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COMMISSION STAFF WORKING PAPER

Annex to the

REPORT FROM THE COMMISSION

**Annual Report from the Commission
on the Guarantee Fund and its Management in 2004**

{COM(2005)262 final}

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1. LEGAL BASES FOR PAYMENTS TO THE GUARANTEE FUND FROM THE GENERAL BUDGET

In line with Regulation No 2728/94, the provisioning of the Fund follows different rules according to the type of operation covered. In the case of EIB loans, the provisioning of the Fund currently 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 can be 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, i.e. on an individual basis. This procedure is also applied even if the loan is paid out in several tranches over a period of more than one year.

Two transfers were made from the guarantee reserve under this procedure in 2004.

1.1. Decisions covered by Transfer DEC34/2004

- 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 29 April 2004 (2004/580/EC) providing macro-financial assistance to Albania and repealing Decision 1999/282/EC (OJ L 261, 06.08.2004, p.116). The loan component of the assistance amounts to EUR 9 million.

1.2. Decision covered by Transfer DEC35/2004

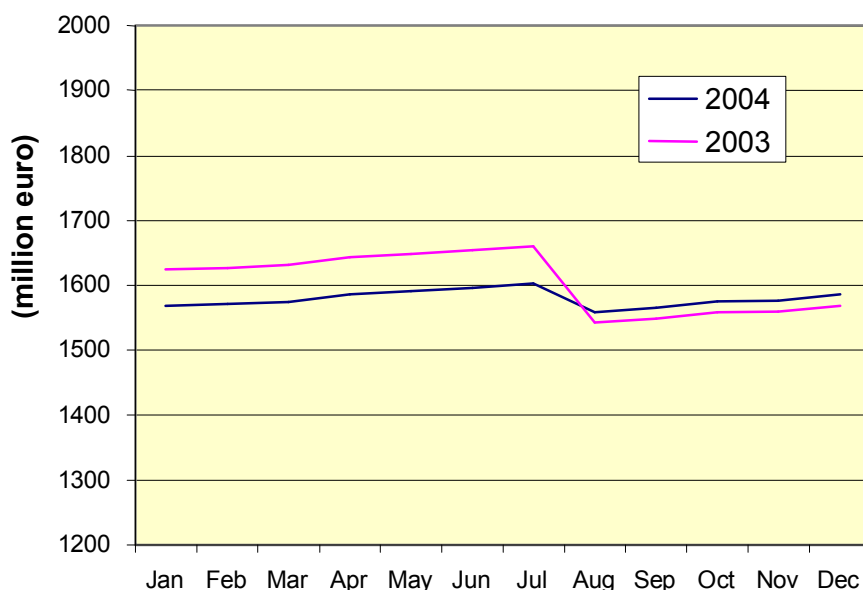
- Commission Decision C(2004) 891/2 of 30 March 2004 granting a Euratom loan for the completion of unit 2 of the Cernavodă nuclear power plant. The amount of the loan is EUR 223.5 million.

2. GUARANTEE FUND - MANAGEMENT REPORT AT 31 DECEMBER 2004¹

2.1. Development of the Fund in 2004

The total book value² of the Fund's holdings stood at EUR 1,586.0 million at 31 December 2004 as against EUR 1,568.5 million at 31 December 2003, an increase of EUR 17.5 million.

Figure 1: Development of holdings in 2004



2.2. The Fund had a surplus of EUR 223.16 million at 31 December 2003. Subsequently, an allocation of EUR 181.875 million was entered on 10 August 2004 by paying the Commission the difference, EUR 41.285 million. Total provisioning to 31 December 2004 amounted to EUR 181.875 million (EUR 161.76 million plus EUR 20.115 million, see section 3.1 in the main Report).

2.3. 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 58.2 million at 31 December 2004 compared with EUR 63.0 million at 31 December 2003. Bond portfolio income (net of the premium / discount spread) amounted to EUR 48.2 million, representing 83% of the income recorded at 31 December 2004. Money market portfolio income amounted to EUR 11.0 million, or 19% of the total result (see section 3), the rest (-2%) being commission and financial charges.

¹ Report prepared by the EIB.

² Total assets less other assets (see section 3).

2.2. Situation of the Fund

2.2.1. The Fund's resources at 31 December 2004

The Guarantee Fund balance decreased by EUR 38.2 million, or 3.2% from EUR 1,177.3 million at 31 December 2003 to EUR 1,139.1 at 31 December 2004.

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

Resources	Situation at 31.12.2003	Movements in 2004	Situation at 31.12.2004
Provisioning	2,355,380,162.91	181,875,000.00	2,537,255,162.91
Repayment of surplus	-1,272,850,000.00	-223,160,000.00	-1,496,010,000.00
Activation of guarantee	-473,490,274.02	-4,370,582.17	-477,860,856.19
Recovery of amounts guaranteed	568,217,579.44	7,456,334.33	575,673,913.77
Balance	1,177,257,468.33	-38,199,247.84	1,139,058,220.49

Guarantee payments by the Fund during 2004 amounted to EUR 4.4 million. Recovery of funds from Argentina during 2004 amounted to EUR 7.5 million.

2.2.2. The Fund's assets at 31 December 2004

The Fund's holdings at 31 December 2004 totalled EUR 1,586.0 million as detailed below. The Fund operates in one currency only, the euro.

- EUR 550.5 million in the monetary portfolio (interbank term deposits)
- EUR 8.8 million in the current accounts
- EUR 1,026.7 million in the investment portfolio (the book value of fixed rate and variable rate securities, see table in section 2.3.1).

2.3. General and segmental analysis of the Guarantee Fund

2.3.1. Liquidity analysis

The distribution of the Guarantee Fund's holdings at 31 December 2004 (book value) was as follows:

Segments	Fixed rate investments			Variable rate	TOTAL
	Less than 3 months	3 months to 1 year	1 to 10 years	Securities	
Current accounts	8,790,146.69				8,790,146.69
Fixed term deposits	550,500,000.00				550,500,000.00
Securities portfolio	48,514,426.47	87,691,252.91	815,770,869.27	74,749,234.19	1,026,725,782.84
TOTAL	607,804,573.16	87,691,252.91	815,770,869.27	74,749,234.19	1,586,015,929.53
Percentage	38.32%	5.53%	51.44%	4.71%	100.00%

2.3.2. General analysis of the results of the Fund

Overall, the Guarantee Fund produced EUR 58.2 million in net revenue, an overall average yield of 3.63%³ on average capital of EUR 1,577 million.

The 3-month Euribid reference rate stood at 1.98%⁴ over the same period, giving an overall positive spread of 165 basis points above the reference benchmark (cf. 2.4.1).

Investment income at 31 December 2004 was as follows:

	January – December 2004 (in EUR million)
Interest on interbank term deposits	10.9
Interest on securities	51.0
Interest on current accounts	0.1
Premium / discount spread	(2.8)
Commission and financial charges	(1.0)
Total	58.2

2.4. Analysis by segment

2.4.1. Analysis of money markets operations

The average yield on money-market investments at 31 December 2004 stood at 2.07%, compared with a benchmark average yield of 1.99%.

The spread calculated this way is 8 basis points above the 3-month Euribid variable reference rates⁵ for 2004, as against a spread of 18 basis points in 2003. This spread does not reflect the margin obtained at the beginning of operations, and this margin is not taken into consideration when calculating yield.

³ The basis for calculating the overall yield is act/360.

⁴ 1.98% is a linear mean of the 3-month Euribid since the beginning of the year.

⁵ The treasury spread measures the difference between the actual interbank investment rate obtained and the benchmark variable, which is the 3-month Euribid rate for that day.

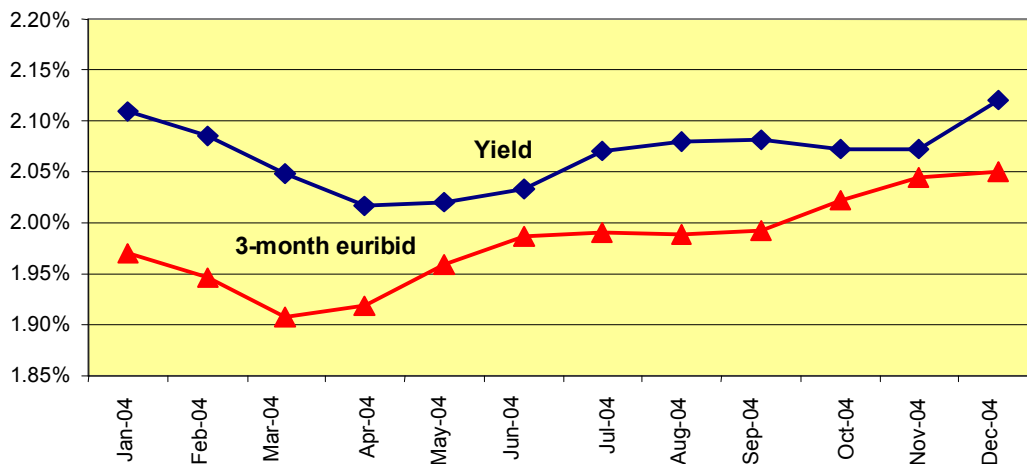
PERIOD	YIELD	3-MONTH EURIBID REFERENCE	SPREAD (basis points)
January – December 2004	2.07 %	1.99% ⁶	8

Interbank investments at 31 December 2004 produced EUR 11.0 million in interest on capital averaging EUR 546.9 million.

Changes in yield and reference rates in 2004

The table below shows the rates obtained for short-term money-market investments as compared with the 3-month Euribid reference rate.

Figure 2: Yield in relation to the benchmark rate



The methodology used to calculate yield involves comparing the yield of (usually 3-month) monetary investments with the daily average of the 3 month LIBID rate. This means that the benchmark tracks the average movement of the 3 month LIBID rate on a daily basis, while the investments recorded in Buy and Hold do not reflect it until later. This produces a mechanical effect which makes itself felt as follows:

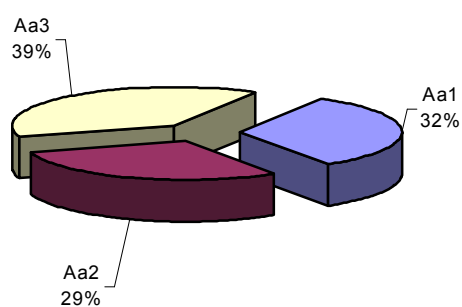
- In a context of falling short-term interest rates, the monetary portfolio broadly outperforms the benchmark (Fig. 2, January – March 2004).
- Conversely, in a context where monetary rates gradually rise over a relatively long period (six months), the performance of the monetary portfolio tends to be closer to that of the benchmark (Fig. 2, March – November 2004).

⁶ 1.99% is a weighted mean of the 3-month Euribid since the beginning of the year.

Profile of counterparties

In accordance with the agreement between the Community and the EIB on the management of the Guarantee Fund, all the interbank investments have a minimum credit rating of A1.

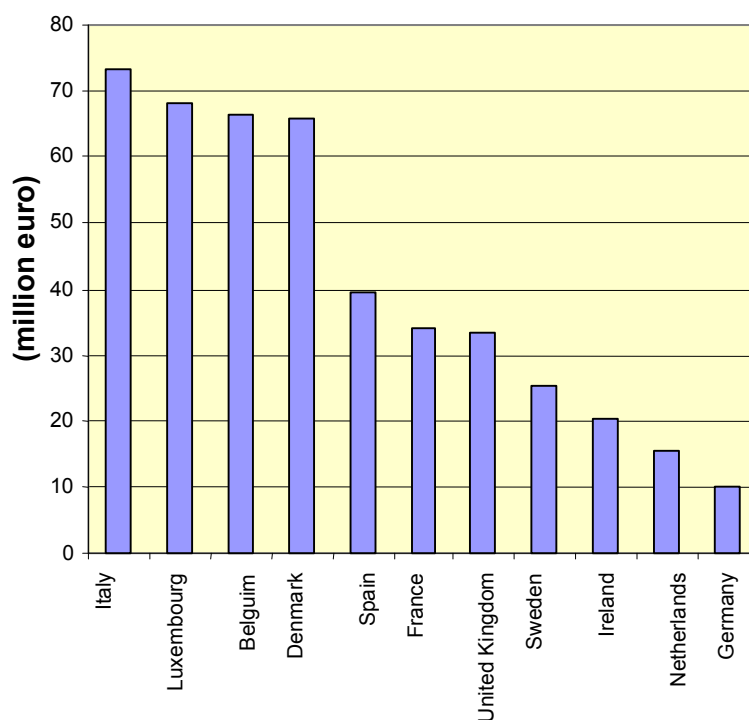
Figure 3:
Breakdown of short-term interbank investments
by type of counterparty at 31 December 2004



Geographical breakdown

The geographical breakdown of the Fund's short-term interbank investments (in terms of average capital) in 2004 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 acquired with the intention of holding them until maturity. At 31 December 2004, the book value of fixed rate securities with a residual period to maturity of less than three months amounted to EUR 48.5 million, between 3 months and one year EUR 87.7 million and between one and 10 years EUR 815.8 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.

At 31 December 2004, the nominal value of the investment portfolio was EUR 989.0 million, against a book value of EUR 996.7 million (including the premiums and discounts to be written off).

The book yield on the investment portfolio came to 4.58%⁷ at 31 December 2004, compared with 4.47% at 31 December 2003. In terms of a Salomon index reference benchmark for fixed-rate securities⁸ and the 3-month Euribid for variable-rate securities, the overall spread is positive by 189 basis points compared with the aggregate benchmark of 2.69% (see section 4). The investments in 2004 were respectively in 10 year fixed securities for a total amount of EUR 20 million and in 2 and 7 years FLRN rate securities for a total amount of EUR 15 million. It has to be kept in mind that due to the expected repayment to the budget of an amount of roughly EUR 340 million, only EUR 20 million out of the redeemed EUR 105.5 million were reinvested in fixed rate bonds.

Consequently, the global duration of the portfolio decreased to 3.55 years compared with 3.68 years as of end 2003. For information, as of 31 December 2004 the market value of the investment portfolio came to EUR 1,053.8 million compared with a book value of EUR 996.7 million (including premiums/discounts), which gives an unrealised gain of EUR 57.1 million, compared with an unrealised gain of EUR 44.0 million and a book value of EUR 1,124.7 million at 31 December 2003.

German government bond rates in 2004 (source Bloomberg):

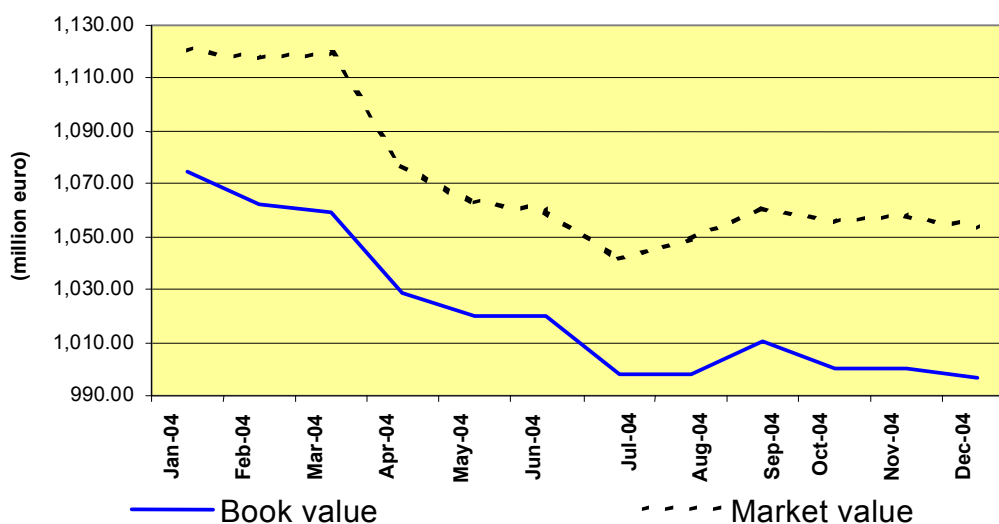
	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004
<i>Bund 3y</i>	2.86	2.48	3.15	2.82	2.62
<i>Bund 5y</i>	3.50	3.09	3.57	3.32	3.03
<i>Bund 7y</i>	3.96	3.48	3.98	3.63	3.36
<i>Bund 10y</i>	4.29	3.93	4.32	3.99	3.68

⁷ The basis for calculating the yield of the investment portfolio is act/365.

⁸ This benchmark will be adjusted once the new approach will be officially adopted by the EIB and the Commission in order to reflect the longer duration and the possibility of investing up to a maturity of 10 years.

Market value compared with book value in 2004

Figure 5: Market value compared with book value in 2004

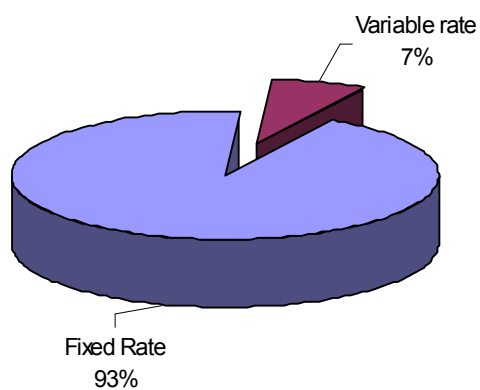


At 1 January 2004, a total of EUR 165.7 million of reimbursements (nominal value) on the securities portfolio were scheduled for the year, split as follows:

- EUR 105.5 million for the fixed rate, and
- EUR 60.2 million for the variable rate.

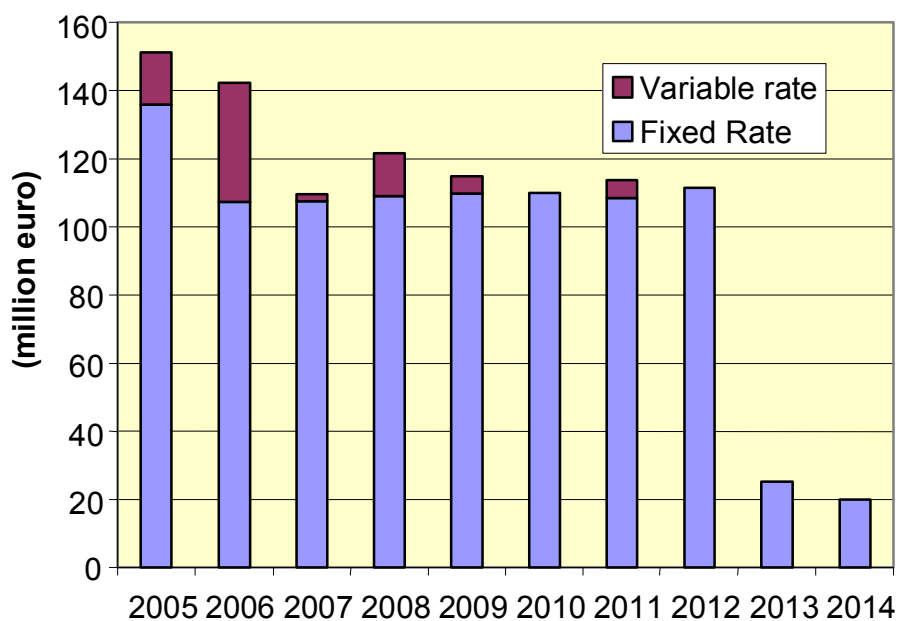
Breakdown of the investment portfolio between fixed rate and variable rate securities

Figure 6:
Breakdown of the portfolio between fixed-rate and variable-rate securities
at 31 December 2004



Redemption profile of investment portfolio (nominal value)

Figure 7: Investment portfolio: Redemption profile at 31 December 2004



The latest final maturity date for fixed-rate securities is 25 October 2014.

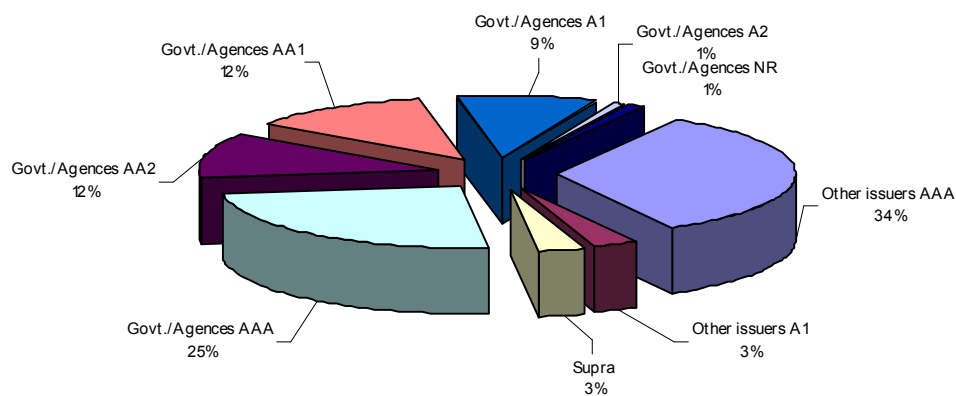
Profile of issuers

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 2004 is as follows:

Figure 8: Investment portfolio: Profile of issuers at 31 December 2004



3. SITUATION OF THE GUARANTEE FUND AT 31 DECEMBER 2004

		<i>In Euro</i>
ASSETS		31.12.2004
<u>Balances with credit institutions</u>		
	CURRENT ACCOUNT	8,790,146.69
	FIXED-TERM DEPOSITS	550,500,000.00
		<u>559,290,146.69</u>
<u>Portfolio</u>		
	COMMERCIAL PAPER	30,000,000.00
	INVESTMENT PORTFOLIO	996,725,782.84
		<u>1,026,725,782.84</u>
<u>Other assets</u>		
	ACCRUALS	26,840,283.91
		<u>26,840,283.91</u>
	TOTAL	<u><u>1,612,856,213.44</u></u>
		31.12.2004
LIABILITIES		
<u>Guarantee Fund</u>		
	GUARANTEE FUND	1,139,058,220.49
		<u>1,139,058,220.49</u>
<u>Other liabilities</u>		
	ACCRUALS	765,497.93
		<u>765,497.93</u>
<u>Result</u>		
	RESULT CARRIED OVER	414,870,431.59
	RESULT 2004	58,162,063.43
		<u>473,032,495.02</u>
	TOTAL	<u><u>1,612,856,213.44</u></u>
		31.12.2004
PROFIT AND LOSS AT		
	Interest on securities	50,411,967.55
	Gain on sale of financial fixed assets	-
	Interest on commercial paper	628,735.18
	Interest on investments	10,855,766.08
	Interest on current account	53,933.68
	Spread of premiums or discounts	- 2,845,532.15
	Commission	- 765,497.93
	Financial charges	- 177,308.98
	RESULT	<u><u>58,162,063.43</u></u>

4. PERFORMANCE OF THE GUARANTEE FUND'S BOND INVESTMENT PORTFOLIO

The performance of the bond portfolio is measured by taking the difference, expressed in basis points, between the yield of the portfolio calculated on the basis of the yields on acquisition of the securities in the portfolio and the yield of the aggregate benchmark calculated on the basis of the YTM rates observed on the date of the report, which combines the yield of the Salomon benchmark and the 3-month Libid rate proportionally to the fixed-rate and variable-rate securities in the portfolio.

	<i>Starting Value Average Capital in Euro</i>	<i>Percentage Variable Rate</i>	<i>Percentage Fixed Rate</i>	<i>Portfolio Yield a/365</i>	<i>YTM Salomon* Benchmark a/365</i>	<i>3-Month Libid Benchmark a/365</i>	<i>Aggregate Benchmark</i>	<i>Spread in bp</i>
Annual 2003	1,210,136,055	11.5%	88.5%	4.47%	2.77%	2.24%	2.71%	176
01-2004	1,117,139,923	9.0%	91.0%	4.50%	2.86%	1.99%	2.78%	172
02-2004	1,076,385,969	6.1%	93.9%	4.58%	2.80%	1.97%	2.75%	183
03-2004	1,068,115,876	6.1%	93.9%	4.57%	2.55%	1.93%	2.51%	206
04-2004	1,053,120,135	6.2%	93.8%	4.58%	2.44%	1.94%	2.41%	217
05-2004	1,030,630,978	6.1%	93.9%	4.60%	2.76%	1.99%	2.71%	189
06-2004	1,026,588,134	5.9%	94.1%	4.62%	2.86%	2.01%	2.81%	181
07-2004	1,024,173,911	5.9%	94.1%	4.61%	2.94%	2.02%	2.89%	172
08-2004	1,005,920,014	6.0%	94.0%	4.60%	2.89%	2.02%	2.84%	177
09-2004	1,012,554,158	6.7%	93.3%	4.59%	2.72%	2.02%	2.67%	192
10-2004	1,007,337,103	7.5%	92.5%	4.56%	2.77%	2.05%	2.72%	184
11-2004	1,008,270,156	7.5%	92.5%	4.56%	2.67%	2.07%	2.62%	194
12-2004	1,010,498,189	7.7%	92.3%	4.55%	2.58%	2.08%	2.54%	201
Annual 2004**	1,036,637,886	6.7%	93.3%	4.58%	2.74%	2.01%	2.69%	189

* Salomon Index EGBI 1-3 years 45.0%
 EGBI 3-5 years 45.0%
 3 M Eurodeposit 10.0%

** Average weighted by actual days in months.

5. CONSOLIDATED FINANCIAL BALANCE SHEET OF THE GUARANTEE FUND AT 31 DECEMBER 2004

In Euro

ASSETS			LIABILITIES		
	31.12.2004	31.12.2003		31.12.2004	31.12.2003
Current account	8,790,146.69	10,768,639.92	Guarantee Fund		
Fixed-term deposits (1)	550,500,000.00	433,000,000.00	Payments from the budget (3)	849,024,500.00	854,279,500.00
Portfolio			- surplus to be paid to the budget	187,130,000.00	223,160,000.00
Commercial paper	30,000,000.00		Provisions and contingencies		477,929.52
Investment portfolio	996,725,782.84	1,124,722,814.99			
Receivables from recipients of loans granted or guaranteed by the Community			Other liabilities		
Arrears covered by the Fund (2)	350,239.79	4,828,133.87	Accruals EIB commission	765,497.93	772,207.20
Accruals of interests on late payments	911,409.96	477,929.52	Accruals (4)		7,574,000.00
Other assets			Result		
Accruals	26,840,283.91	31,982,652.21	Result carried over	519,516,533.79	456,474,871.71
			Result for financial year	57,681,331.47	63,041,662.08
TOTAL ASSETS	1,614,117,863.19	1,605,780,170.51	TOTAL LIABILITIES	1,614,117,863.19	1,605,780,170.51

PROFIT AND LOSS AT 31 DECEMBER 2004

	31.12.2004	31.12.2003		31.12.2004	31.12.2003
Premium/discount spread	2,845,532.15	3,191,993.05	Interest on securities	50,411,967.55	57,239,094.50
Commission	765,497.93	772,207.20	Gain on sale of financial fixed assets		220,540.59
Recovery commission	77,745.25		Interest on commercial paper	628,735.18	
Financial charges	177,308.98	191,836.55	Interest on investments	10,855,766.08	9,673,382.98
			Interest on current account	53,933.68	64,680.81
Foreign exchange losses, realized (5)	1,260,433.70		Interests accrued on late payments	433,480.44	477,929.52
Foreign exchange losses, unrealized (6)	53,962.97				
Provisions (7)		477,929.52	Takeover / provisions (6)	477,929.52	
TOTAL COSTS	5,180,480.98	4,633,966.32			
Net result	57,681,331.47	63,041,662.08			
TOTAL CHARGES AND NET RESULT	62,861,812.45	67,675,628.40	TOTAL INCOMES	62,861,812.45	67,675,628.40

(1) An amount of € 338.8 million will be transferred to the budget on 10 January 2005, following the adoption of the Council Regulation 2273/2004 of 22 December 2004.

(2) Capital, interest and default interest covered by payments from the Fund.

(3) Reduced by € 1,496.01 million (the overall surplus repaid to the statement of revenue in the budget of the European Union in accordance with Article 3 of Regulation 2728/94 establishing the Guarantee Fund).

(4) Advance EIB in 2003 to be netted with the current account in 2004.

(5) Foreign exchange losses realized on debts recoveries from beneficiaries of loans granted or guaranteed by the Communities.

(6) Foreign exchange losses unrealized on debts recoveries from beneficiaries of loans granted or guaranteed by the Communities.

(7) Cancellation of the provision entered in 2003 following the call to the Guarantee Fund (appliance of IPSAS rules on provisions).

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