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Methodological note

GUIDANCE NOTE ON THE RECORDING OF THE FUTURE EIB PAN-EUROPEAN GUARANTEE FUND

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I. Introduction

1. In order to respond to the economic and social impacts that the EU faces in the wake of the COVID-19 pandemic, a number of measures have been introduced at European and at national levels. The creation of the Pan-European Guarantee Fund in response to COVID-19 (further Guarantee Fund or PEGF) is one of the response measures envisaged by MSs and by the European Investment Bank (EIB) Group. The Guarantee Fund initiative was welcomed by the Eurogroup in its conclusions of 9 April 2020, as well as being endorsed by the European Council on 23 April 2020 as part of the overall EU COVID-19 response package.
2. The EIB created the pan-European guarantee fund of EUR 25 billion, which could support EUR 200 billion of financing for entities throughout the EU, whether provided directly or through financial intermediaries, including national promotional banks.

II. Overview of the PEGF role, institutional set-up, governance and the main activities

1) THE ROLE OF THE PEGF

3. The objective of the PEGF is to ensure that eligible entities in EU Member States will have sufficient liquidity available. The entities that could benefit from the measures financed by PEGF are small and medium-sized enterprises (SMEs), mid-caps[1], corporates (primarily private sector entities, but also public sector corporations) and public entities providing essential services, in particular in the areas of health, research and education. The latter public entity category is an exception to the access rules for existing EIB products.

[1] Mid-caps are defined here as companies that have between 250 and 3,000 employees.

4. The PEGF is foreseen as temporary. The initial investment period is due to end on 31 December 2021[2]. The date of 31 December 2037 is mentioned in the Guarantee and Contribution agreements as a possible expiry date of the Fund.

2) OVERVIEW OF THE INSTITUTIONAL ARRANGEMENTS RELATED TO THE GUARANTEE FUND

5. The Guarantee Fund will not be a separate legal entity. It will be established under the EIB's structure of Partnership Platform for Funds and will therefore benefit from their existing legal framework and procedural aspects. The PEGF will be funded by the participating EU Member States on a voluntary basis, the EIB Group and possibly by other institutions of the European Union or institutions created by Member States of the European Union.

6. Each participating Member State will individually sign a Contribution agreement in which it commits to a Contribution. The main part of this contribution will be made by the Member States in the form of guarantees. In some very specific cases, a part of the Contribution could be made in the form of an upfront cash payment. The total liability of the individual Member State shall amount to EUR 25bn times its percentage shareholding in the EIB. The EIB will be responsible for keeping the dedicated register of the upfront contribution as well of any other contributions made by each Contributor.

7. The fund will be considered formally established only when the signed Contribution agreements will reach 60% of EIB's capital share. To eliminate any impact from earlier or later signatures of the Contribution agreement, a so-called equalisation mechanism is foreseen, i.e., all contributors will bear a pro rata share of all claims under the Guarantee Fund since its inception.

8. Each participating Member State will also sign a Guarantee agreement, in which it provides an irrevocable, unconditional and first demand guarantee to the EIB.

9. If needed, in order to meet their obligations under the Guarantee agreement, Member States can benefit from a liquidity facility offered by the EIB. The total amount of the facility is EUR 7.5 billion. In case a demand is made under the Guarantee agreement (i.e., a guarantee call) and there are insufficient amounts available from the Dedicated Register, the EIB would make an advance to the Contributor under the Liquidity facility. In the terms of the liquidity facility, the EIB is referred to as the lender and the Contributor as the borrower. The advance has a defined repayment date and a defined interest rate that will be charged at the Advance repayment date.

10. Each participating Member State will nominate a representative to the Contributors Committee. The decisions of the Contributors Committee will cover all the main aspects of the Fund's activities, such as approving proposed operations, approving Third Party Financing, approving redemption (to the Contributors) or reallocation (to another Fund) of remaining Contributions Paid in the relevant Fund upon its termination and approving any amendment to the Fund Description, including any prolongation of the Fund.

11. The Committee will be responsible for approving the use of some guarantees for individual operations presented by the EIB and/or the European Investment Fund (EIF). Such decisions on the use of the guarantee for individual transactions outside a delegation framework (see below) will be taken by a qualified majority of contributions, i.e., 50% of Contributing Member States representing a 2/3 share of contributions. Key strategic decisions, including changes in the product and/or beneficiary mix, require a super-majority of contributions, i.e., 50% of Contributing Member States representing an 80% share of

[2] Prolongation of the initial investment period by 6 months or more is possible upon agreement of the participating countries.

contributions. The Contributors Committee may also decide to grant global authorizations to the EIB/EIF for operations within certain parameters. This could take the form of a global authorization from the Contributors Committee for lines of products. The Contributors Committee will receive an annual Operational Report on Guarantee Fund operations and will approve the PEGF's financial statements.

3) OPERATIONS OF THE GUARANTEE FUND

12. Participating Member States will provide, via the PEGF, counter-guarantees and guarantees to the EIB direct guarantees/financing towards final recipients, as well as to the EIB's indirect operations. An indirect operation is one where financing or guarantees are provided to a financial entity[3] entering into a transaction with a final recipient.
13. In terms of foreseen distribution of PEGF-supported financing, 65% is aimed at debt operations with SMEs, 28% is foreseen for non-SMEs and 7% is planned to be directed to venture and growth capital.
14. Permitted instruments that PEGF can use cover both 'unfunded' (e.g. guarantees and counter-guarantees) and 'funded instruments' (e.g. loans, equity and quasi-equity investments, risk participation, asset-backed securities' purchases). It was confirmed by the EIB that, at the outset of the PEGF, it is foreseen that guarantees and counter-guarantees will be the overwhelming majority of the product mix.
15. Regarding geographical eligibility, contributions will not be earmarked to support the operations in any given participating Member State. The PEGF however will be aiming at geographical distribution following the principles below:
    - for the three Member States that will receive most of the Fund's financing, the cumulative financing will not exceed 50% share of the total Fund's financing;
    - for the 15 Member States which will receive the least of the Fund's financing, the cumulative financing will exceed 10% share of the total Fund's financing.

4) OTHER ASPECTS RELEVANT FOR THE STATISTICAL ANALYSIS

16. As regards the involvement of the EIB, a guarantee agreement foresees that individual Member States (Contributors) will instruct and irrevocably authorise the EIB to act on their behalf. Some articles in the agreement's text mention explicitly that the EIB will in fact act as an agent of a Contributor.
17. The EIB, moreover, will be charging a fee for administering the Guarantee Fund. From the signature date of the first Contribution Agreement until 31 December 2037, an annual management fee will be paid by MS (via the PEGF) to the EIB. It will be equal to up to 0.5% of the committed amounts, subject to an overall aggregate cap of 2.5% of total Contributions.
18. The Fund will be established in a way that it will be completely off-balance sheet for the EIB. No residual credit risks or costs will be borne by the EIB, implying that the management of the Fund will have no negative impacts on EIB's key internal capital ratios.
19. It is also foreseen that the EIB will bear no residual risk and losses regarding the operations of the fund.

[3] The EIB documentation refers to the term of "financial intermediaries" in a broader sense than national accounts. They are described as "*commercial banks, financial institutions, guarantee institutions, leasing companies, venture capital and private equity funds, micro-finance institutions, National Promotional Banks/ Institutions, Special Purpose Vehicles (SPV), private credit funds, alternative lenders, crowd-lenders, guarantee societies etc*."

20. However, if the EIB or EIF contribute with their own resources to the Fund, the residual risk of such contributions will be borne by them.

21. The PEGF is created as a high risk and high impact intervention tool. It will de facto extend the existing EIB/EIF products to a wider range of beneficiaries. The expected loss for participating Member States of the PEGF portfolio net of recoveries has been estimated by the EIB, on the basis of the observed results of the EIB/EIF product mix, at 20% (this figure represents an average between the conservative scenario and the baseline scenario). The gross expected loss figure stands at 33.6%.

III. The classification of the PEGF in national accounts

1) THE PEGF IS NOT AN INSTITUTIONAL UNIT ACCORDING TO THE ESA 2010 CRITERIA

22. The PEGF is not a legal entity and does not have decision-making autonomy in the exercise of its principal function. The EU Member States (via their representatives on the Contributors Committee) will make decisions covering all main aspects of the activities of the Fund. In substance, the PEGF can be assimilated to a bank account (although with allegedly very limited cash at the outset) managed by the EIB for the participating Member States.

23. The PEGF will not own any goods or assets in its own right. The EIB will raise the funds needed to deploy the so-called funded products. Similarly, in case of indirect operations (delegated by the EIB/EIF to the financial intermediaries or to national promotional institutions), "a full delegation will be envisaged to the Financial intermediary with respect to servicing of the underlying exposures". The EIB will prepare the annual financial statement of the Fund. The financial statements will be drawn up on the basis of cash receipts and disbursements (on guarantee calls).

24. Considering all the above, it is concluded that the PEGF cannot be considered an institutional unit as defined by ESA 2010 paragraph 2.12. According to ESA 2010 paragraph 2.13c, it should be allocated to the units, which control it, which are in this case the governments of the EU Member States that participate in the PEGF.

2) RECORDING OF MEMBER STATES' GUARANTEES

25. Under the PEGF arrangements, the EU Member States grant to the EIB/EIF (and for indirect operations to the participating national promotional institutions) an irrevocable, unconditional and first demand guarantee.

26. ESA 2010 B5.1.2 distinguishes guarantees into two types that may be relevant here: standardised guarantees and one-off guarantees. As the PEGF guarantees cover a wide range of products, which have a high variety of final beneficiaries in terms of nature, size and geographical distribution, they do not meet the ESA definition of a standardised guarantee. Instead, they are classified as one-off guarantees.

27. ESA 2010 B.5.1.2c considers one-off guarantees as contingent liabilities, although ESA 2010 paragraph 20.256 complements this by specifying cases where government one-off guarantees should be treated as if called at inception[4]. The conditions mentioned are that the beneficiaries are financially distressed, implying a very high likelihood of a guarantee call.

[4] If a reliable estimate of the expected call is available, then this is the amount to be recorded as a capital transfer and imputed as a debt of the borrower.

28. In order to be effective and achieve its goals, the PEGF will extend the existing EIB/EIF products to a wider range of beneficiaries compared to the usual beneficiaries of the EIB operations. The EIB has made an estimate of the expected net losses at 20%. However, the question remains whether the estimate is accurate enough to be considered as 'reliable'. The initial EIB estimates could be seen as highly sensitive to various risk, cost and revenue assumptions and possibly having a non-negligible range around their expected value. Some of the PEGF beneficiaries will probably be the units that, under normal circumstances, would not be eligible for the EIB funding, which adds to the difficulty of estimating the expected losses. Furthermore, there is uncertainty regarding the exact configuration of the benefiting countries (inevitably facing different socio-economic situations), and there is also an uncertainty about the final product mix to be deployed, which itself depends on several parameters such as market gaps and demands, timing of deployment, risk appetite, envisaged investment multiplier, etc.

29. Considering the above doubts on the reliability of the estimated loss, which will be incurred, no government expenditure (capital transfer expenditure) should be imputed at inception. General rules for guarantee recording should be applied instead[5], that is: guarantees will be treated as contingent liabilities at inception, and government expenditure will be recorded at the time of each guarantee call. The recording of recoveries (if any) will also be done on an ongoing basis as government revenue (capital transfer revenue).

3) RECORDING OF UP-FRONT CONTRIBUTIONS TO THE PEGF

30. In very few specific cases where a Member State chooses to make an upfront payment in cash instead of providing a guarantee, the accounting treatment in terms of impact on government deficit/surplus should not differ from the mainstream guarantee case, that is, government expenditure should not be recorded at the time of the cash upfront payment. The cash paid in to PEGF is recorded as a financial advance an F.89 receivable towards the EIB (S.2). Capital transfer expenditure (with a counterpart financial transaction reducing the AF.89 asset) will be recorded when guarantee calls crystalize.

31. Moreover, the treatment decided for Member States' contributions to PEGF also applies to possible contributions from institutions of the European Union, institutions created by Member States of the European Union or the EIB group, should they occur.

32. If additional contributions (i.e., exceeding the upfront payments) are called by the EIB / EIF, due to losses on PEGF's funded transactions, a capital transfer from the participating Member States to the EIB will be recorded at the moment of the call.

4) RECORDING OF FUNDS OFFERED BY THE EIB UNDER THE LIQUIDITY FACILITY

33. The uncollateralized credit facility offered by the EIB to PEGF guarantors (the Member States) provides funds for the payment of EIB demands in cases where they cannot be funded by upfront payment or by amounts available under the countries' dedicated register. The Liquidity facility financing (Advance) has to be repaid to the EIB in a short-term (depending on the circumstances, 3 or 6 months). Interest on each Advance is payable on the Advance repayment date (at a rate defined in the Contribution agreement). Considering the features of the Liquidity facility according to ESA 2010 paragraph 5.113, any borrowing under it will be recorded as loans (F.4). The liquidity assured by the EIB to the participating Member State will be repaid by them at the defined term and will be interest bearing, and

[5] It is also in line with ESA2010 par. 5.197 saying that, in case of one-off guarantees, the guarantors are not able to make a reliable estimate of the risk of calls.

therefore in national accounts it should be recorded as loan (liability) of the concerned Member State's government towards the EIB.

5) RECORDING OF FUNDED INSTRUMENTS

34. From the available documentation and according to the information received from the EIB, it seems that guarantees are going to be the overwhelmingly predominant instruments that will be used by PEGF. However, some 'funded instruments' (of the type typically recorded in ESA categories AF.3, AF.4 and AF.5) could also be used (see paragraph 14 above).

35. To address the issue of proper recording in national accounts of PEGF-guaranteed funded instruments, there is a need to analyse the governance of PEGF as well as to consider which party (the EIB or the Member States) bears the majority of the risks and rewards.

36. In the context of the PEGF, the Contributors Committee must approve both the individual operations above a certain limit and some specific one-off operations. The Committee can also give a global authorisation to the EIB to decide on operations guaranteed by the Fund up to a certain threshold.

37. Based on the information provided, it can be concluded that the major decisions related to the primary functions of the PEGF will, in practice, be taken by the participating Member States and not by the EIB. At the same time, the participating Member States, by granting to the EIB unconditional and irrevocable first demand guarantee, collectively take over all risks and rewards relating to the functioning of the Fund. In such circumstances, and based on the rules included in the 2019 MGDD chapter 1.2.4.5.2[6], the funded transactions of the PEGF should be rearranged via the general government accounts of the participating Member States.

38. When it comes to the characteristics of the entity, a parallel can be drawn for the PEGF from the EFSF case (neither qualifying as an institutional unit): for both of them risks and rewards are totally borne by the participating Member States. Therefore, from a conceptual point of view, as it is in case of the EFSF, the funded operations of the PEGF should be allocated to or consolidated with, in national accounts tables, the participating Member States.

[6] 2019 MGDD chapter 1.2.4.5.2. Rearranging of transactions carried out by non-government units when they act as 'government agents' or at government's request, paragraphs 110 and 118 are to be applied.