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**REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT, THE COUNCIL
AND THE COURT OF AUDITORS**

**Annual report from the Commission
on the Guarantee Fund and the management thereof in 2009**

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1. LEGAL BASIS

Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009¹ (codified version) established a Guarantee Fund for external actions ('the Fund') in order to repay the Union's creditors in the event of default by beneficiaries of loans granted or guaranteed by the European Union. In accordance with Article 7 of the Regulation, the Commission entrusted the financial management of the Fund to the European Investment Bank (EIB) under an Agreement signed between the Community and the EIB on 23 November 1994 in Brussels and on 25 November 1994 in Luxembourg ('the Agreement').

Under Article 8(2) of the Agreement, by 1 March of each year the EIB must send the Commission an annual status report on the Fund and the management thereof ('Statement of financial performance') and a financial statement for the Fund for the preceding year ('Statement of financial position of the Fund'). Further details of the report covering the year 2009 can be found in Section 2 of the Commission Staff Working Document.

In addition, Article 8 of the Regulation requires the Commission to send a report to the European Parliament, the Council and the Court of Auditors on the situation of the Fund and the management thereof for each financial year by 31 May of the following year.

2. POSITION OF THE FUND AT 31 DECEMBER 2009

2.1. Financial flows of the Fund (resources of the Fund)

The position of the Fund is presented in accordance with International Financial Reporting Standards (IFRS) at the close of the 2009 financial year.

The Fund totalled EUR 1 240 497 760.63 (see Section 2 of the Staff Working Document: Statement of financial position of the Fund at 31 December 2009, as provided by the EIB). This is the sum of the flows since the Fund was established:

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

Guarantee Fund	Amount
Budget payments to the Fund	+ EUR 2 891 874 500.00
Successive yearly net results	+ EUR 717 683 872.56
Recoveries of payments made by the Fund for defaults	+ EUR 576 705 008.19
Accrued ² EIB management and audit fees in 2008 corresponding to the payments to be made in 2009	+ EUR 717 539.60
Commission received on late recovery in 2002	+ EUR 5 090 662.91
Adjustment due to application of the IFRS for the valuation of the Fund's portfolio (See item 'Reserves' in the liabilities on the Guarantee Fund balance sheet in Section 2 of the SWD)	+ EUR 27 678 560.35
Minus calls on the Fund's resources	- EUR 477 860 856.19
Minus successive repayments of the surplus in the Fund to the general budget of the European Union and repayments following accession of candidate countries to the EU	- EUR 2 501 391 526.79
Accounting value of the Fund at 31 December 2009	EUR 1 240 497 760.63

Under Article 5 of the Fund Regulation, the amount to be transferred from the budget to the Fund in year n + 1 is calculated on the basis of the difference between the target amount and the value of the Fund's net assets at the end of year n - 1, calculated at the beginning of year n.

The Fund's net assets (i.e. the Fund's net cash resources) at 31 December 2009 totalled EUR 1 333 590 221.03. This is the sum of the accounting value of the Fund, i.e. EUR 1 240 497 760.63, minus accrued EIB and audit fees of EUR 717 539.60, of which EUR 687 539.60 were management fees (2009 EIB remuneration) and the transfer from the budget of EUR 93 810 000.00, as established in 2009 for the 2010 budget³.

² This amount of EUR 717 539.60 includes EUR 687 539.60 for EIB management fees plus external audit fees of EUR 30 000.00 in 2009 (see Section 3.7, 'Current liabilities', in the SWD).

³ The amount of EUR 93 810 000.00 was paid to the Fund on 10 February 2010 from the general budget of the European Union.

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

Outstanding lending and loan guarantee operations for third countries plus accrued interest totalled EUR 16360727665.19 at 31 December 2009, of which EUR 121760043.39 was accrued interest. The ratio between the Fund's net assets of EUR 1333590221.03 and the outstanding capital liabilities referred to in the Regulation was 8.15%. Since this is lower than the target amount of 9% of the total guaranteed outstanding amount (rounded to EUR 1472470000.00), a transfer has to be made from the general budget of the European Union to the Fund, as provided for in Article 5 of the Regulation. The amount to be included in 2010 as provisioning in the preliminary draft budget for 2011 is EUR 138880000.00.

2.2. Presentation of the accounts

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

2.3. Pre-consolidated financial statement for the Guarantee Fund at 31 December 2009

The total amount indicated in the pre-consolidated balance sheet is EUR 1091447384.92. This includes the total amount of the Fund plus any arrears covered by the Fund, the interest accrued on late payments and other accounting accruals and thus produces a full set of financial statements for the Fund at the end of the year to be consolidated in the EU consolidated balance sheet.

The major changes in the presentation of accounts are explained in the notes and reconcile the figures with the EIB financial statement presented in the SWD (see Section 2).

⁴ The amended 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.

2.3.1. *Guarantee Fund: Pre-consolidated balance sheet*

<u>Balance sheet: Assets (EUR)</u>	2009	2008
Current assets		
Short-term receivables		
Others	3 626.09	
Short-term investments	1 049 413 319.19	886 949 667.40
AFS portfolio — cost	1 004 786 115.50	857 292 051.50
AFS portfolio — actuarial difference	-3 096 484 .22	-633 286.00
AFS portfolio — adjustment to fair value	27 525 747.60	11 509 579.98
AFS portfolio — accruals	20 197 940.31	18 781 321.92
AFS portfolio — impairment		
Cash and cash equivalents	191 080 815.35	204 497 717.52
Current accounts	1 078 498.12	1 209 530.44
Short-term deposits — nominal	153 300 000.00	182 557 991.00
Accrued interest on short-term deposits	113 282.91	872 562.49
Other cash equivalents — cost	36 554 203.91	19 842 008.01
Accrued interest on other cash equivalents	34 830.41	15 625.58
Total current assets	1 240 497 760.63	1 091 447 384.92
TOTAL	1 240 497 760.63	1 091 447 384.92

<u>Balance sheet: Liabilities (EUR)</u>	2009	2008
A. EQUITY		
Capital (Guarantee Fund)	390 482 973.21	298 522 973.21
<i>Payment from the budget</i>	390 482 973.21	298 522 973.21
<i>(surplus to be paid to the budget)</i>		
Reserves	27 678 560.35	11 565 625.28
First-time application — fair value reserve	152 812.75	56 045.30
Change in fair value of AFS assets	27 525 747.60	11 509 579.98
Accumulated surplus/deficit	780 668 814.11	732 583 019.02
Results brought forward	780 668 814.11	732 583 019.02
Economic result of the year	80 949 873.36	48 085 795.09
Total equity	1 239 780 221.03	1 090 757 412.60
B. CURRENT LIABILITIES		
Accounts payables	717 539.60	689 972.32
Others	717 539.60	689 972.32
Total current liabilities	717 539.60	689 972.32
TOTAL	1 240 497 760.63	1 091 447 384.92

Notes on the balance sheet:

- ‘Short-term receivables/others’ means the amount of calls on the Fund. This includes the capital, interest and penalties due to the budget of the European Union following release of the Fund guarantee.
- The difference in ‘accumulated surplus’ in equity compared with the financial position of the Fund presented in Section 2 of the SWD is explained by the successive repayments of calls and penalties to the Fund.
- ‘Accounts payables/others’ in 2009 include the EIB management commission, audit fees, accrual of closing accounts audit fees and accrual of the recovery fees due to the EIB following payment of the penalty fees due to the Fund.

2.3.2. *Guarantee Fund: Pre-consolidated economic outturn account*

Guarantee Fund — Consolidated economic outturn account (EUR)	2009	2008
Financial operations revenue	41 753 692.10	48 907 685.22
Interest income		
Interest income on cash and cash equivalents	3 496 637.06	8 095 172.09
Interest income on AFS assets	38 180 007.32	39 622 151.89
Other interest income	77 047.72	
Exchange gains		105 124.43
Realised gains on sale of AFS assets		1 085 236.81
Reversal of impairment losses on AFS assets		
Other financial income		
Financial operations expenses	-803 818.74	-821 890.13
Interest charges		
Interest charges on cash and cash equivalents		
Exchange losses		
Realised losses on sale of AFS assets		
Impairment losses on AFS assets		
Other financial charges	-803 818.74	-821 890.13
of which: Management fees	-687 539.60	-658 322.32
SURPLUS FROM NON-OPERATING ACTIVITIES	40 949 873.36	48 085 795.09
SURPLUS FROM ORDINARY ACTIVITIES		
Extraordinary gains		
Extraordinary losses		
SURPLUS FROM EXTRAORDINARY ITEMS		
ECONOMIC RESULT OF THE YEAR	40 949 873.36	48 085 795.09

Note on the pre-consolidated economic outturn account:

‘Other financial charges’ include the EIB management commission, audit fees, accrual of closing accounts 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

3.1. Legal basis for payments to the Fund from the general budget

The Fund Regulation was amended in 2007⁵ to ensure more efficient use of budgetary resources by provisioning the Fund on the basis of the observed amounts of guaranteed loans outstanding.

In line with the amended Regulation, a new rule applies to provisioning of the Fund. 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.

Under the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management⁶, the amount available for financing the Fund is provided from budget line 01040114 ‘Provisioning of the Guarantee Fund’ under Heading 4 (External Relations) and not ‘off budget’ as was the case before 2007.

3.2. Payments to or from the general budget in the course of the financial year

On the basis of outstanding guaranteed operations of EUR 16 360.73 million as at 31.12.2008, an amount of EUR 93.81 million, corresponding to the 2008 provisioning, was inserted in budget line 01040114 ‘Provisioning of the Guarantee Fund’ for 2009 in the statement of expenditure in the general budget of the European Union for 2010. This amount was paid in one transaction from the budget to the Fund on 10 February 2010.

3.3. Interest from investment of the Fund’s liquid assets

The Fund’s liquid assets are invested in accordance with the management principles laid down in the Annex to the Community/EIB Agreement of 23/25 November 1994, as amended by Supplementary Agreement No 1 of 17/23 September 1996, Supplementary Agreement No 2 of 26 April/8 May 2002 and Supplementary Agreement No 3 of 25 February 2008. Accordingly, 20% of the Fund must be invested in short-term investments (up to one year). These investments include variable-rate securities, irrespective of their maturity dates, and fixed-rate securities with a maximum of one year remaining to maturity, irrespective of their initial maturity period. This is because fixed-rate securities are reimbursable at 100% of their nominal value at the end of their life, while variable-rate securities can usually be sold at any time at a price close to 100%, whatever their remaining period to maturity. To maintain a

⁵ 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.

⁶ OJ C 139, 14.6.2006, p. 1.

balance between the various instruments providing the required liquidity, a minimum of EUR 100 000 000.00 is kept in monetary investments, particularly bank deposits.

In 2009 the portfolio yielded a total return of 4.56 %, against 6.42 % in 2008.

The accounting results were strongly affected by the very low levels of absolute interest rates, which reduced the level of financial income. Market conditions in 2009 slowly improved compared with 2008, helped by the combination of the various rescue packages, government intervention and central bank measures which kept interest rates low and liquidity abundant. The portfolio outperformed the benchmark by 77.80 basis points (see Section 1.4.2. of the SWD 'Performance' for details). During the first half of 2009, the Fund's performance totalled 0.1587 basis points due to a volatile market environment. The Fund's performance accelerated during the second half up to December. This significant increase was mainly due to higher asset prices resulting from a tightening of credit spreads, generating a positive impact on the return on the securities portfolio.

The list of banks authorised to receive deposits is agreed by the Commission and the EIB. The original list has been regularly revised in the light of the latest changes in bank ratings. The banks all 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.

In 2009, interest income on cash and cash equivalents, on the Fund's current accounts and on securities totalled EUR 41 753 692.10, broken down as follows:

- From deposits and current accounts: EUR 3 496 637.06; this reflects the situation at 31 December 2009, including interest received on bank deposits of EUR 4 206 817.81 and changes in accrued interest of -EUR 740 074.75 in 2009. Current accounts raised EUR 29 894.00 from interest.
- From securities: EUR 38 180 007.32; this includes EUR 36 922 145.60 of interest on securities and changes in accrued interest of +EUR 1 416 618.39 at 31 December 2009. The interest on securities is generated by investments placed in the form of securities in accordance with the investment principles laid down in the Agreement giving the EIB the mandate to manage the Fund's liquid assets. Of this amount, an adjustment of -EUR 158 756.67 must be made from the securities entered in the course of the year as the difference between the entry price and the redemption value divided *pro rata temporis* over the remaining life of the securities held (corresponding to the spread of the premium or discount entered in the profit-and-loss account).

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

3.4. Recovery from defaulting debtors

The Fund has no amount to be recovered.

4. THE FUND'S LIABILITIES

4.1. Default payments

The Fund was not called on for default payments in 2009.

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 2009 was set at EUR 687 539.60 and was entered in the profit-and-loss account and as accruals (liabilities) on the balance sheet. The remuneration was paid from the Fund to the EIB in January 2010.