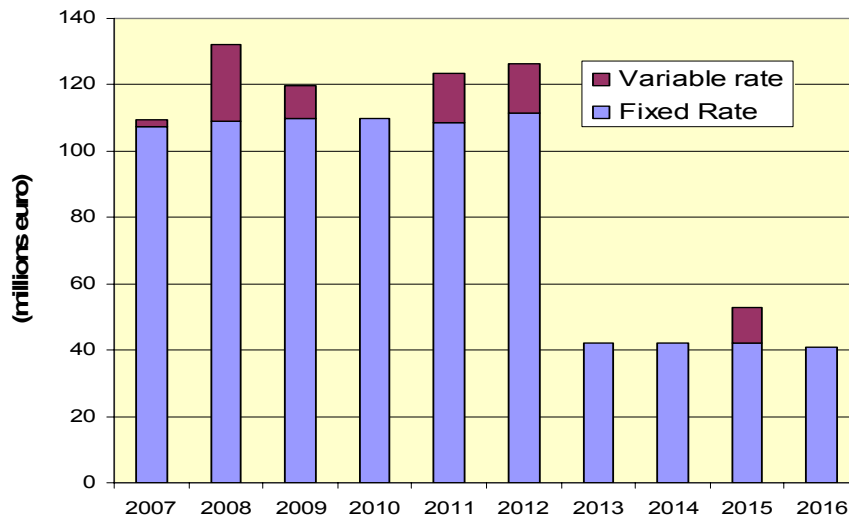


Figure 8: Investment portfolio: Redemption profile at 31 December 2006

The latest final maturity date for fixed rate securities is 1 August 2016.

Relative to the target allocation, the actual portfolio is underinvested in the longer dated fixed coupon bonds as of 31<sup>st</sup> December 2006. The main part of this difference can be explained by the fact that an outflow of the Fund of EUR 260 million has occurred in February 2007 for the accession of Bulgaria and Romania and hence requested higher holdings in short-term money market instruments which limited the available amounts to be invested in the longer maturity. The investment strategy for 2007 foresees to bring the portfolio into the target allocation by the end of this year.

- **Profile of issuers**

All the securities held meet the following criteria:

- Either they are issued by States in, or by institutions guaranteed by, the European Union, the G10 or supranational bodies;
- Or they are issued by another sovereign State with a rating of at least AA3;
- Or they are issued by another issuer with a rating of AAA.

The profile of issuers at 31 December 2006 is as follows:

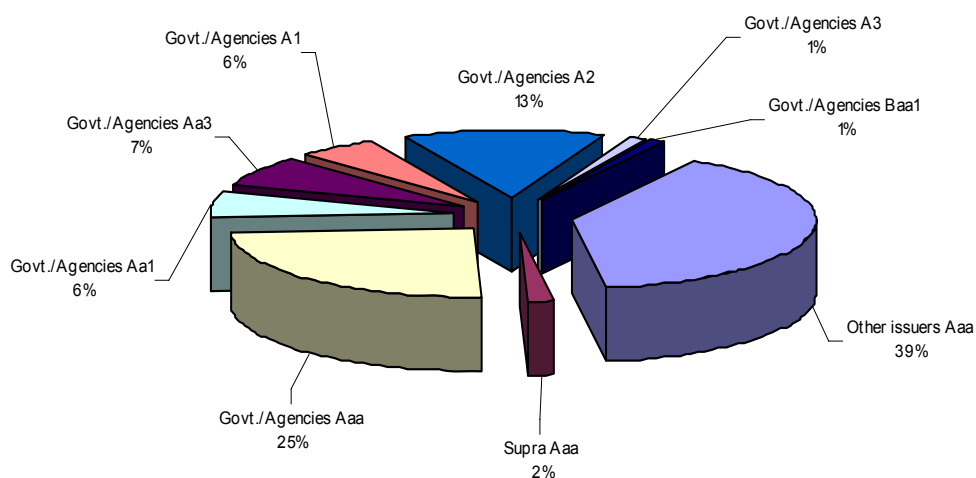


Figure 9: Investment portfolio: Profile of issuers at 31 December 2006

## 2.5. Performance and interest rate risk analysis

A new Fund Risk and Performance Report has been developed and implemented in 2006. This report provides information on portfolio composition (per maturity buckets, instrument types and credit ratings), interest risk measurements and performance.

The performance of the Fund is monitored on a marked-to-market (MTM) basis against a composite index. This index is the result of the combination of the following sub-indices:

- Euribid 1M for money-market operations
- Euribid 3M for floating rate notes and fixed rate bond with less than one year to maturity
- IBOXX EUR Sovereign indices for fixed rate bonds issued by sovereign (or similar) issuers, split by maturity buckets
- IBOXX EUR Corporate indices for fixed rate bonds issued by corporate (or similar) issuers, split by maturity buckets

Index weightings are based on portfolio composition and are reviewed every month. The table below gives an overview of the 2006 average composition.

Bucket (years)	Performance Benchmark Sector	Instrument	Percentage of total portfolio (2006 average)
0-1	1 m	Money Market	30.0%
	3 m	FRN and Fixed Rate bonds	14.4%
1-3	sovereign	Fixed Rate Bonds	15.6%
	corporate		0.8%
3-5	sovereign		15.1%
	corporate		1.6%
5-7	sovereign		13.0%
	corporate		1.2%
7-10	sovereign		7.5%
	corporate		0.8%
<b>Total</b>			<b>100.0%</b>

### 2.5.1 Interest rate risk

The interest rate risk sensitivity of the MTM value of the portfolio mainly stems from its fixed rate exposure. A 1bp increase of interest rates reduces the value of the portfolio by EUR 294,902, of which EUR 289,588 is related to the fixed rate bond exposure. The global duration of the fund arose, at the end of 2006, at 2.14 years.

GF Sub- Portfolios	Market Value (excluding accrued interest) <sup>2</sup>	Modified Duration (Years)	Interest Rate Exposure (+/-1bp)
Floating Rate Notes	76,357,806	0.17	-/+ 1,304
Fixed Rate Bonds	840,426,740	3.36	-/+ 289,588
Money Market Deposits	436,463,173	0.09	-/+ 4,010
Cash account	2,055,072	0	0
<b>Total GF</b>	<b>1,355,302,791</b>	<b>2.14</b>	<b>-/+ 294,902</b>

<sup>2</sup>

(1) The EUR 2.1 M “cash account” balance reported in this table does not include the payment of (EUR 0.9 M) due for “commission and financial charges” as reported in Section 2.3.2. The net position (EUR 1.2 M) matches the “current account” balance as of 31.12.2006.

(2) For performance and risk measurement purposes, floating rate securities are valued using an NPV-based approach, while the market values reported in Section 2.3.1 are derived from market prices.

## 2.5.2 Performance

Over 2006, the portfolio has delivered a 1.603% MTM return. The evolution of the portfolio return and excess return vis-à-vis its benchmark is presented in the following table.

	Portfolio			Out-performance	
	Market Value (including accrued interest)	Monthly return (absolute return in %)	YTD return (absolute return in %)	Monthly Excess Return (in %)	YTD Excess Return (in %)
31/01/2006	1,322,766,201	-0.0796	-0.0796	0.0279	0.0279
28/02/2006	1,324,480,078	0.1296	0.0499	0.0039	0.0318
31/03/2006	1,319,183,664	-0.3999	-0.3502	-0.0308	0.0009
30/04/2006	1,317,982,106	-0.0911	-0.4410	-0.0094	-0.0085
31/05/2006	1,322,970,059	0.3785	-0.0642	0.0212	0.0126
30/06/2006	1,321,983,161	-0.0746	-0.1387	-0.0362	-0.0236
31/07/2006	1,364,714,352	0.5916	0.4521	0.0212	-0.0025
31/08/2006	1,372,296,143	0.5556	1.0101	0.0227	0.0203
30/09/2006	1,376,111,594	0.2780	1.2910	0.0061	0.0265
31/10/2006	1,378,669,283	0.1859	1.4792	0.0151	0.0418
30/11/2006	1,384,137,137	0.3966	1.8817	0.0043	0.0464
31/12/2006	1,380,354,838	-0.2733	1.6033	0.0179	0.0645

One will note the negative impact of the interest rate increases observed in 2006 on the portfolio absolute returns measured in MTM, especially during the first half of the year and in December. These returns however remained in line with the portfolio benchmark, as evidenced by the monthly excess returns reported on the right hand side of the table, resulting into an overall 2006 out-performance reaching 6.45 bp.

### **3. STATEMENT OF FINANCIAL POSITION OF THE FUND AT 31 DECEMBER 2006**

The Funds' financial statements have been prepared by the EIB in accordance with International Financial Reporting Standards (IFRS) and the accounting rules adopted by the European Commission, in particular "Accounting rule 11 – Financial assets and liabilities", dated September 2004<sup>3</sup>. These financial statements are presented in Euro. This is the financial statement for the Fund's assets managed by the EIB. The annual accounts of the Guarantee Fund for the year ending of 31<sup>st</sup> December 2006, have been audited and certified by an Independent Auditor.

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<sup>3</sup>

This is based on the revised standards IAS 32 and 39 as issued by the IASB on 18 December 2003 and consequently, does not integrate the carved out provisions as set out in the version of IAS 39 endorsed by the European Commission on 19 November 2004.



**3.1 Economic Outturn Account (Statement of Financial Performance) for the year ended 31 December 2006**

	Notes	Year to 31.12.2006	Year to 31.12.2005
<b>Financial operations revenues</b>	4.7		
Interest income		52,981,320.04	50,439,477.94
Interest income on cash and cash equivalents		11,443,127.48	6,280,520.69
Interest income on AFS assets		41,538,192.56	44,158,957.25
Exchange gains		0.00	0.00
Realised gains on sale of AFS assets		0.00	1,150,249.86
Reversal of impairment losses on AFS assets		0.00	0.00
Other financial income		0.00	0.00
<b>Financial operations expenses</b>	4.8		
Interest charges		0.00	0.00
Interest charges on cash and cash equivalents		0.00	0.00
Exchange losses		0.00	0.00
Realised losses on sale of AFS assets		0.00	0.00
Impairment losses on AFS assets		0.00	0.00
Other financial charges		(903,894.45)	(858,586.18)
Thereof: Management fees		(714,719.38)	(702,497.47)
<b>SURPLUS FROM NON OPERATING ACTIVITIES</b>		<b>52,077,425.59</b>	<b>50,731,141.62</b>
<b>SURPLUS FROM ORDINARY ACTIVITIES</b>		<b>52,077,425.59</b>	<b>50,731,141.62</b>
Extraordinary gains		0.00	0.00
Extraordinary losses		0.00	0.00
<b>SURPLUS FROM EXTRAORDINARY ITEMS</b>		<b>0.00</b>	<b>0.00</b>
<b>ECONOMIC RESULT OF THE YEAR</b>		<b>52,077,425.59</b>	<b>50,731,141.62</b>

The notes refer to the Notes to the Financial Statements.

### 3.2 Balance Sheet (Statement of Financial Position) as at 31 December 2006

<b>ASSETS</b>	<b>Notes</b>	<b>31.12.2006 EUR</b>	<b>31.12.2005 EUR</b>
<b>CURRENT ASSETS</b>			
<b>Short-term Investments</b>	4.2.3.3		
AFS Portfolio - cost		909,631,292.30	946,662,502.30
AFS Portfolio – actuarial difference		(7,298,412.75)	(8,860,547.41)
AFS Portfolio – adjustment to fair value		14,654,734.60	46,565,266.11
AFS Portfolio - accruals		22,976,717.88	24,272,713.02
AFS Portfolio – impairment		0.00	0.00
<b>Total Short-term Investments</b>		<b>939,964,332.03</b>	<b>1,008,639,934.02</b>
<b>Cash and Cash Equivalents</b>	4.2.3.2		
Current accounts		1,158,007.44	1,582,089.98
Short-term deposits – nominal		436,500,000.00	313,500,000.00
Accrued interests on short-term deposits		2,075,352.42	941,933.25
Other cash equivalents – cost		0.00	0.00
Accrued interests on other cash equivalents		0.00	0.00
<b>Total Cash and cash equivalents</b>		<b>439,733,359.86</b>	<b>316,024,023.23</b>
<b>Total Current Assets</b>		<b>1,379,697,691.89</b>	<b>1,324,663,957.25</b>
<b>TOTAL</b>		<b>1,379,697,691.89</b>	<b>1,324,663,957.25</b>

<b><u>LIABILITIES</u></b>	<b>Notes</b>	<b>31.12.2006</b> <b>EUR</b>	<b>31.12.2005</b> <b>EUR</b>
<b>A. EQUITY</b>			
<b>Capital (Guarantee Fund)</b>		788,116,818.42	753,206,818.42
<b>Reserves</b>			
First Time application – Fair value reserve		341,827.26	416,678.61
Change in fair value of AFS assets		14,654,734.60	46,565,266.11
<b>Accumulated surplus / deficit</b>			
Results brought forward		523,763,636.64	473,032,495.02
<b>Economic result of the year</b>		52,077,425.59	50,731,141.62
<b>Total Equity</b>		<b>1,378,954,442.51</b>	<b>1,323,952,399.78</b>
<b>B. CURRENT LIABILITIES</b>			
<b>Accounts Payable</b>	4.6		
Sundry Payables		0.00	0.00
Others		743,249.38	711,557.47
<b>Total Current Liabilities</b>		<b>743,249.38</b>	<b>711,557.47</b>
<b>TOTAL</b>		<b>1,379,697,691.89</b>	<b>1,324,663,957.25</b>

The notes refer to the Notes to the Financial Statements.

### 3.3 Statement of changes in equity for the year ended 31 December 2006

Equity (EUR)	Capital	Reserves		Accumulated Surplus / Deficit	Economic Result of the year	Total
		Fair value reserve	Changes in fair value of AFS			
<b>Balance as of 01.01.2005</b>	<b>1,139,058,220.49</b>	<b>446,341.58</b>	<b>57,511,677.51</b>	<b>473,032,495.02</b>	<b>0.00</b>	<b>1,670,048,734.60</b>
Fair value adjustment – AFS reserve	0.00	0.00	(10,946,411.40)	0.00	0.00	(10,946,411.40)
Fair value reserve	0.00	(29,662.97)	0.00	0.00	0.00	(29,662.97)
Repayment to the European Union	(385,851,402.07)	0.00	0.00	0.00	0.00	(385,851,402.07)
Result of the year 2005	0.00	0.00	0.00	0.00	50,731,141.62	50,731,141.62
<b>Balance as of 31.12.2005</b>	<b>753,206,818.42</b>	<b>416,678.61</b>	<b>46,565,266.11</b>	<b>473,032,495.02</b>	<b>50,731,141.62</b>	<b>1,323,952,399.78</b>
Fair value adjustment – AFS reserve	0.00	0.00	(31,910,531.51)	0.00	0.00	(31,910,531.51)
Fair value reserve	0.00	(74,851.35)	0.00	0.00	0.00	(74,851.35)
Payment from the European Union	34,910,000.00	0.00	0.00	0.00	0.00	34,910,000.00
Allocation of the Economic result of the year 2005	0.00	0.00	0.00	50,731,141.62	(50,731,141.62)	0.00
Result of the year 2006	0.00	0.00	0.00	0.00	52,077,425.59	52,077,425.59
<b>Balance as of 31.12.2006</b>	<b>788,116,818.42</b>	<b>341,827.26</b>	<b>14,654,734.60</b>	<b>523,763,636.64</b>	<b>52,077,425.59</b>	<b>1,378,954,442.51</b>

### 3.3 Cash Flow Statement as at 31 December 2006

	Year to 2006 EUR	Year to 2005 EUR
<b>Investing activities</b>		
Interest received (current accounts, deposits, commercial	11,443,127.48	6,280,520.69
Management fee paid during the year	(702,497.47)	(765,497.93)
Bank charges paid during the year	(169,705.07)	(147,028.71)
Purchase of investments - AFS portfolio	(115,177,650.00)	(79,777,150.00)
Proceeds of investments - AFS portfolio	148,625,000.00	137,389,940.00
Interest received - AFS bond portfolio	44,781,061.69	48,997,994.99
<b><i>Net Cash Flows from investing activities</i></b>	<b><i>88,799,336.63</i></b>	<b><i>111,978,779.04</i></b>
<b>Financing activities</b>		
Capital payment from European Union	34,910,000.00	0.00
Capital repaid to European Union	0.00	(385,851,402.07)
Repayments of financial liabilities	0.00	0.00
Proceeds of financial liabilities	0.00	0.00
Extraordinary items	0.00	0.00
<b><i>Net Cash Flows from financing activities</i></b>	<b><i>34,910,000.00</i></b>	<b><i>(385,851,402.07)</i></b>
Net increase/(decrease) in cash and cash equivalents	123,709,336.63	(273,872,623.03)
<b><i>Cash and cash equivalents at beginning of financial year</i></b>	<b><i>316,024,023.23</i></b>	<b><i>589,896,646.26</i></b>
<b><i>Cash and cash equivalents at end of financial year</i></b>	<b><i>439,733,359.86</i></b>	<b><i>316,024,023.23</i></b>

## 4. NOTES TO THE FINANCIAL STATEMENTS

### 4.1 General disclosures

The rules and principles for the management of the Fund are laid out in the Convention between the European Commission (the “Commission”) and the European Investment Bank (the “EIB”) dated 25 November 1994 and the subsequent amendments dated 17/23 September 1996 and 8 May 2002.

The main principles of the Fund, as extracted directly from the Convention, are as follows:

- The Fund will operate in one single currency being Euro (EUR). It will exclusively invest in this currency in order to avoid any exchange rate risk.
- Management of the Fund will be based upon the traditional rules of prudence adhered to for financial activities. It will have to pay particular attention to reducing the risks and to ensuring that the managed assets have a sufficient degree of liquidity and transferability, taking into account the commitments to which the Fund will have.
- The Fund will be able to use all the hedging instruments against the market and interest risks, already used by the Portfolio Division of the EIB.
- The portfolio management will be based on the optimal duration and on the best possible allocation between short term and long term, in order to draw a real advantage from the rates curve. In order to be able to quickly modify the duration of the portfolio according to the forecast of the future conditions of the market, the promoter will use, with the exclusive aim of hedging, the instruments available on the market for which the EIB already has the necessary experience.

### 4.2 Significant accounting policies

#### 4.2.1 *Basis of preparation*

The Fund’s financial statements have been prepared in accordance with the accounting rules adopted by the Accounting Officer of the European Commission, in particular “Accounting rule 11<sup>1</sup> – Financial assets and liabilities”, dated December 2004 and updated in October 2006.

#### 4.2.2 *Significant accounting and judgments and estimates*

The preparation of financial statements in conformity with the accounting rules adopted by the Accounting Officer of the European Commission requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Fund’s accounting policies. The area involving a higher degree of

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<sup>1</sup> This is based on the revised standards IAS 32 and 39 as issued by the IASB on 18 December 2003 and consequently, does not integrate the carved out provisions as set out in the version of IAS 39 endorsed by the European Commission on 19 November 2004.

judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed.

The most significant use of judgments and estimates are as follows:

- Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgments include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives.

- Impairment losses on financial instruments

The Fund reviews its problem at each reporting date to assess whether an allowance for impairment should be recorded in the economic outturn account. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required.

The Fund shall assess at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply different rules, depending on whether the financial assets is carried at amortised cost or classified as available-for-sale, to determine the amount of any impairment loss.

#### 4.2.3 *Summary of significant accounting policies*

##### 4.2.3.1 Foreign currency translation

These financial statements are presented in Euro (EUR), which is also the Fund's functional and presentational currency.

Monetary assets and liabilities denominated in currencies other than in Euro are translated into Euro at the exchange rate prevailing at the balance sheet date. The gain or loss arising from such translation is recorded in the economic outturn account.

The elements of the economic outturn account are translated into Euro on the basis of the exchange rates prevailing at the end of each month

##### 4.2.3.2 Cash and cash equivalents

The Fund defines cash equivalents as current accounts or short-term deposits with original maturities of three months or less.

##### 4.2.3.3 Short-term investments

The bond portfolio, seen as a short-term investment portfolio, is made up of euro-denominated securities. These securities are classified as Available For Sale (AFS)

according to the accounting rules adopted by the Accounting Officer of the European Commission and consequently, are carried out at their fair value through equity. Unrealised gains or losses are reported in reserves until such security is sold, collected or otherwise disposed of, or until such security is determined to be impaired. If an available for sale security is determined to be impaired, the cumulative unrealised gain or loss previously recognised in own funds is included in economic outturn account for the year. Quoted securities are considered impaired if the decline in market price below cost is of such a magnitude that recovery of the cost value cannot be reasonably expected within the foreseeable future.

On disposal of an available for sale security, the accumulated unrealised gain or loss included in equity is transferred to the economic outturn account for the year. Interest income on available-for-sale securities is included in “interest income”.

The determination of fair values of available for sale investments is generally based on quoted market rates in active markets.

These securities are initially measured at their acquisition cost, being their fair value at this moment. The difference between the entry price and the redemption value, i.e. the premium/discount spread, is amortised over the remaining life of each of the securities using the effective interest rate method as specified under Accounting Rule 11.

The Fund treats available-for-sale financial assets as impaired when a decline in the fair value of an available-for-sale asset has been recognised directly in equity and there is objective evidence that the asset is impaired. A financial asset is impaired when its carrying amount is greater than its estimated recoverable amount. The amount of the cumulative loss that is removed from equity and recognised in profit and loss shall be the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit and loss. If in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit and loss, the impairment loss shall be reversed, with the amount of the reversal recognised in profit and loss.

Evidence of impairment is mainly about significant financial difficulties of the issuer, a breach of contract, a restructuring of the debt of the issuer, a high probability of bankruptcy. It is important to stress that the disappearance of an active market because an entity’s financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity’s credit rating is not, in itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment.

#### 4.2.3.4 Taxation

The Protocol on the Privileges and Immunities of the European Union, appended to the Treaty of 8 April 1965 establishing a Single Council and a Single Commission of the European Communities, stipulates that the assets, revenues and other property of the Institutions of the Union are exempt from all direct taxes.



#### 4.2.3.5 Capital

Capital is composed of contributions received from the budget of the European Union and is recognized in the balance sheet on the date when payment of a contribution is received.

### 4.3 Financial Risk Management

#### 4.3.1 *Interest Rate and Liquidity Risks*

- Interest rate risk position

Theoretically, hedging instruments could be used to manage the interest rate (market) risk. However as agreed between the Commission and the EIB, no significant risk is currently taken and therefore hedging is not performed.

As the transactions and operations are only denominated in Euro, no other hedging is required.

The distribution of the Fund's holdings at 31 December 2006 (market value excluding accrued interest) is detailed in the table below:

Segments	Fixed rate investments			Variable rate securities EUR	TOTAL EUR
	Less than 3 months EUR	3 months to 1 year EUR	1 to 10 years EUR		
accounts	1,158,007.44	0.00	0.00	0.00	1,158,007.44
Short term deposits - nominal	436,500,000.00	0.00	0.00	0.00	436,500,000.00
AFS portfolio	56,535,900.00	51,292,050.00	732,804,128.15	76,355,536.00	916,987,614.15
<b>TOTAL</b>	<b>494,193,907.44</b>	<b>51,292,050.00</b>	<b>732,804,128.15</b>	<b>76,355,536.00</b>	<b>1,354,645,621.59</b>
<i>Percentage</i>	<b>36.48%</b>	<b>3.79%</b>	<b>54.09%</b>	<b>5.64%</b>	<b>100.00%</b>

The distribution of the Fund's holdings at 31 December 2005 (market value excluding accrued interest) is detailed in the table below:

Segments	Fixed rate investments			Variable rate securities EUR	TOTAL EUR
	Less than 3 months EUR	3 months to 1 year EUR	1 to 10 years EUR		
accounts	1,582,089.98	0.00	0.00	0.00	1,582,089.98
Short term deposits - nominal	313,500,000.00	0.00	0.00	0.00	313,500,000.00
AFS portfolio	25,564,200.00	83,102,060.00	791,230,957.00	84,470,004.00	984,367,221.00
<b>TOTAL</b>	<b>340,646,289.98</b>	<b>83,102,060.00</b>	<b>791,230,957.00</b>	<b>84,470,003.00</b>	<b>1,299,449,310.98</b>
<i>Percentage</i>	<b>26.21%</b>	<b>6.40%</b>	<b>60.89%</b>	<b>6.50%</b>	<b>100.00%</b>

At 31 December 2006, for the Cash and Cash equivalents (fixed term deposits), the effective interest rate range is between 3.39% and 3.63%. For the Available For Sale (AFS) securities portfolio, the effective interest rate range is between 2.94% and 5.52%.

- Liquidity position

The table below provides an analysis of certain assets, liabilities and equity into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date.

Those assets and liabilities that do not have a contractual maturity date are grouped together in the “Maturity undefined” category.

<b>Maturity</b>	<b>Less than 3 months</b>	<b>3 months to 1 year</b>	<b>1 to 10 years</b>	<b>Maturity undefined</b>	<b>TOTAL</b>
<b><u>Assets in EUR</u></b>					
Current accounts	1,158,007.44	0.00	0.00	0.00	<b>1,158,007.44</b>
Short term deposits	438,575,352.42	0.00	0.00	0.00	<b>438,575,352.42</b>
<i>Of which: accrued interests</i>	<i>2,075,352.42</i>	<i>0.00</i>	<i>0.00</i>	<i>0.00</i>	<i>2,075,352.42</i>
AFS portfolio	65,188,628.94	65,616,038.84	800,919,596.25	8,240,068.00	<b>939,964,332.03</b>
<i>Of which: accrued interests</i>	<i>8,652,728.94</i>	<i>14,323,988.94</i>	<i>0.00</i>	<i>0.00</i>	<i>22,976,717.88</i>
<b>TOTAL</b>	<b>504,921,988.80</b>	<b>65,616,038.84</b>	<b>800,919,596.25</b>	<b>8,240,068.00</b>	<b>1,379,697,691.89</b>
<b><u>Liabilities in EUR</u></b>					
Equity	0.00	0.00	0.00	1,378,954,442.51	<b>1,378,954,442.51</b>
Account payable	743,249.38	0.00	0.00	0.00	<b>743,249.38</b>
<b>TOTAL</b>	<b>743,249.38</b>	<b>0</b>	<b>0</b>	<b>1,378,954,442.51</b>	<b>1,379,697,691.89</b>

<b>Net liquidity position at 31.12.2006</b>	<b>504,178,739.42</b>	<b>65,616,038.84</b>	<b>800,919,596.25</b>	<b>(1,370,714,374.51)</b>	<b>0.00</b>
<b>Cumulative liquidity position at 31.12.2006</b>	<b>504,178,739.42</b>	<b>569,794,778.26</b>	<b>1,370,714,374.51</b>	<b>0.00</b>	
Net liquidity position at 31.12.2005	347,324,331.08	100,927,108.11	791,230,956.75	(1,239,482,395.94)	0.00
Cumulative liquidity position at 31.12.2005	347,324,331.08	448,251,439.19	1,239,482,395.94	0.00	

#### 4.3.2 Credit Risk

- Fixed Term Deposits - Profile of counterparties

In accordance with the agreement between the Community and the EIB on the management of the Fund, all the interbank investments should have a minimum credit rating of A1. Short-term interbank investments, including accrued interests, by type of counterparty at 31 December 2006 is as follows:

Rating	31.12.2006		31.12.2005	
	EUR		EUR	
A1	171,276,161.81	39.05%	74,203,179.16	23.60%
A2	0.00	0.00%	30,104,815.55	9.57%
Aa1	44,158,408.19	10.07%	28,093,133.33	8.93%
Aa2	56,470,517.56	12.88%	37,110,996.11	11.80%
Aa3	166,670,264.86	38.00%	144,929,809.10	46.10%
<b>Total</b>	<b>438,575,352.42</b>	<b>100.00%</b>	<b>314,441,933.25</b>	<b>100.00%</b>

- Available for Sale portfolio - Profile of issuers

All the securities held meet the following criteria:

- Either they are issued by States in, or by institutions guaranteed by, the European Union, the G10 or supranational bodies;
- Or they are issued by another sovereign State with a rating of at least AA3;
- Or they are issued by another issuer with a rating of AAA.

The profile of issuers, market value excluding accrued interests, at 31 December 2006 is as follows:

Issuer	31.12.2006		31.12.2005	
	EUR		EUR	
Other issuers Aaa	361,416,852.40	39.42%	322,068,453.18	32.72%
Supra Aaa	15,443,045.25	1.68%	16,279,007.63	1.65%
Govt./Agencies Aaa	224,469,794.40	24.49%	248,536,575.26	25.25%
Govt./Agencies Aa1	58,089,620.00	6.33%	133,813,520.39	13.59%
Govt./Agencies Aa2	0.00	0.00%	100,525,979.68	10.21%
Govt./Agencies Aa3	66,610,240.00	7.26%	0.00	0.00%
Govt./Agencies A1	49,208,982.10	5.37%	137,672,642.02	13.99%
Govt./Agencies A2	121,701,580.00	13.27%	15,014,542.84	1.53%
Govt./Agencies A3	10,297,000.00	1.12%	0.00	0.00%
Govt./Agencies Baa1	9,750,500.00	1.06%	0.00	0.00%
Govt./Agencies NR	0.00	0.00%	10,456,500.00	1.06%
<b>Total</b>	<b>916,987,614.15</b>	<b>100.00%</b>	<b>984,367,221.00</b>	<b>100.00%</b>

#### 4.4 Short-term Investments – Available For Sale Assets

The following table shows the situation of the Available For Sale Assets during 2006:

	EUR
<b>Amount at 1 January 2006</b>	<b>1,008,639,934.02</b>
Acquisitions	115,177,650.00
Disposals and withdrawals (original acquisition cost)	(152,208,860.00)
Transfer between headings	0.00
Exchange differences	0.00
Change in carrying amount (actuarial difference & change of accrual amount)	266,139.52
Revaluation surplus/(deficit) fair value adjustment transfer to equity	(31,910,531.51)
Impairment loss	0.00
<b>Amount at 31 December 2006</b>	<b>939,964,332.03</b>

At 31 December 2006, the nominal value of the investment portfolio was EUR 899.2 million, against a market value of EUR 917.0 million, without accrued interests.

Two bonds held in the portfolio are issued by the European Community through the financial instrument “Macro-financial Assistance”. The position of these bond holdings at 31.12.2006 are as follows:

- ISIN XS0080177941 Market Value EUR 1,997,388; accrued interest EUR 18,517.57
- ISIN XS0083965748 Market Value EUR 6,242,680; accrued interest EUR 81,051.95

The accrued interests at 31 December 2006 amounting to EUR 22,976,717.88 (2005: EUR 24,272,713.02) are split between:

- Fixed rate notes EUR 22,485,430.44 (2005: EUR 23,990,107.52)
- Floating rate notes EUR 491,287.44 (2005: EUR 282,605.50)

#### 4.5 Cash and Cash Equivalents

The following table shows the split of the cash and cash equivalents:

<i>Description</i>	<b>31.12.2006</b> EUR	<b>31.12.2005</b> EUR
<i>Unrestricted Cash</i>		
A. Amounts with Treasuries	0.00	0.00
B. Accounts with Central Banks	0.00	0.00
C. Current Accounts	1,158,007.44	1,582,089.98
D. Imprest Accounts	0.00	0.00
E. Short-term Deposits	438,575,352.42	314,441,933.25
F. Cash in Hand	0.00	0.00
G. Transfers (Cash in transit)	0.00	0.00
H. Other Cash Equivalents (Commercial Papers <3 months)	0.00	0.00
I. Funds in transit at year end	0.00	0.00
<b>Total</b>	<b>439,733,359.86</b>	<b>316,024,023.23</b>

#### 4.6 Current Liabilities

<i>Description</i>	<b>31.12.2006</b> <b>EUR</b>	<b>31.12.2005</b> <b>EUR</b>
<i>Accounts Payable</i>		
Management fees	714,719.38	702,497.47
Other	28,530.00	9,060.00
<b>Total</b>	<b>743,249.38</b>	<b>711,557.47</b>

Management fees are payable to the EIB (hereafter referred to as the management fees) on an annual basis. The management fees are calculated as a percentage per annum of the average of Fund's assets. This percentage is a declining rate depending on the Fund's assets.

#### 4.7 Financial operations revenues

	<b>2006</b> <b>EUR</b>	<b>2005</b> <b>EUR</b>
Total amount, thereof:	52,981,320.04	51,589,727.80
Interest income, thereof:	52,981,320.04	50,439,477.94
Interest income from short-term investments and cash and cash equivalents	52,981,320.04	50,439,477.94
Other financial income, thereof:	0.00	1,150,249.86
Realized gain on sale of financial (current & non-current) assets	0.00	1,150,249.86



#### 4.8 Financial operations expenses

	2006 EUR	2005 EUR
Total amount, thereof:	(903,894.45)	(858,586.18)
Other financial expenses, thereof:	(903,894.45)	(858,586.18)
Realized loss on sale of financial (current and non-current) assets	0.00	0.00
Impairment losses on financial (current and non-current) assets	0.00	0.00

#### 4.9 Subsequent events

There have been no material post-balance sheet events, which would require disclosure or adjustment to the 31 December 2006 financial statements.