

# Audit Committee Annual Reports

for the year 2019



European  
Investment  
Bank

*The EIB bank* 



**AUDIT COMMITTEE  
OF THE EUROPEAN INVESTMENT BANK**

**ANNUAL REPORT TO THE BOARD OF GOVERNORS  
FOR THE 2019 FINANCIAL YEAR**

**ANNUAL REPORT TO THE BOARD OF GOVERNORS  
ON THE INVESTMENT FACILITY  
FOR THE 2019 FINANCIAL YEAR**

**RESPONSE OF THE MANAGEMENT COMMITTEE  
TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE  
FOR THE 2019 FINANCIAL YEAR**



# ANNUAL REPORT TO THE BOARD OF GOVERNORS FOR THE 2019 FINANCIAL YEAR

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## EXECUTIVE SUMMARY

This report summarises the results of the Audit Committee's (AC) work in 2019. Based on this work and building on the work and the recommendations elaborated in last year's report, AC makes key observations and recommendations. This year's AC key observations are grouped under four headings compared to five in last year's report<sup>1</sup>, namely: 1) sustainability and business model, 2) group alignment, 3) risk management and internal control, and 4) best banking practice.

The mandate and scope of the AC's work is determined by the EIB's Statute and Rules of Procedure. This sets out three responsibilities: i) the auditing of the EIB (the Bank) and the EIB Group's<sup>2</sup> (the Group) accounts, for which AC largely relies on the external auditor; ii) the verification that the operations of EIB are conducted in a proper manner having regard to: the monitoring of the internal control environment, risk management, compliance and internal audit activities; and iii) the verification that the Bank's activities conform to Best Banking Practice (BBP).

In 2019, AC fulfilled its responsibilities by: i) the issuance of the Statements on the EIB and EIB Group's Financial Statements as at 31 December 2019, which have been delivered to the Board of Governors and form an intrinsic part of the EIB Group Annual Report, and (ii) the preparation of this Annual Report.

AC stresses the importance of improving the EIB Group's financial strength and sustainability in the long term. These are essential to maintain the Bank's AAA rating and investors' confidence, as the EIB is reliant on funding from the capital markets and is not an EU budget institution.

In terms of financial sustainability, AC acknowledges the strategic direction on profitability and capital consumption adopted by Board of Directors (BoD) and Management Committee (MC) as described by the 2019 EIB Group Capital Plan. At the same time, AC cautions that this plan must be strictly monitored and not exceeded in terms of the decline in the net surplus. It is important that the EIB Group's profitability is such that the EIB can remain financially self-sustainable in the long-term. The annual net surplus is a significant source of future capital needed by the EIB to meet demanding and increasing public policy objectives. It is key that the EIB's earning capacity will ensure that its targeted lending plan and capital strength will remain intact without further shareholder support. These comments also apply to the European Investment Fund (EIF) where the subsidiary's approach to capital sustainability needs to be reviewed in light of policy objectives and EIB-EIF capital allocation.

Related to the financial sustainability of the Group, AC is concerned with the continually rising overall cost base. Costs have risen across the board, as a result of smaller but more complex EFSI projects and investment in risk management and compliance frameworks. AC would like Management Committee to explore digitalisation of processes as one means among many others within the EIB Group in order to address the upwards pressure on the overall cost base.

The external environment was marked by unfavorable geopolitical events, a global economic slowdown, protracted low interest rates, the tangible effects of climate change and increased cyber security threats. Most recently, the uncertainty to global and EU economies increased because of the COVID-19 pandemic. These demanding headwinds to delivery of the Group's public policy objectives, its sustainability and risk profile require high quality leadership and oversight by the EIB's governing bodies.

2019 and the beginning of 2020 saw ambitious commitments made by the EIB Group. First with regards to climate change: a pledge to initiate EUR 1 trillion of climate investment in the decade to 2030. Second, confirmation of the EIB Group as the European Union's key implementing partner in financing European priority projects under the next EU budget 2021-2027. Third, the EIB Group's Coronavirus crisis response program of EUR 40 billion to finance SMEs and Mid-cap companies.

The recommendations raised by AC in last year's annual report are now subject to a Management Committee implementation roadmap (see Annex 2 for details of last year's AC recommendations and the additional elements to these recommendations as result of the AC's work this year). AC expects MC to review the roadmap on a quarterly basis. AC expects that the MC and Services with the support of the Board of Directors to implement these recommendations according to the timeline, which it is agreed will be adapted as a consequence of the COVID-19 outbreak.

<sup>1</sup> This was due to the inclusion of a new category of non-financial risk, which encompasses the previous category of risk culture, conduct, remuneration and resources category.

<sup>2</sup> The EIB Group comprises the EIB and the European Investment Fund, which is majority-owned by the EIB.

With regards to compliance with the prevailing Anti-Money Laundering and Counter-Terrorist Financing (AML-CTF) Directives, work has been ongoing to address Internal Audit (IA) action points raised earlier in 2019. A Task Force was created to address the action points that the AC brought to the attention of the Governors during last year's annual meeting. AC has closely monitored implementation of agreed actions and is satisfied with progress so far. However, this demanding programme will continue to require Management Committee's particular attention.

AC continues to press for Group oversight of all three lines of defence. Playing its own part, Audit Committee has continued its collaboration with the Audit Board of the EIF, as well as with supervisory authorities. In 2019, AC met with the European Central Bank-Banking Supervision to exchange views on topics of supervisory priority and to discuss the design of the EIB Review and Evaluation Process (EIB REP). AC also met with the Banque Centrale du Luxembourg (BCL), which supervises the liquidity and funding pillar of the EIB.

Concerning BBP, AC is pleased with the codification by the Bank of an enforceable and clear framework and with the progress achieved with its operationalisation. The framework should enable better oversight of BBP by the Bank. In order to further improve EIB Group oversight, AC has begun the process of implementing the EIB Group's equivalent of an EBA Supervisory Review and Evaluation Process (SREP) Guidelines, designated as the EIB Review and Evaluation Process (EIB REP). The EIB REP will be based on the four SREP pillars: Business Model and Sustainability, Governance and Risk Management, Risk to Capital and Risk to Liquidity and Funding.

The annual BBP self-assessments prepared by the Services used a harmonised template this year as requested by the AC. In terms of overall level of compliance with BBP, on the basis of the 2019 self-assessments prepared by the Services, the MC in agreement with the Services, concluded that the EIB is assessed as "partially compliant" with BBP. The AC concurs with the MC's conclusion, recognising that gaps exist in a period of transition to full completion of the applicability assessment procedures and the EIB REP. AC will continue to oversee and press for the closure of the identified gaps according to their agreed timeline included in the Bank's roadmap prepared as a result of AC recommendations included in the Annual Report to the Governors issued in 2019.

Finally, AC considers that it has adopted a focused approach during the year in terms of the objectives and means utilised to obtain the necessary assurances and achieve the outcomes of its work. AC believes that it has maintained appropriate relations with the MC and the Bank's staff, as well as the external auditors and consultants, while remaining independent at all times.

In 2019 AC received full support from MC and Services, thus AC was able to properly discharge its responsibilities. AC expects to receive similar support going forward.

AC appreciates and is grateful for the relevant assistance it has received from the President, Management Committee, Board of Directors and Services throughout the Group.

## LOOKING FORWARD

2020 is expected to be a transformational year as the Bank's business and new mandates pivot towards climate and InvestEU. This will take place against a backdrop of the headwinds already experienced: unfavorable geopolitical events, a global economic slowdown, protracted low interest rates, the tangible effects of climate change and increased cyber security threats. Additionally, the severity of the impact of COVID-19 on national economies is only beginning to be understood.

Another event impacting the Bank in 2019-2020 period is the withdrawal of the United Kingdom from the EU and the termination of its membership in the EIB and its share of the EIB's subscribed capital. Effective 1 February 2020, the share of the United Kingdom in respect of the EIB's subscribed capital was fully replaced by a pro rata capital increase of the remaining EU Member States. In addition, Poland and Romania increased their capital share in the EIB, as of 1 March 2020. This positive support by shareholders has been noted by external credit rating agencies who, subsequent to the 2019 year end, have confirmed the bank's AAA rating.

AC notes the adoption of an EIB Group equity strategy by the BoD and MC. This gives welcome clarity and rationalises the roles and responsibilities of the EIB and EIF enhancing Group efficiency. AC expects both the BoD and MC to exercise close oversight of the risks arising from the increasing portfolio of equity and quasi-equity exposures across the EIB Group.

AC expects that the MC and the BoD fully address the recommendations set out in Section 1 of this report. The AC has noted priority elements including the Bank's financial sustainability, especially in view of the new climate strategy, InvestEU and the program to respond to the COVID-19 crisis, the management of non-financial risks including cyber and operational risk as well as the implementation of the three lines of defence within the Bank and the EIB Group. The latter three points have been highlighted previously in the AC's Annual Reports of 2017 and 2018.

Related to the financial sustainability of the Group, AC is concerned with the continually rising overall cost base. AC would like the Management Committee to explore the digitalisation of processes across the EIB Group. Additionally, AC is not convinced the EIB Group is making best use of the possibilities of cloud computing to reduce costs, improve resilience and increase agility and flexibility. Therefore, included in the exploration of digitalisation of processes should be a thorough examination of the possibilities of cloud computing across the Group.

AC recognises the impact of serious cyberattacks on large organisations. There is no forward-looking prospect of such attacks diminishing. The damage already suffered by large and reputable organisations show these risks to have high adverse operational, financial and reputational impact. Serious cyberattacks can take many forms, such as a ransomware attack or massive data loss. AC expects Management Committee and Services to ensure recovery plans are revised and exercised regularly and allied with the best possible defences against such attacks. AC has seen good practice in large organisations whereby an advisory committee of IT experts is available to the governing bodies. AC suggests that the MC consider forming such a committee to advise them and the BoD on these matters.

The recommendations in the previous paragraphs should form an integral part of the Group's IT Strategy.

AC is overseeing the start of the implementation of the EIB REP, is committed to its operationalisation and seeing that the first full EIB REP exercise will be concluded by the end of 2022. AC considers that the EIB REP is an important development and that it enhances its ability to oversee the BBP Framework within the EIB. The objective being to improve the long-term financial strength and sustainability of the EIB Group.

AC will collaborate with the ECB-Banking Supervision, the EBA, the Banque Centrale du Luxembourg and with EU National Competent Authorities, as necessary.

AC is strongly committed to continue its cooperation with the Audit Board of the EIF in order to strengthen further the Group oversight of the EIB and the EIF. AC has been pleased to see a marked improvement in the cooperation between the EIB and EIF Services, as evidenced by the new Group equity strategy.

## MAIN REPORT

### 1. KEY OBSERVATIONS AND RECOMMENDATIONS

AC sets out below its key observations and recommendations as priorities for the MC, the BoD and the Board of Governors. These are based on the AC activities during 2019 described in Section 2 of this report.

AC has received from the MC a roadmap setting out actions it will take to fully implement the 23 recommendations AC made in last year's report (see Annex 2), as well as new elements to these recommendations of this year's AC work. AC expects that the MC and Services with the support of the BoD ensure that the implementation of these recommendations is achieved according to their agreed timeline. AC will review the progress with the implementation with Services on a quarterly basis.

AC intends that this roadmap becomes the key control document from one Annual Report to the next. In this way MC, BoD, AC and the Board of Governors can see with clarity the timeline for clearing outstanding AC actions. The roadmap will be formally refreshed and agreed with MC each year as actions are cleared and new actions are added.

#### 1.1 Sustainability and Business Model

##### Introduction

Trends observed over recent years continued in 2019. The backdrop was the sustained low interest rate environment. Against this, a slight decline in lending volumes together with insufficient cost coverage of certain mandates and operations, and volatility of net surplus on equity activities, continued to exert downwards pressure on the EIB Group net surplus. Further, cost pressures arose because the Bank's lending increasingly focused on smaller size and higher risk EFSI transactions. Although the EC guarantee mitigates the risk, the cost pressures remain.

The year also saw ambitious commitments made by the EIB Group. First, climate change - the Green Deal: a pledge to initiate EUR 1 trillion of climate investment in the decade to 2030. This commences with alignment of all financing activities, by the end of 2020 with the goals of the 2015 Paris Agreement. Second, the confirmation of the EIB Group as the EU's key implementing partner for the EC, in the financing of European priority projects under the next EU budget 2021 to 2027. This will be done through InvestEU, the proposed programme to boost private and public investment in Europe. In response to the Coronavirus crisis, the EIB Group has proposed EUR 40 billion-response program to finance SMEs and Mid-cap companies. In addition, AC notes the adoption of a new equity strategy by the Board of Directors and Management Committee. This clarifies the roles and responsibilities of the EIB and EIF. AC expects both the Board of Directors and Management Committee to exercise close oversight of the risks arising from the increasing portfolio of equity and quasi equity exposures across the EIB Group.

##### AC Assessment

In 2018, the AC recommended that: i) the EIB monitors closely the viability of the evolving and more diversified business model of the Bank, as well as the trends in margin, net surplus and asset quality as contributing factors to the Bank's sustainability, ii) the EIB prepares a strategic review of profitability per product and per mandate, and iii) the EIB develops further the capacity to analyse revenue and expense drivers as well as cost coverage with the aim to ensure adequate profitability per product and per mandate, as well as the Bank's financial sustainability.

The EIB is not an EU budget institution and is reliant on confidence-sensitive capital markets funding. On the other hand, the EIB is the public policy bank of the EU. The EIB must continue to balance its policy mission with an adequate level of cost coverage for the services it provides, to produce a sustainable net surplus. AC acknowledges the strategic direction on profitability and capital consumption adopted by Management Committee and Board of Directors as described in the EIB Group Capital Plan of 2019. At the same time, AC cautions that this plan must be strictly monitored in terms of the projected decline in net surplus. It is important that the EIB profitability is such that the EIB Group can remain financially self-sustainable in the long-term. The annual net surplus is a significant source of future capital needed by the EIB to meet demanding and increasing public policy objectives. It is key that the EIB's earning capacity will ensure

that its targeted lending plan and capital strength will remain intact without further shareholder support. These comments also apply to the EIF where the subsidiary's approach to capital sustainability needs to be reviewed in light of policy objectives and EIB-EIF capital allocation.

Furthermore, the Bank needs to preserve the confidence of its institutional and private investors by maintaining its AAA rating, which is key to the Group being able to offer competitively priced products. The Bank's AAA rating is therefore at the core of its business model. The Bank's AAA rating is anchored on its financial strength, long-term sustainability and the support of the EU Member States as shareholders.

Prior years' recommendations of the AC therefore remain relevant especially in light of the strategy about climate, InvestEU and the increasing exposure to equity and quasi equity on the Group's balance sheet.

## Recommendations

In addition to Management Committee progressing with the implementation of prior years' recommendations, the AC reiterates the importance of ensuring adequate cost coverage of all mandates, especially of the new mandates still under negotiation.

## 1.2 Group Alignment

### Introduction

Group alignment is the creation of a genuine Group structure with the parent company exercising effective oversight of the EIB and EIF, and of any future subsidiaries. Group alignment includes Group oversight of the first line by the second and third lines of defence and the establishment of support functions.

In its 2018 report, the AC formulated four recommendations related to EIB Group alignment. These recommendations encompassed: i) the development of a genuine Group structure, and ii) enhancing Group risk management, and setting up of Group control and support functions of a fully-fledged and operating three lines of defence model. The other two AC recommendations sought the clarification of the roles and responsibilities for business lines within the Group, such as, for example, the equity and quasi-equity exposures, and the build-up of a Group level common data warehouse. The AC underlined the need to extend the prudential risk management policies to a Group dimension. A summary of prior year AC recommendations can be found in Annex 2, which also includes this year's additional elements to some of the recommendations.

### AC Assessment

The Bank has initiated numerous projects and initiatives concerning the achievement of Group alignment. The AC notes with approval the endorsement of the Group Risk Management Charter (GRMC), which is the main building block for establishing Group risk management and the proper oversight of the Group. The AC acknowledges that other Group policies were developed: the first Group Capital Plan, the Group Stress Testing Framework and Program, and that the Internal Capital Adequacy Assessment Process (ICAAP) document was extended to cover the capital requirements for the EIF and for the EIB Group. The AC understands that the ICAAP is on track to be developed as a fully-fledged Group document, along with the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Risk Appetite Framework (RAF), according to the agreed timeline as per the roadmap.

With respect to other key developments in the area of Group Alignment, the AC understands that the main elements of an equity strategy have been set out by the BoD and that this will be translated to practical solutions in 2020. The development of a clear Group level equity strategy gives welcome clarification of roles and responsibilities within the Group. In addition, the AC notes that a new Group Chief Risk Officer (GCRO) is being recruited, leading to the implementation of the second line of defence of the Group oversight.

Regarding the Group data warehouse, the Bank has launched a long-term project, which is also one of the four high priority projects of the Prudential BBP Programme. The requirement for data aggregation and an integrated data warehouse are essential for systemically important banks of the size of EIB.

## Recommendations

In 2020, the AC expects that continued progress is achieved on its four broad recommendations of 2018 in accordance with the agreed timelines. The ongoing evolution of the three lines of defence model and the creation of the Group Chief Risk Officer function is work in progress. This will be closely monitored by AC with the expectation of further progress.

### 1.3 Risk Management and Internal Control

#### 1.3.1 Risk Management

- **Oversight and management of Financial Risk**

AC monitors prudential risks to which the Bank is exposed, including credit, market, capital and liquidity. AC focused on topics such as credit risk assessment, monitoring of the asset quality, liquidity risk management, capital adequacy and capital planning and regularly reviewed the Bank's Risk Appetite Framework (RAF) Dashboard and risk management reports, as well as other prudential risk management documents and policies. Regular discussions were held with respect to exposures vulnerable to emerging risks.

AC discussed and provided comments on the capital and gearing ratios, the Group Capital Plan and the model risk management. AC reviewed the stress-testing exercises and results, including the macro-economic stress test. AC notes that in 2020, the Bank intends to replicate the EBA stress testing exercise in addition to the other idiosyncratic and sensitivity stress tests.

In terms of market risk and liquidity, AC monitored the Bank's preparedness for the transition from LIBOR. AC will continue to monitor the implementation of BCL's liquidity recommendations.

With specific reference to the credit appraisal and approval, the AC makes the following comments: AC notes that in the first instance it needs to be clarified which Services, and which functions are first line and which are second line of defence, for credit risk but also for all other risk types. Once clarified a reorganisation of Services must take place to separate, as far as possible, the two lines of defence and remove overlap. The role of the Board of Directors and Management Committee in the credit process and the issues of delegation to Services needs to be clarified, afterwards. AC however agrees with MC's view that the first reorganisation element must be completed before the delegation element can be analysed.

#### AC Assessment

With regards to financial risks, AC requested in its last year's report that: i) the capital consumption of different BBP projects of the Prudential BBP Programme be estimated, disclosed in the risk report, and integrated in the capital planning process of the Bank, and ii) results of the stress testing exercises should not be less conservative as if they were prepared on an IFRS basis. AC underlines that capital planning needs to better incorporate the evolving regulatory developments. These AC recommendations (also referred in the section on BBP) should be considered for implementation in 2020.

## Recommendations

With respect to its previous recommendations related to capital adequacy and stress testing, AC expects to see continued progress in accordance with the agreed timeline. AC underlines that the results of the stress testing exercises this year should be better integrated in the capital adequacy assessment process.

AC's last years recommendations with respect to liquidity and funding are covered in detail in the section on BBP and are reflected in the planning of the BBP Programme as well as in the plan to address BCL recommendations.

The financial risk RAF was approved a few years ago and needs to be complemented by non-financial risk indicators. The RAF needs to be extended to a Group dimension in 2020.

- **Oversight and management of Non-Financial Risks (NFRs)**

#### Introduction

In the context of the EIB ICAAP, non-financial risks are defined by the EIB to include operational, legal, model risk as well as strategic, conduct and compliance, Information and Communication Technology (ICT), and cyber and reputational risks.

AC underlines the need for a comprehensive framework embracing all types of NFRs such as the outsourcing risk, compliance with AML-CFT Directives, market abuse regulation and data protection requirements.

AC notes that risk appetite, risk mitigation and reporting is relatively underdeveloped for NFRs compared to financial risks. Yet NFRs can have substantial strategic, business, economic, and/or reputational impacts.

AC reviewed the Risk Appetite Framework Policy for NFRs and noted that these need to be reflected in measurable limits and actual indicators in the EIB RAF for NFRs.

#### AC Assessment

AC has previously encouraged the EIB to move towards a holistic approach to risk management to ensure that the identification, management and reporting of risks includes NFRs as well as financial risks. AC has also required that this holistic approach include all parts of the group. AC welcomes steps taken to this end to recruit a Group Chief Risk Officer.

Going forward AC considers that the GCRO, once functional in the role in 2020, should promote and facilitate the further development of integrated EIB Group policies, processes, and controls required to identify, manage and report comprehensively on both financial and non-financial risk types. AC will monitor closely such initiatives and developments in the coming year.

AC raised in its prior year report four recommendations concerning conduct and cyber risks. These include: i) the enhancement of the oversight and control of IT, cyber security preparedness and operational risks, ii) encouragement of a sound risk culture within the EIB Group in order to ensure that it includes such features as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak-up, iii) a review the Code of Conduct of MC and the BoD, and iv) addressing the gaps identified in remuneration policies in order to foster a sound risk culture within the EIB Group. These recommendations encompass ensuring that remuneration practices are better balanced to reflect not only volume-based KPIs as a driver of objectives setting.

With regards to compliance with the prevailing AML-CTF Directives, work has been ongoing to address IA action points raised earlier in 2019. A Task Force was created to address the action points that the AC brought to the attention of the Governors during last year's annual meeting. AC has closely monitored implementation of agreed actions and is satisfied with progress so far. However, this is a demanding programme that will continue to require Management Committee's particular attention.

AC was informed by Services during the year of various initiatives to enhance the oversight and control of IT, cyber security and preparedness, and which have included the strengthening of the second line of defence in this regard. AC expects further progress during 2020, in particular relating to effective oversight and management of cyber risk.

AC has been informed that the reviews of the Code of Conduct of MC and the BoD are progressing and are expected to be completed in the course of 2020.

With regards to the promotion of a sound risk culture, AC welcomes the conclusion and publication during the year of the revised EIB Group Whistleblowing Policy and the staff Code of Conduct. With regards to the Whistleblowing Policy, AC notes further simplification of how employees of the Group raise whistleblowing cases is planned. AC sees this as having a welcome impact of the culture of the Group. AC will monitor progress with MC and Personnel.

Finally, the AC has noted some progress to address previous gaps in remuneration policies, which include a move to reflect a non-lending volume-based indicator within corporate KPIs in line with the agreed timeline.

## Recommendations

AC considers that the EIB has a developed risk framework to mitigate financial risks. However, AC recommends the EIB further enhance its oversight of NFRs. Many of the largest risk events observed in the market in recent years have stemmed from NFRs such as conduct and cyber risk, rather than from traditional financial risks. AC expects this to be an early focus of the new GCRO. Of course, this needs to remain a strong focus of the Directors General and the MC.

AC recommends that, once appointed, the GCRO oversees the further development of integrated EIB Group policies, processes, and controls required to identify, manage and report comprehensively on both financial and non-financial risk types. AC expects the GCRO to be both independent of Services it controls and to be an authoritative voice assisting MC and BoD in developing the Group risk management framework.

AC expects the Bank to continue work to close existing gaps to achieve full compliance with BBP in the field of AML-CFT, as per the agreed action plans of the IA report.

AC also maintains its recommendation from the prior year regarding the encouragement of a sound risk culture within the EIB Group in order to ensure that it includes such features as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak-up. AC looks forward to further initiatives in this regard in 2020.

AC expects that the final gaps that remain in remuneration policies be closed, with remaining enhancements to remuneration practices completed. For example, the further diversification of corporate KPIs as a driver of objectives setting from previously volume-driven indicators, and the balancing of the scorecard of the Senior Cadre.

## 1.3.2 Internal control

### Introduction

Internal controls are defined as the systems, policies, procedures and processes implemented by management to safeguard assets, limit or control risks and achieve objectives. A critical component of safe bank management is an effective and efficient system of internal controls. AC attaches great importance to sound internal control systems at the EIB.

### AC Assessment

AC raised in its prior year report three recommendations in relation to the functioning of the control functions and the internal control environment of the EIB. The AC expects that: i) the Internal Control Framework (ICF) is further developed and is sufficiently robust, by integrating and enhancing the ICFs in each Directorate, ii) the Internal Audit Agreed Action Plans (AAPs) are closed in a timely manner, and iii) the review of the terms of reference of the control functions is completed.

In addition, the deployment of the three lines of defence model as recommended by AC, once concluded is intended to serve as the foundation of EIB's system of effective and efficient internal controls.

AC understands that a review of the terms of reference of the control functions has been initiated, and that work has continued during the year to enhance the ICF. This includes enhancements to the EIB's New Product Approval Process.

AC considers that further efforts are, however, required in order to see that the Bank's ICF is operating at the maturity expected of it. AC noted that despite encouraging progress, internal reviews highlighted that improvements are required. AC expects the MC to pay close attention to development and improvement of the ICF and will follow closely progress made during the year.

AC monitored the evolution of implementation of IA AAPs over the year and observed that, whilst most AAPs are implemented within the original timeframe set, there have been exceptions. The Group needs to continue in the coming year to ensure the timely closure of outstanding IA AAPs.

## Recommendations

AC carries forward its recommendations from the prior year's report and notes its own close monitoring of the development and improvement of the ICF.

## 1.4 Best Banking Practice

### Introduction

In last year's report, AC formulated six recommendations related to BBP. These include: i) the completion and operationalisation of the BBP Framework within the EIB Group; ii) the closure of BBP gaps encompassing the BCL's recommendations; iii) the enhanced management of the BBP Programme within the right scope, timeline and resources and the prioritisation of BBP projects; iv) the development of a common data warehouse; v) the build-up of the capability to calculate prudential ratios and stress testing results on an IFRS basis; and vi) to fully deploy the three lines of defence model within the Bank and the responsibilities of the Members of the Management Committee.

### EIB REP

In July 2018, the EIB's Board of Governors approved a number of measures relating to the EIB's capital and governance in preparation for a withdrawal of the United Kingdom from the EU, and the consequent termination of its membership of the EIB. These measures included the decision to strengthen the supervisory role of the Audit Committee of the EIB within the existing statutory framework.

In October 2019, AC presented to the BoD its proposed approach for an EIB-Review and Evaluation Process, based on the four pillars of the EBA SREP Guidelines. The EIB REP approach and methodology will be tailored to the EIB's specific nature as an IFI and will be in line with the current BBP Framework and the BBP Guiding Principles of the Bank.

The objectives of the EIB REP will be to:

- meet the public interest of having a robust and financially secure and sustainable EU IFI by strengthening the EIB Group adherence to BBP,
- ensure appropriate risk management and internal governance, and
- ensure that the expanding EIB Group remains adequately capitalised and liquid.

An EIB REP team is expected to be operational in 2020 and able to perform the first EIB REP by 2022. EIB REP team is expected to be assisted by the external auditor of the EIB, which will be requested to conduct an additional assignment to produce a Long Form Report showing the extent of compliance of the EIB Group with the applicable regulatory requirements. AC considers that the EIB REP enhances its ability to oversee the BBP Framework within the EIB.

### AC Assessment

During 2019, the EIB achieved the following: set-up a BBP Watch Team and established its Work Programme, prepared the first edition of the BBP Book, and completed several BBP Applicability Assessment Procedures. AC has reviewed and provided guidance related to these documents forming the remaining elements of the BBP Framework, with the exception of the BBP Rules repository, which is still to be developed. A fully-fledged regulatory compliance function is still to be established within the Bank.

AC has had several discussions and received updates on the project to deploy the three lines of defence within the Bank.

AC recognises that the Group is in the process of implementing the governance proposals, part of the July 2018 decisions of the BoD, which including the deployment of the three lines of defence model, as well as the establishment of the position of a GCRO, which is in the process of being filled.

A fully-fledged regulatory compliance function is still to be established within the Compliance Directorate (Office of the Chief Compliance Officer, OCCO), which will have a direct reporting line to the GCRO. In addition, the compliance function will focus its work on the implementation of the Group compliance risk assessment and controls monitoring program.

With regards to the BCL recommendations on EIB's liquidity adequacy and liquidity/ funding management, AC notes that while good progress was achieved in closing some recommendations, work remains to be completed on a number of important projects. For example: the intraday liquidity management (one of the four high priority projects of the Prudential BBP Programme), systems integration and risk data aggregation capacity for liquidity reporting, liquidity stress testing, and the development of a Group approach to liquidity management.

Partial progress has been achieved with respect to the AC recommendation on ensuring that the stress-testing exercises are performed in line with prudential requirements of the European Banking Authority. This includes the calculation of stress-testing results and prudential ratios on an IFRS-basis. This would ensure comparability between the risk profile of the Bank and other financial institutions. The RAF 2.0 project on non-financial risks needs to become operational and to be extended to the whole of the EIB Group.

The AC suggests that the Bank gives serious thought to adopting the reporting mechanisms of COREP and FINREP (please refer to the Annex of Abbreviations for the definitions), of particular relevance in the context of the EIB REP. FINREP and COREP has been implemented by banks across the EU for a number of years. Delivering into the EIB Group data standardisation, risk aggregation, consistent with comprehensive risk measurement, the use of commercially available tools and the ability to benchmark with other large EU banks is an attractive proposition for the EIB Group that AC strongly encourages. It is part of Best Banking Practice, which makes assessment and comparative analysis much more feasible in the European banking environment and therefore gives a more transparent picture to the MC and the stakeholders. The AC would support a positive decision in this direction and a roadmap for its early implementation.

## Recommendations

AC acknowledges that the Bank has achieved good progress with the operationalisation of the BBP Framework, addressing the BCL recommendations and the RAF 2.0 BBP project. The AC expects further progress with its recommendations as the Bank begins to implement the data warehouse. AC 2018 recommendation # 17 is reiterated, which is related to the reporting of prudential ratios and to the development of the capacity to produce stress-testing results, on an IFRS basis.

## 2 AUDIT COMMITTEE ACTIVITIES

### 2.1 Mandate

The AC is established under European Investment Bank Statute as one of the EIB's four governing bodies, which is independent from the Board of Directors and reports directly to the Board of Governors.

In accordance with the EIB Statute and Rules of Procedure, AC has three main responsibilities:

- i. the auditing of the EIB and the EIB Group's<sup>3</sup> accounts, which is performed while relying largely on the external auditor,
- ii. the verification on an annual basis that the operations of EIB are conducted and its books kept in a proper manner in particular with regard to risk management and monitoring; as well as the monitoring of the internal control environment, risk management, compliance, the inspectorate general and internal audit activities, and
- iii. the verification that the Bank's activities conform to the best banking practice.

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<sup>3</sup> EIB's Financial Statements under the EU Directives comprise each unconsolidated and consolidated balance sheets as at 31 December 2019, the profit and loss account and the cash flow statement for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies and other explanatory information. The EIB's consolidated Financial Statements under IFRS comprise the consolidated balance sheet as at 31 December 2019, the consolidated income statement, the consolidated statement of profit and loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and notes to the consolidated Financial Statements, including a summary of significant accounting policies and other explanatory information.

## 2.2 Composition

At the date of this report, AC has 6 members and 2 observers.

In June 2019, the Chairmanship passed from Prof. Dr. Duarte Pitta Ferraz to Mr. John Sutherland. In addition, one new member joined the AC, Prof. Dr. Nuno Gracias Fernandes, replacing the outgoing AC member, Prof. Dr. Duarte Pitta Ferraz.

The members and the observers of AC are appointed by the Board of Governors and are independent experts and professionals with knowledge, expertise and skills in finance, banking, accounting and auditing, risk management and banking supervision in both the private and public sectors. The CV's of the AC members and observers are available on the EIB's website. The AC has established a skill matrix to learn whether its members are disposing with the necessary important skills to discharge the function of the AC. The result is satisfactory: the overwhelming majority of skills and professional experience are ensured by the present membership of the AC, which should be maintained with new incoming members as well.

## 2.3 Meetings and external liaison

In 2019, AC held 12 meetings over 26 business days (2018: 10 meetings over 24 business days).

During these meetings AC had regular discussions with representatives from the Bank's Services, including Members of the EIB's Management Committee, the Secretary General, Risk Management, Transaction Management and Restructuring, Internal Audit, Inspectorate General, Compliance, Financial Control, Operations, Finance, IT, Legal, Personnel, as well as the external auditors, KPMG.

AC also met on three occasions with:

- the Audit Board of the EIF to discuss common issues in relation to the consolidated Financial Statements of the EIB Group or group policies for example in the field of risk management, equity and quasi-equity activities, IT, and the outcome of Group internal audits, and
- the BoD of the EIB where common issues of interest were covered including in relation to the process of approving the EIB Group/ EIB Financial Statements, the AC Annual Report and recommendations thereon and status update with regards to the EIB REP process.

AC continued its close collaboration with the ECB-Banking Supervision and with the Banque Centrale du Luxembourg, notably to discuss the annual review and BCL expectations for the liquidity and funding.

**Luxembourg, 09 June 2020**

Signed by:

**J. SUTHERLAND**  
CHAIRMAN

**L. BALOGH**

**V. IUGA**

**P. KRIER**

**N. GRACIAS FERNANDES**

**U. CERPS**

**D. PITTA FERRAZ**

## ANNEX 1 – DETAIL OF AC DUTIES/ ACTIVITIES DURING THE YEAR

This section contains a summary of AC's activities, classified in accordance with the AC's statutory duties, listed above.

The key observations and recommendations raised by AC as a result of its activities enumerated below are set out in Section 1 of this report.

### *i. the auditing of the EIB's and the EIB Group's accounts*

Duties	Action taken by the Audit Committee
<b>EIB Group Financial Statements</b>	
<b>AC review of the Financial Statements and other financial information</b>	<ul style="list-style-type: none"> <li>Reviewed the individual and consolidated Financial Statements and formulated its conclusions thereon, as enumerated in the AC's Statements issued to the Board of Governors, which accompany the EIB Group's Annual Report.</li> <li>Met with Financial Control (FC) at 8 of 12 Audit Committee meetings held in 2019.</li> </ul>
<b>Relationship with the external auditor</b>	<ul style="list-style-type: none"> <li>Met with the external auditor, KPMG, at 9 of the 12 Audit Committee meetings held in 2019. Held private sessions with KPMG without the presence of EIB Services at 2 of these meetings.</li> <li>Reviewed and challenged the application of the audit methodology and approach set out in KPMG's annual audit plan including key areas of judgement and estimation in the Financial Statements.</li> <li>Monitored the execution of KPMG's audit plan through regular meetings with senior members of the audit team, including the lead audit engagement partner.</li> <li>Discussed outcome of the audit procedures, in particular in relation to the priority audit areas set out above, together with the identification and reporting of Key Audit Matters as set out in KPMG independent auditor's reports on the Bank's Financial Statements.</li> <li>Reviewed and discussed the summary of identified adjusted and unadjusted audit differences.</li> <li>Made inquiries in relation to KPMG's understanding and extent of evaluation.</li> <li>Read and challenged the content of regular written reports submitted to it from the external auditor, addressing the various stages of the external audit process and including audit methodology and audit approach, the results of audit testing, levels of materiality, audit differences, significant matters arising from the audit process and auditor independence.</li> </ul>
<b>Relationship with the external auditor</b>	<ul style="list-style-type: none"> <li>Received assurance from the external auditor that the audit process was achieved as planned, with support from the Bank's Services.</li> <li>Discussed KPMG's recommendations, which are reported in their Management Letter to the Bank, as well as the status of the implementation of prior year recommendations.</li> </ul>
<b>Monitoring of external auditor independence</b>	<ul style="list-style-type: none"> <li>Received and discussed details of the various safeguards in place at KPMG to maintain auditor independence.</li> <li>Received written confirmation from KPMG that the members of the audit team remained independent within the meaning of regulatory and professional requirements and that the objectivity of the audit team, including the audit, was not impaired.</li> </ul>

*ii. verification operations of EIB are conducted and its books kept in a proper manner in particular with regard to risk management and the monitoring of the internal control environment*

Duties	Action taken by the Audit Committee
<b>Internal Audit</b>	
<b>Performance of the internal audit function</b>	<ul style="list-style-type: none"> <li>Met with the Head of IA, at 10 of the 12 meetings held in 2019, and at each of the 3 meetings held jointly with the EIF Audit Board to review joint audits of EIB/ EIF.</li> <li>Examined and discussed the salient features of IA reports including recommendations and main conclusions.</li> <li>Received quarterly updates of the status of implementation of the related agreed action plans and monitored the timely implementation of these action plans.</li> <li>Reviewed and provided comment on the draft IA work plan for 2020-2021.</li> <li>Discussed the adequacy of resourcing of the IA function.</li> </ul>
<b>Internal control framework</b>	
<b>Efficacy of internal control systems</b>	<ul style="list-style-type: none"> <li>Met with the Financial Control - Internal Controls and Assertion Division on 3 occasions during 2019.</li> <li>Examined and discussed the summary report regarding the implementation and maintenance of the Internal Control Framework.</li> </ul>
<b>Inspectorate General</b>	
<b>Coordination with the Inspectorate General</b>	<ul style="list-style-type: none"> <li>Met with the Inspector General at 5 of the 12 meetings held in 2019.</li> <li>Examined and discussed the status of on-going fraud investigation cases.</li> <li>Received regular presentations from the Complaints Mechanism of the status of the complaints received, reviewed the anti-fraud activity report and reviewed the outcome of various evaluations performed during the year together with the status of implementation of related recommendations.</li> </ul>
<b>Compliance</b>	
<b>Coordination with Compliance</b>	<ul style="list-style-type: none"> <li>The AC met with the Compliance function at 3 of the 12 meetings held, and met on 3 occasions with the task force overseeing the implementation of IA AML-CFT recommendations.</li> <li>Discussed highlights of OCCO activity in relation to operations, the process for reporting suspicious transactions, the Non-compliant Jurisdictions and the compliance culture programme.</li> <li>Reviewed revisions to the EIB Group Staff Code of Conduct and Whistleblowing Policy.</li> <li>Received updates on the status of implementation of IA AML-CFT related recommendations.</li> </ul>
<b>Risk Management</b>	
	<ul style="list-style-type: none"> <li>The AC met with the RM Directorate at 9 of the 12 AC meetings held, and discussed regular risk reports including the Monthly Risk Report and the quarterly RM Dashboard and Outlook covering the Risk Appetite Framework (RAF) Dashboard and key credit, market and operational risk metrics, the monthly Watch List and the EIB Group RM Disclosure Report.</li> <li>Regular updates were provided to the AC on the impacts and developments around the withdrawal of the UK from the shareholding of the</li> </ul>

	<p>Bank, and the reconciliation between the different capital metrics including the regulatory Capital Adequacy ratio (CAD) and S&amp;P RAC ratio, and the Bank's statutory gearing ratio.</p> <ul style="list-style-type: none"> <li>Reviewed a proposal for a revised Risk Reporting Framework and on the potential implementation of IFRS for risk reporting purposes.</li> </ul>
<b>Credit and Market Risk</b>	<ul style="list-style-type: none"> <li>Reviewed a proposal for a revised Risk Reporting Framework and on the potential implementation of IFRS for risk reporting purposes.</li> <li>Received updates on FX settlement risk, the pricing framework and on the intraday liquidity risk.</li> <li>Discussed the profitability per product project which is a transversal initiative led by RM.</li> </ul>
<b>Capital adequacy, Stress Testing, Liquidity and Funding</b>	<ul style="list-style-type: none"> <li>Reviewed the following: the Bank's ICAAP document which included an overview of the EIF and the Group capital requirements, the ILAAP and the BCL's liquidity management-related recommendations, the RAF for Non-financial Risks, the results of the stress-testing exercises and Group stress testing framework and stress testing Programme for 2020 entailing the EBA stress test exercise, the Recovery and Capital Contingency Plans, as well as the Contingency Funding Plan of the Bank, and the Capital Sustainability Policy.</li> <li>Received updates on model risk management.</li> <li>Met with the BCL supervision team and separately with the Governor of BCL.</li> </ul>
<b>Prudential Risk Management: Regulations Monitoring and Prudential BBP Program</b>	<ul style="list-style-type: none"> <li>Received regular updates on regulatory monitoring within RM and the respective implementation of regulatory developments via the Quarterly Outlook of the Risk Report, was updated on the work and proposals related to the implementation of the three Lines of Defence (LoDs) model in credit risk, received semi-annual in-depth updates of the Prudential BBP Program in RM.</li> </ul>
<b>Operational Risk and Information Security</b>	<ul style="list-style-type: none"> <li>Received and reviewed the Monthly Operational Risk Report and an overview of the setting up of the second LoDs for Information Security.</li> </ul>
<b>Risk Management within the EIB Group</b>	<ul style="list-style-type: none"> <li>Reviewed the revised Group Risk Management Charter, the first Group Capital Plan.</li> </ul>
<b>Transaction Management and Restructuring</b>	
	<ul style="list-style-type: none"> <li>The AC held 8 meetings with the TMR Directorate.</li> </ul>
<b>Monitoring and Reporting of Asset quality</b>	<ul style="list-style-type: none"> <li>Reviewed the regular TMR reporting including the Non-compliance events reports, the report on the coverage of internal ratings, the quasi-equity performance reports, as well as the monthly Watch List report, prepared jointly with RM.</li> </ul>
<b>Restructuring of operations</b>	<ul style="list-style-type: none"> <li>Received the annual restructuring report as well as discussed the Indirect Project Finance exposures and non-performing exposures review.</li> </ul>
<b>Finance</b>	
	<ul style="list-style-type: none"> <li>The AC held 3 meetings with the FI Directorate.</li> </ul>
<b>Liquidity, Funding and Treasury Management</b>	<ul style="list-style-type: none"> <li>Reviewed the annual Funding and Treasury Management report, as well as an update on the impact of Brexit on derivatives and on the Bank's preparedness for Libor replacement.</li> <li>Reviewed the Contingency Funding Plan.</li> <li>Received updates on market developments and discussions held at the Annual World Bank and IMF meetings.</li> </ul>

	<ul style="list-style-type: none"> <li>Was briefed on Blockchain developments and implications for payments systems.</li> </ul>
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*iii. the verification of EIB's compliance with Best Banking Practice*

Duties	Action taken by the Audit Committee
<b>EIB Compliance with Best Banking Practice</b>	
<b>BBP Framework:</b> <ul style="list-style-type: none"> <li>BBP Guiding Principles,</li> <li>BBP Book,</li> <li>BBP Applicability Assessment Procedure, and</li> <li>BBP Rules repository</li> </ul>	<ul style="list-style-type: none"> <li>The AC held seven meetings with the Secretary General Directorate related to the operationalisation of the holistic BBP Framework, which comprises four elements, namely the BBP Guiding Principles (BBP GP), the BBP Book of exemptions, the Applicability Assessment Procedure, and the BBP Rules repository, which tracks applicable regulations and to other governance projects as well as the three LoDs.</li> </ul>
	<ul style="list-style-type: none"> <li>The following elements of the BBP Framework were discussed and endorsed by the AC during these meetings: <ul style="list-style-type: none"> <li>the first version of the BBP Book, which was later approved by the Board of Directors, as well as the Applicability Assessment Procedure methodology,</li> <li>the Terms of Reference of the BBP Watch Team, the related Work Plan of ongoing Applicability Assessment Procedures for H1 2020, and the long-term Work Programme,</li> <li>the first two Applicability Assessment Procedures covering the related applicable regulatory requirements for Non-performing exposures and Global Systemically Important Institutions were presented to the AC.</li> </ul> </li> </ul>
<b>BBP self-assessments</b>	<ul style="list-style-type: none"> <li>The AC reviewed the BBP self-assessments of Services.</li> <li>In terms of overall level of compliance with BBP, on the basis of the 2019 self-assessments prepared by the Services, the MC in agreement with the Services, concluded that the EIB is assessed as "partially compliant" with BBP. There are key BBP requirements that still need significant efforts to close the existing gaps. The AC concurs with the MC's conclusion and will continue to oversee the closure of the identified gaps according to their agreed timeline included in the Bank's roadmap prepared as a result of the AC recommendations included in the Annual Report to the Governors issued in 2019.</li> </ul>
<b>Review of Prudential Risk Management documents and Prudential BBP Programme</b>	<ul style="list-style-type: none"> <li>The AC reviewed prudential risk management documents such as the ICAAP, ILAAP, RAF, Stress testing Framework, the recovery and capital contingency plan, and the Contingency Funding Plan as part of its sessions with RM (please refer to the table on RM for a detailed overview of these documents).</li> <li>The Prudential BBP Programme, within the responsibilities of the RM Directorate was focused in 2019 mainly on four high priority projects.</li> </ul>
<b>Task Force on the three Lines of Defence</b>	<ul style="list-style-type: none"> <li>The AC met on 3 occasions with the Task Force on the 3 LoDs.</li> <li>The AC reviewed the outcome of the gap analysis performed with respect to the existing credit appraisal and approval process of the EIB and best practices.</li> <li>The AC also received a presentation on the implementation roadmap to close the identified gaps of the credit appraisal process.</li> <li>The AC understands that a renewed effort on the three LoDs is taking place at the level of Services.</li> </ul>

## ANNEX 2 – SUMMARY TABLE OF PRIOR YEAR AC RECOMMENDATIONS AND OF THE ADDITIONAL ELEMENTS OF THIS YEAR

AC will review the status of the implementation roadmap with Services in July/ October and December 2020.

	Key Observations	Summary of prior year AC recommendations	Summary of additional elements to prior year AC recommendations
1.	<b>Sustainability and Business Model</b>	<p>1. monitor closely the viability of the evolving and more diversified business model of the Bank, as well as the trends in margin, net surplus and asset quality as contributing factors to the Bank's sustainability,</p> <p>2. prepare a strategic review of profitability per product and per mandate, and</p> <p>3. develop further the capacity to analyse revenue and expense drivers as well as cost coverage with the aim to ensure adequate profitability per product and per mandate and ensure the Bank's financial sustainability.</p>	<p>- AC would like Management Committee to explore digitalisation of processes across EIB Group as one means of many to address upward pressure on the overall cost base, and to make best use of cloud computing.</p> <p>- In view of the EIB Group pledge to initiate climate investments in the decade of 2030 and to be the key implementing partner to the EU for InvestEU and other priorities, AC reiterates the need for cost coverage of all mandates, including those under negotiations.</p>
2.	<b>Group Alignment</b>	<p>4. prioritise group alignment within the EIB Group by creating a genuine group structure with the parent company exercising effective oversight of the EIF, and of any future subsidiaries, and including group control (second and third lines of defence) and support functions. As a matter of priority, the EIB needs to ensure that the three lines of defence model functions in the existing structure, and to ensure the group oversight of risk management and the establishment of group control functions. The AC recommends that the focus of the group alignment in 2019 be on Risk Management,</p> <p>5. ensure a coordinated approach within the EIB Group of the equity and quasi-equity operations as these activities have grown in importance over the past few years. This approach should aim to avoid an overlap of product offerings between EIB and EIF and to ensure a clear delineation of roles and responsibilities within the EIB Group,</p>	<p>- AC expects further progress with the development of the Group data warehouse.</p>

		<p>6. develop the capability within the EIB Group to capture and aggregate all material risks, enhance group reporting and build a common data warehouse, as well as establish group IT policies; invest in appropriate IT infrastructure as the current state of such group infrastructure also poses increased operational risks, and</p>	
		<p>7. extend the EIB Risk Appetite Framework to a group dimension in order to steer the risk profile of the EIB and the EIF within the group, as well as develop the ICAAP, ILAAP, stress testing framework, liquidity, capital contingency plans and recovery plan at a group-level.</p>	
<p>3.</p>	<p><b>Risk Management and Internal Control</b></p>	<p>8. address the findings in the IA report on the credit appraisal and approval process,</p> <p>9. complete the review of the terms of reference of the control functions, of the roles and responsibilities within each control functions, and across the EIB Group,</p> <p>10. ensure that the ICF is further developed and is sufficiently robust, by integrating and enhancing the ICFs in each Directorate,</p> <p>11. ensure the timely closure of outstanding IA AAPs, and</p> <p>12. enhance the oversight and control of IT, cyber security preparedness and operational risks in view of increased operational threats and elevate cyber security within the Bank and the EIB Group by adopting a group approach and policies.</p>	<p>- AC expects further progress with the enhancements to the ICF.</p> <p>- AC recommends that the EIB Group further enhances the oversight of the Non-Financial Risks, including AML-CFT compliance, conduct and cyber risks.</p>

<p>4.</p>	<p><b>Best Banking Practice</b></p>	<p>13. complete the development and fully operationalize the holistic BBP Framework by implementing the necessary processes and procedures within the EIB and the EIB Group,</p>	<p>- AC expects that the MC explores the options to build up the FINREP COREP reporting.</p> <p>- AC expects the Bank to continue work to close existing gaps to achieve full compliance with BBP in the field of AML-CFT.</p>
		<p>14. close the remaining BBP compliance gaps, including the closure of the BCL’s recommendations in relation to systems integration and risk data aggregation, liquidity stress testing and the ILAAP document, as well as the development of a group approach to liquidity management,</p>	
		<p>15. enhance the management of the prudential BBP Programme and its implementation within the right scope, timeline and resourcing, including in IT, as well as the right prioritisation of BBP projects with a view to anticipate and proactively manage upcoming regulatory changes impacting the EIB and the EIB Group,</p>	
		<p>16. develop a common data warehouse,</p>	
		<p>17. develop the capability to calculate prudential ratios and stress testing results on an IFRS basis,</p>	
		<p>18. in terms of best governance practices and the full deployment of the three lines of defence at the Bank, complete the review of the responsibilities of the Members of the Management Committee be completed, and ensure that the requirements of EU law are applied to their collective and individual skills, knowledge and experience; the review should be completed in conjunction with the review of the terms of reference of the control functions (referred to under AC’s recommendations for Risk Management and Internal Control).</p>	

<p>5.</p>	<p><b>Culture, Conduct, Resources and Remuneration</b></p>	<p>19. encourage a sound risk culture within the EIB Group in order to ensure that it includes such features as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak-up,</p> <p>20. review the Code of Conduct of the Management Committee and the Board of Directors,</p> <p>21. ensure the appropriate, efficient and effective pace of hiring of the second and third lines of defence within the Bank to enable them to perform effectively their duties and to deliver high quality work; close any recruitment gaps in the control functions as a matter of priority,</p> <p>22. address the gaps identified in remuneration policies in order to foster sound risk culture within the EIB Group, and ensure that remuneration practices are better balanced to reflect not only volume-based KPIs as a driver of objectives setting; enhance the remuneration governance, remuneration structure, performance assessment, and remuneration disclosure requirements in line with best banking practice, and</p> <p>23. ensure that the findings of the IA and the Task Force reports on the gaps related to the inefficient and complex administration of staff benefits be addressed by the development of an action plan, which must be implemented quickly.</p>	
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## LIST OF ABBREVIATIONS

AC	Audit Committee
AML-CTF Directives	Anti-Money Laundering and Counter-Terrorist Financing Directives
BBP	Best Banking Practice
BoD	Board of Directors
BoG	Board of Governors
CAD	Capital Adequacy Ratio
BCL	Banque Centrale du Luxembourg
CET 1	Common Equity Tier One
COP	Corporate Operational Plan
COREP	Common Reporting (COREP) is the standardized reporting framework issued by the European Banking Authority (EBA) for the Capital Requirements Directive reporting. It covers credit risk, market risk, operational risk, own funds and capital adequacy ratios.
CRD IV/ V	Capital Requirements Directive IV / V
CS	Corporate Services
CSSF	Commission de Surveillance du Secteur Financier
DG	Director(s) General
EBA	European Banking Authority
ECB-Banking Supervision	European Central Bank-Banking Supervision
EFSI	European Fund for Strategic Investments
EIB Group (Group)	EIB Group comprises the Bank and the European Investment Fund (EIF).
EIB	European Investment Bank
EIF	European Investment Fund
EIB REP	EIB Review and Evaluation Process (build on the four pillars of EBA Supervisory Review and Evaluation Process, SREP Guidelines)
EBA	European Banking Authority
EC	European Commission
ECap	Economic Capital
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EU	European Union
FC	Financial Control
FI	Financial Directorate
FINREP	Financial Reporting (FINREP) intends to step up the harmonization in supervisory reporting. It applies to all credit institutions and investment firms (IFPRU Firms) across the EU that consolidate their financial reports based on IFRS.
GAAP	Generally Accepted Accounting Principles
GRMC	Group Risk Management Charter
G-SIB	Global Systematically Important Bank

IA	Internal Audit
ICT	Information and Communication Technology
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
IG	Inspectorate General Directorate
JU	Legal Directorate
KRI	Key Risk Indicator
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LoDs	Lines of Defence
MC	Management Committee
MP	Mandates Portfolio
NCA	National Competent Authorities
Net Surplus	Net Surplus of the Bank
NII	Net Interest Income
NSFR	Net Stable Funding Ratio
OCCO	Office of the Chief Compliance Officer
OPS	Operations Directorate
Personnel	Personnel Directorate
P&L	Profit & Loss
PJ	Projects Directorate
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
RM	Risk Management Directorate
RWA	Risk Weighted Assets
SG	General Secretariat Directorate
SMEs	Small and medium sized enterprises
TEU	Treaty of the European Union
TFEU	Treaty on the Functioning of the European Union
TMR	Transaction Management and Restructuring Directorate

# ANNUAL REPORT TO THE BOARD OF GOVERNORS ON THE INVESTMENT FACILITY FOR THE 2019 FINANCIAL YEAR

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## 1. INTRODUCTION

The Audit Committee is responsible by the EIB's Statute and Rules of Procedure for the following: i) the auditing of the EIB and the EIB Group's accounts, for which the Audit Committee relies on the external auditor; ii) the verification on an annual basis that the operations of EIB are conducted and its books kept in a proper manner in particular with regard to risk management and monitoring, as well as the monitoring of the internal control environment, compliance and internal audit activities; and iii) the verification that the Bank's activities conform to best banking practice ('BBP').

This report from the Audit Committee to the Board of Governors provides a summary of the Committee's work focused more specifically on the Investment Facility during the period since the last annual report date. The Audit Committee issues a statement each year, confirming to the best of its knowledge and belief, that the Investment Facility's ('IF') Financial Statements, prepared in accordance with the International Financial Reporting Standards, as adopted by the European Union ('IFRS'), give a true and fair view of the IF's financial position, its financial performance and its cash flows for the year then ended (see section 3 for more details).

## 2. AUDIT COMMITTEE REVIEW

The assurance expressed by the Audit Committee is based on the work of the external auditor performed by KPMG, but also on the fact that the IF relies on a number of systems provided by the Bank, notably the ones of: risk management, human resources management, treasury management and financial reporting. The Audit Committee obtains an understanding of the activities and risks associated with the various developments by reviewing management reports and by interacting with the relevant Bank services involved in the IF activities.

### Meetings with Management

During the past year, the Audit Committee received updates and reviewed reports on the IF, which provided details about the recent developments and future orientations for the IF and the Bank's activities in Africa, the Caribbean, and the Pacific ('ACP') region in general. The IF portfolio, including the watch list, together with current project trends were discussed.

### External auditors (KPMG)

The external auditors responsible for the audit of the IF's Financial Statements are appointed by and report to the Audit Committee. In order to be able to rely on the work performed by the external auditors, the Audit Committee properly monitored KPMG's activity, by requesting verbal and written reports, by reviewing the external auditors' deliverables and making further inquiries and through a formal interview before the sign-off of the accounts.

The Audit Committee held discussions with the external auditors throughout the year, in order to keep the Audit Committee briefed on the audit progress and the audit and accounting issues. The Audit Committee had an audit de-briefing meeting with KPMG before giving its clearance on the various Financial Statements. The Audit Committee received assurances that the audit process went as planned, with the full support from the Bank's Services.

The Audit Committee assesses regularly the external auditors' independence, including the absence of conflicts of interests.

### Internal Audit

The Internal Audit ('IA') Department is an independent function within the EIB with a direct reporting line to the Bank's President. The Head of IA retains unrestricted access to the Audit Committee and may request private sessions.

The Audit Committee met with the Head of IA at 10 of the 12 meetings held in 2019. The Audit Committee discussed all the significant internal audit recommendations and agreed action plans. The EIB's Internal Audit performed no specific internal audits in relation to the IF during the reporting period.

## Inspectorate General

The internal oversight function at the Bank is headed by the Inspector General ('IG'). The Inspectorate General comprises three lines of service: fraud investigation, operations evaluations and complaints mechanism. IG has a privileged relationship with the Audit Committee; the Inspector General retains unrestricted access to the Audit Committee and may request private sessions. In carrying out its responsibilities, the Audit Committee meets regularly with IG and examines reports and ongoing cases with the Fraud Investigations Division.

The Audit Committee met with the Inspector General at five of the 12 meetings held in 2019. The Audit Committee examined and discussed with IG the ongoing cases under their remit and was informed about any alleged cases of wrongdoing and ongoing investigations relating to Bank projects, including IF operations, if applicable.

## European Court of Auditors

The Audit Committee notes that the European Court of Auditors did not perform any audits related to the IF during the year ended 31 December 2019.

## 3. THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2019 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE

The Audit Committee examined the Investment Facility's 2019 Financial Statements, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union and had discussions with the external auditors, in the presence of the Bank's management and in private, in order to obtain an understanding of the audit procedures applied.

### Basis of accounting

In accordance with the Investment Facility Management Agreement ('the Agreement'), the Bank prepares Financial Statements guided by International Public Sector Accounting Standards or International Accounting Standards as appropriate. The accounting framework applied to the IF's Financial Statements is the International Financial Reporting Standards, as adopted by the European Union.

The Financial Statements of the Investment Facility comprise of the statement of financial position as at 31 December 2019, the statement of profit or loss and other comprehensive income, the statement of changes in contributors' resources, the statement of cash flows for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies and other explanatory information and are prepared in accordance with the accounting framework mentioned above.

## 4. CONCLUSION

In 2019, the Audit Committee aimed to achieve a balanced approach in terms of focus, issues handled and means utilised to obtain the necessary assurance. The Audit Committee is of the opinion that it has been able to carry out its work to fulfil its statutory mission under normal, unrestrictive conditions. The Audit Committee received full cooperation from the Management of the Investment Facility within the EIB during the reporting period.

Based on the work undertaken and the information received (including the opinion from the external auditors on the Financial Statements and a representation letter from the Management Committee of the Bank), the Audit Committee confirms that the Financial Statements of the Investment Facility, which comprise the statement of financial position as at 31 December 2019, the statement of profit or loss and other comprehensive income, the statement of changes in contributors' resources, the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, give a true and fair view of the financial position of the Investment Facility as of 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, as adopted by the European Union.

On this basis, the Audit Committee signed its annual Statement on the Investment Facility's 2019 Financial Statements, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, as of 18 March 2020, the date on which the EIB Board of Directors approved the submission of the Investment Facility Financial Statements to the EIB Board of Governors.

**Luxembourg, 09 June 2020**

**Signed by:**

**J. SUTHERLAND  
CHAIRMAN**

**L. BALOGH**

**V. IUGA**

**P. KRIER**

**N. GRACIAS FERNANDES**

**U. CERPS**

**D. PITTA FERRAZ**

# **RESPONSE OF THE MANAGEMENT COMMITTEE TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE FOR THE 2019 FINANCIAL YEAR**

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## I. KEY MESSAGES

1. The Management Committee (MC) takes note of the Audit Committee (AC) Annual Report for the 2019 financial year and concurs with the AC that the COVID-19 pandemic expands the set of new threats affecting the world and EU economies and citizens and may have a sizeable impact on the EIB Group's activities. In terms of ensuring business continuity and in the interest of safeguarding the safety of EIB Group staff, visitors and helping to mitigate the spreading of the virus, the EIB Group management took prompt action putting in place preventive and precautionary measures, with immediate effect on accesses to premises, meetings/gatherings, travelling and working methods in general. In this context, the remote working environment was tested and enhanced, accompanied by appropriate IT security measures, and teleworking and travelling guidelines were updated and adjusted to that working environment.
2. In parallel, the EIB Group has made proposals to assist the EU policy makers to respond to the economic and financial challenges posed by this health crisis. On 16 March 2020, the EIB Group proposed a comprehensive package to support the SME sector in the European Union following the outbreak of COVID-19. The EU Bank expects to mobilise financing up to EUR 40bn to mitigate crisis-induced immediate liquidity constraints for the SME sector, in a joint effort with the European Commission, other banks and public sector intermediaries. Moreover, the EIB Group will continue to support the health sector and innovation in the area of health, building on a current pipeline of projects of around EUR 5bn. Areas where funding can be quickly allocated include inter alia support to the EU Member States for emergency measures (in particular infrastructure and equipment needs), and vaccine development and production facilities.
3. In the current general context of uncertainty due to the COVID-19, the EIB continues to maintain a robust liquidity position and flexibility to access the necessary liquidity resources, thanks to its prudent approach to liquidity management. Moreover, in view of the severity of the unfolding crisis whose impact is difficult to quantify at this early stage, the MC will continue to closely monitor the quality of the EIB's loan portfolio and will report, as appropriate, to the Board of Directors and the Audit Committee.
4. The MC takes note of the AC recommendations. In 2019, the MC developed a roadmap to address the AC recommendations building on the programmes already established to enhance control and risk management frameworks, such as the BBP prudential programme. Looking forward, the MC, in close consultation with the AC, expects to adapt the roadmap to reflect the rapidly changing events brought about by the COVID-19 crisis, if that is needed to strengthen the EIB Group's ability to respond to that crisis. The MC will continue to monitor the implementation on a quarterly basis and will report semi-annually to the AC and annually to the Board.
5. The roadmap seeks to address the AC recommendations and covers compliance gaps identified in the BBP Self-Assessments in 2018 and it will include any gaps identified in the 2019 self-assessments. The AC acknowledges that those assessments have been prepared using a framework established in 2010 that will be superseded by the upcoming implementation steps of the BBP Framework. The MC will assess how to upgrade the current BBP Self-Assessments Framework and will discuss with the AC possible improvements for next year's exercise to be agreed jointly. At the same time, it is worth mentioning that, where appropriate, the Bank has also implemented regulatory requirements before they became applicable to EU credit institutions.
6. The AC acknowledged the challenging economic, regulatory and operational environment, shifted substantially by the COVID-19 outbreak, in which the EIB operates. Particularly in this context, the MC has the responsibility to carefully manage the implementation impact on resources, and set up implementation priorities under a phased approach, whilst keeping the level of ambition and commitment to implement best banking practice (BBP) and address the AC recommendations.
7. Whilst reiterating its commitment to fully implement all the AC recommendations, the MC appreciates the guidance on the AC's priorities: financial sustainability, non-financial risks (including ICT and cyber risk) and implementation of the three lines of defence. The programme, which has been set-up by the MC, will require additional expertise, work force and IT investment. The management of resources is being closely monitored by the MC to best balance and prioritise between the requirements.
8. Concerning the references to IT and its increasing relevance, both as potential tool to enhance agility, flexibility and cost reduction and as a new source of risks (ICT and cyber risks), the MC reaffirms its commitment to develop a medium to long-term IT Strategy based on three pillars: regulatory compliance; innovation, including digitalization and AI; cyber security, prevention and resilience. In this context, a new IT Governance Framework is being prepared and will be adopted in the course of 2020. This framework is focusing primarily on fostering the alignment between IT and business

priorities. Pending the adoption of such a strategy, progress is being and will be made on a number of key digitalization projects, including at Group level.

9. As regards the use of cloud computing, an EIB Group Cloud Policy was approved in 2019 providing a framework for a “hybrid” approach combining on-premise and cloud-based solutions. Cloud solutions will be adopted primarily on the basis of agility, time to market and functional match with EIB needs while respecting the cybersecurity protection requirements in line with best practice. In line with the referred policy, security and integration considerations will be taken into account when choosing solutions. In addition, a cloud risk assessment will be performed for every new application that is required to support business needs. It is unlikely that further adoption of cloud computing will lead to significant cost reductions, but cost effectiveness will indeed be a factor in the evaluation of potential solutions.

10. Cyber-attacks are indeed becoming more prevalent and sophisticated, and the MC confirms that action is being taken to constantly assess the Bank’s technical vulnerabilities and identify solutions that can be implemented to increase the EIB protection against such attacks and to improve our recovery capabilities in the event of a serious cyber-attack (for example, ransomware). On business continuity, a cyber-resilience project has been launched to determine the institution’s capability to maintain a subset of critical business activities with either non-electronic solutions or alternate applications under a ‘no-IT’ scenario for a period significantly longer than the agreed Recovery Time Objective.

11. The MC will assess the AC suggestion to reinforce the IT advisory capacity for the benefit of the governing bodies, as well as the best way to implement it within the Group context, duly taking into account the internal governance and statutory framework related issues.

12. The MC will continue to fully support the work of the AC, including by ensuring a swift setting up of the EIB-Review and Evaluation Process (EIB-REP) team, and hopes to further strengthen the fruitful cooperation with the AC.

## **II. RESPONSE TO THE KEY AUDIT COMMITTEE OBSERVATIONS AND RECOMMENDATIONS**

### **1. SUSTAINABILITY AND BUSINESS MODEL**

13. The long-term based interest rate decline and prolonged low interest rate environment alongside increasing requirements for mandates’ implementation and regulatory compliance affected the EIB net surplus. Against this background, the Bank adopted and implemented tools to steer and monitor the related impacts on the capital and on the Profit & Loss of the Bank. Related efforts will continue in 2020.

#### **Capital – steering and monitoring tools**

14. For the first time, an EIB Group Capital Plan supported the discussion and approval of the EIB Group Operational Plan for 2020 by the Board of Directors. The EIB Group Capital Plan implements the Group Capital Sustainability Policy approved by the Board of Directors in March 2019 and gives the MC and the Board additional means to better anticipate and correct any deviations from a sustainable path. It assesses the sustainability of the Operational Plan from a capital perspective over a 5-year planning horizon and ensures that capital is allocated in an efficient way to enable the EIB Group to achieve its mission. The EIB Group Capital Plan will be prepared annually together with the Group Operational Plan and reviewed in a similar sequence like the Operational Plan, i.e. at least semi- annually.

15. The Board of Directors approved an updated Risk Appetite Framework (RAF) in 2019 with a gradual implementation by mid-2021. Major steps have been achieved in the cascading of financial risk indicators, in the introduction of non-financial risk indicators and in the framework governance compared to the previous RAF. Meanwhile, the EIB and the EIF have launched the Group RAF project aiming at expanding the framework at Group level, part of BBP Prudential Programme and the roadmap to address the AC recommendations.

## Profitability, revenue and costs

16. Bank-wide and mandate cost coverage information will be provided to the AC on a yearly basis. In parallel, the Bank will undertake in 2020 a strategic review of the product lines' lifetime profitability.

17. Beginning of 2019, risk management started reporting on the profitability per product line integrating the risk dimension through the Risk Return on Equity (RRoE) indicator. The Risk Return on Equity reporting provides for an analysis of the Bank's Net Surplus split by product line and is based on the allocation of risk (Economic Capital) and revenues (using the Funds Transfer Pricing system). The methodology was fine-tuned to allocate the profitability by activity type and the results were presented to the AC in September 2019. Going forward, quarterly reporting will be submitted, on a quarterly basis, with first such reporting based on end of year 2019 figures.

18. During 2019, a number of active cost management measures and initiatives have been completed or started, including the efficiency gains initiative relating to staffing. These efforts will continue in 2020. In particular, proposals to streamline and/or rationalize certain activities will be developed in the course of this year. The MC is also determined to develop the internal capacity to analyse expense drivers and cost coverage by strengthening the cost control capacity within the EIB and the ability to measure, assess and mitigate the cost structure evolution, in the framework of the Budget Task Force and in the preparation of the EIB Group Operational Plan. Reinforcing the financial controller function will be part of these overall efforts and addressed in the comprehensive review of the Terms of Reference (ToRs) of control functions in 2020.

19. As a basic principle, cost coverage in relation to existing and new mandates is targeted and monitored at mandate level or at the level of the mandate family (e.g. EU blending facilities or trust funds under the Partnership Platform of Funds). Cost coverage is calculated on the basis of a unified methodology that takes into account all costs and revenues of both the underlying operations, as well as the purely mandate related contribution/activity. The final level of cost coverage of a mandate depends on many factors like for example (i) the nature and size of the underlying operations, (ii) the type of products to be deployed, (iii) the level of disbursement, (iv) the number of operations in restructuring/default or (iv) services to be provided under the mandate. The ultimate cost coverage of any mandate is therefore only known after the completion of the mandate. This is why the Bank calculates mandate cost coverage ex-ante (forecast), annually (to adjust ex-ante assumptions) and ex-post. Cost coverage considerations are in the centre of negotiations of all mandates. The ultimate objective of negotiation teams is to achieve full cost coverage relying on all related revenues and costs of the mandate itself as well as of the underlying operations.

## 2. GROUP ALIGNMENT

20. The Bank has started analysing the strengths and weaknesses of the current group structure and, in the course of 2020, the MC will submit proposals for discussion with the Board of Directors aiming at enhancing group alignment and allowing an effective oversight by the EIB as parent company of the EIF and any future subsidiaries.

21. The ongoing work on Group functions will also continue in order to develop synergies and Group alignment possibilities. The establishment of the Group Chief Risk Officer (GCRO) function, stronger alignment of internal audit activities between the Bank and the European Investment Fund (EIF) and the ongoing work on the strengthening Group compliance in the last years are examples of projects already being established.

22. In July 2018, the creation of a GCRO function was an element of the governance package agreed by the Board in the context of the EIB capital increase discussions. The Board of Directors endorsed the respective role and responsibilities in March 2019 and these were then reflected in the revised Group Risk Management Charter adopted by the Board of Directors in April 2019 (and by the EIF Board of Directors in May 2019) and incorporated in the review of EIB statutory framework approved by the EIB Governors in May 2019.

23. The GCRO will be responsible for overseeing the EIB Group financial and non-financial risks and will also cover compliance responsibilities, whilst preserving the necessary autonomy of the compliance function in line with best banking practice. The selection procedure of the GCRO has been started. The objective is to have the GCRO in place by the last quarter of 2020, at the latest.

24. The Bank will continue implementing the revised Group Risk Management Charter (GRMC) by codifying jointly with the EIF a set of implementing provisions in 2020. The provisions will address the procedural and organisational aspects related to Group Risks oversight by the GCRO function and will be approved in 2020 by both the EIB and EIF, after consultation with the AC and the EIF Audit Board. The provisions will cover roles and responsibilities, the general governance and approval processes for all components of the Group Risk Management Framework together with elaboration of financial and non-financial risk related processes and requirements around Group risk documents and group risk data aggregation, systems and data exchange.

25. As part of strengthening group risk oversight in the area of risk management, it is also worth noting that the Risk Policy Committee of the Board of Directors is increasingly discussing agenda topics and opining on policies with relevance for the EIB Group. At operational level, a Group Risk Steering Committee is in place composed of EIB and EIF CROs to ensure alignment and proactive steering of EIB Group risks. Once the GCRO is appointed, a Group Risk Steering Panel will be set up and be chaired by the GCRO and composed of representatives of EIB and EIF risk and control functions.

26. As acknowledged by the AC, the processes to adopt the first EIB Group ICAAP (Internal Capital Adequacy Assessment Process), ILAAP (Internal Liquidity Adequacy Assessment Process) and RAF (Risk Appetite Framework) are on track.

27. The 2019 ICAAP document, approved at the level of the Board of Directors, aims at incorporating the Group dimension by expanding the scope of Group solvency related metrics as part of the Group capital adequacy assessment and the introduction of a Group risk taxonomy as part of the “Group Risk Identification” document. Notwithstanding, further work is in process – and reflected in the roadmap to address the AC recommendations - to establish the broader set of remaining prerequisites needed for a fully-fledged ICAAP on Group level (to be reflected in the 2020 ICAAP, due in 2021).

28. The ILAAP as of December 2019 will be the first one prepared at a Group level. The ILAAP of the EIB Group contains extensive information on the liquidity risk frameworks in place at EIB and EIF and features a quantification of the liquidity risk of the Group via the consolidated LCR and NSFR, which are well above their regulatory EU minima. In addition to the stand-alone ones, also stress tests at group level are enclosed in the ILAAP 2019 to support the Group Liquidity Adequacy Statement. The latter, approved at the level of the EIB Board of Directors, expresses an opinion on the liquidity adequacy at Group consolidated level and on the liquidity risk management practices in place at EIB and EIF.

29. The extension of the current risk appetite framework to a Group RAF (i.e. the setting up of risk appetite at the EIB Group consolidated level) is in the process of being developed in the context of the Implementing Provisions for the Group Risk Management Charter and as per the timelines defined in the AC Roadmap. The Group RAF Governance Policy is planned to be approved by the Board of Directors in the last quarter of 2020.

30. The Board of Directors endorsed the EIB Group Equity Strategy in December 2019 with a view to provide a coordinated approach within the EIB Group for direct and indirect equity-type operations, avoiding product offering overlaps between EIF and EIB and ensuring a clear delineation of roles and responsibilities within the EIB Group. The related governance, organizational and procedural changes will be made in the course of 2020 with the aim of concluding implementation by December 2020.

31. In what concerns Group data and reporting, the BCBS 239 multi-year programme continues to be a key priority for the EIB Group. It involves establishing improvements in data quality, data lineage, risk data management and risk reporting capabilities, which depend on a robust data architecture and IT infrastructure. In 2019, the EIB and EIF focused on strengthening compliance with BCBS 239 principles for a set of key risk indicators as well as defining a Target Operating Model (TOM) for a Group-wide risk reporting architecture and governance. A 5-year-roadmap towards BCBS 239 compliance was presented to the Joint Audit Committee/Audit Board. As part of this roadmap, a project was launched in November 2019 aimed at building the foundations of the TOM including a Group Data Warehouse, Group data governance and implementation of a Group risk reporting framework. In parallel, additional projects have been launched to further strengthen data quality, improve Group risk reporting and reduce reliance on End-User Computing tools (EUC), all part of the roadmap to address the AC recommendations.

### 3. RISK MANAGEMENT AND INTERNAL CONTROL

#### Implementation of three lines of defence

32. In 2019 and in order to promote further alignment with BBP and the regulatory framework, the Bank hired consultants to carry out an holistic review of the lending and credit appraisal process. This review presented to and discussed by the MC identified a number of findings and has produced a roadmap for the proposed remedial actions providing a foundation for the implementation of the three lines of defence model to the Bank. In this context, a Task Force (chaired by an MC member) has been set up to prepare proposals on the allocation of responsibilities between the first and the second line on credit risk (credit and appraisal approval process for lending operations). The MC has already started discussing possible options and the organizational implications of such proposals. In accordance with the roadmap to address the AC recommendations, 2020 is a decisive year to achieve progress, in particular by reinforcing the expertise and specialization in the first line, as implementation in 2021 should focus on achieving an efficient segregation between the two lines of defence. For the remaining risks, it is foreseen that an implementation plan is prepared and adopted by the MC in the last quarter of 2020.

#### Financial Risks

33. On Financial Risk, the MC reaffirms its commitment to fully implement the Group Stress Testing Framework, as approved by the Board of Directors in December 2019, over time and integrate the respective results in the decision-making process of the Bank, in particular in the capital planning process. Furthermore, the MC will also ensure that the relevant components of the Group Risk Management Framework are developed in accordance with the timelines outlined in the roadmap to address the AC recommendations.

#### Non-Financial Risks

34. As to the AC recommendation for the Bank to further enhance the oversight of Non-Financial Risks (NFR), in November 2019 the EIB Board of Directors approved a new RAF Governance Policy which among other improvements introduces a comprehensive framework for Non-Financial Risks through four Key Risk Indicators (KRIs) capturing Operational, Reputational, Conduct, Compliance and Information and Communication Technology (ICT) risks. This represents an important step towards further strengthening and embedding a strong risk culture at the EIB as the inclusion of NFR KRIs broadens the scope of the RAF and sets out specific roles and responsibilities in defining, measuring, reporting and managing NFR. More specifically, the four RAF NFR KRIs represent an aggregation of granular risk indicators that capture a broad range of risks, including third-party risk (e.g. procurement), compliance with the AML/CFT policies, market abuse (e.g. escalated market conformity checks), integrity, confidentiality and availability of the data managed through the IT assets and data protection (e.g. cases of non-compliance with the EU data privacy requirements). The NFR KRIs will be monitored against set thresholds and reported quarterly starting from Q2 2020. The Bank-wide list of RAF NFR indicators and related thresholds are reviewed and approved annually by the Board of Directors, following discussions with the AC. Meanwhile, the EIB and the EIF launched the Group RAF project aiming at expanding the Framework at Group level, as part of the BBP Prudential Programme and the roadmap to address the AC recommendations.

35. In addition, the Bank is in the process of reviewing the Operational Risk Framework against the relevant regulatory guidelines and best practices in scope of Operational Risk Management, including benchmarking against relevant peer institutions. The assessment will be completed in mid-2020 and will result in an action plan and roadmap to address identified gaps at Group level.

#### Compliance & AML/CFT

36. In 2020 and beyond, reinforcing the AML-CFT across the EIB continues to be key priority. The further development of the AML-CFT Framework (and related processes) including at the Group level together with the clarification and implementation of roles and accountabilities for the first and the second line of defence are critical elements in achieving that objective. In 2019, efforts focused on developing a well-defined Compliance Risk Assessment (CRA) and putting in place a related structure, as key drivers for adopting a compliance monitoring programme, to be concluded

in 2020. The MC remains determined to promote and monitor the closure of all the compliance gaps identified in the area of AML/CFT.

37. In February 2019, the Board of Directors (and in March 2019, the EIF Board of Directors) approved the EIB Group Policy towards Weakly Regulated, Non-transparent and Non-cooperative Jurisdictions and Tax Good Governance that takes account of the latest EU legal framework and policy developments as well as developments in the area of tax. The approval of the EIB Group NCJ Policy was followed by a series of awareness-raising sessions on the tax integrity due diligence (TIDD) process for the first line of defence and further refinement of TIDD tools. Work in 2020 will focus on the finalisation of the NCJ Procedures.

38. In 2019, a centralized sanctions compliance function has been established to improve the coordination of sanction related activities. The responsibilities of the sanctions team were formalized in the Implementing Procedures to the EIB Group Sanctions Compliance Policy approved by the EIB in 2017 and by the EIF in early 2018. The EIB Group Sanctions Compliance Policy ('Sanctions Policy') and its Implementing Procedures became effective in July 2019. More specifically, operational provisions covering the name screening processes have been established, and their implementation in the processes of the first and second line of defence is currently ongoing. This has been complemented by awareness raising initiatives and will be further supported by a Quality Assurance Programme and an ongoing review of contractual documentation to align it with the relevant policies and development of Sanctions Risk Assessment.

## Risk Culture

39. The MC acknowledges that a stronger risk culture programme will help to reinforce and increase further the consistency and impact of the ongoing initiatives and programmes, and that the GCRO will play a key role in this respect. Currently, many initiatives are contributing to foster a stronger risk culture. In this respect, it is worth mentioning in addition to the general training programmes, the Compliance Culture Change Programme, specific and focused training courses for staff in the first line of defence, as well as face-to-face workshops on operational risk across the Bank, the Industry Risk Mapping and Financial Ratio guidance and RM Credit Market Pulse. The Bank is developing a Sound Risk Culture programme, which will cover, among others, four key areas: organization (e.g., strategy, policies and governance), skills (e.g., trainings, workforce planning), motivation (e.g., performance management, KPIs and remuneration) and behaviour (e.g., tone from the top, raising awareness).

40. The MC acknowledged the importance of reviewing the Codes of Conduct (CoC) of the MC of the Board of Directors in a scoping paper provided to the Board of Directors in February 2019. As an immediate step, in March 2019, the Board of Directors approved an MC proposal to incorporate additional provisions in the MC CoC regarding the segregation of first and second lines of defence activities at MC level. As second step, a proposal will be made in the course of 2020 reviewing both the MC and the Board of Directors CoC, in line with the above-mentioned scoping paper. Furthermore, in 2019, the reform of the EIB Group Staff Code of Conduct and the EIB Group Whistleblowing Policy were important milestones in the revision of policies and procedures within the Compliance Culture Change Programme. In 2020, a single reporting platform will be developed to clarify the whistleblowing reporting. In order to encourage a strong speak-up culture across the Bank, pilot workshops were organized in 2019, focusing on the main professional duties and whistleblowing. In 2020, a staff awareness and internal communication campaigns on the EIB Group Code of Conduct and on the EIB Group Whistleblowing Policy are planned. The EIB Group Ethics and Integrity e-Learning is under preparation to be rolled out by end 2020.

## Cyber Risks

41. On cyber risks, confidentiality, integrity, and availability of information are critical for the EIB Group. The Information Security function (ISO) in risk management, which acts as a second line of defence for IT Security, became operational in the second half of 2019. It uses best practices in independent risk assessments and evaluations of current processes to ensure the appropriate mitigation of cyber security risks. In 2019, the Information Security Policies were reinforced to include further enhancements to the EIB Group ICT Risk Management and expand on the role of the ISO function as well as the Terms of Reference for the Information Security Steering Committee (ISeC). Furthermore, information security risk early warning indicators were introduced in the RAF and information security risk scenarios were provided for the ICAAP exercise. Compliance requirements have been met, in particular Swift CSP Risk Scenarios and Target 2 ECB Guidelines as well as ISO 27001 against current Information Security Policies. The prospective gaps shall be addressed in the policy reviews planned in the course of 2020.

42. The strengthening of the second line control function overseeing information security and cyber risk has to be seen in conjunction with the strengthening of the Bank's cyber resilience, of its IT governance and the continuous improvements of the IT ICF in line with regulatory expectations.

## Remuneration

43. The BBP Book does not contain a Remuneration section yet. This section will be submitted to the Board of Directors for approval during H1/2020. The Bank will also promote a corporate view of performance objectives for Senior Cadres, in order to ensure further alignment between objective setting, performance assessment and rewards. Furthermore, the set of KPIs used for performance award determination are currently under review. The proposal is to progressively adjust the KPIs in order to ensure that they are fit for purpose.

## Internal Control Framework (ICF)

44. In 2019, the MC has paid particular attention to internal controls, including the timely closure of internal audit points. Several methodological improvements have been introduced in the ICF process of the EIB, accompanied by second line oversight actions assisting the ICF implementation. These evolutions, with encouraging bankwide progress, intended to continue bringing the bank closer to expected internal control oversight standards and future EIB REP requirements. Main developments notably resulting in:

- Increased awareness raising action;
- Completion of a simplified process architecture linked to transactions;
- Expanding the coverage of ICF documentation;
- Increasing the coverage of risk and control self-assessments;
- Continuing the implementation project "Governance, Risk & Control" application: the go-live is expected by the end of Q4-2020;
- The definition and implementation of the New Product Approval Policy intending to better assess operational impacts triggered by new product initiatives and adapt accordingly the existing internal control framework.

45. The Bank is aware that the ICF maintenance is an ongoing cycle and is committed to continue addressing the enhancements required in order to fulfil expected internal control standards. In 2020, the Bank will continue to allocate resources in order to put in place a centralized testing of controls (independent permanent control) that will allow reporting on control operating effectiveness (i.e. verification of actual execution of internal control actions in a consistent, systematic and formalized manner).

## 4. BEST BANKING PRACTICE

### BBP Framework

46. After the approval of the BBP Guiding Principles by the Board of Governors in July 2018, the MC approved the Applicability Assessment Procedure in February 2019. This procedure implements the "comply or explain approach" in the assessment of the applicability of EU banking regulatory requirements to the Bank. Those requirements shall be applicable to the extent they are compatible with the mission and mandate of the EIB and all the adaptations and non-applicable requirements should be reflected in the BBP Book. The Board of Directors approved the first version of the BBP Book in May 2019 and further adaptations in June 2019.

47. The BBP Book will be subject to regular revisions in order to reflect the evolving regulatory landscape. In this context and in the coming years, the outcome of the ongoing applicability assessment procedures carried out by the Watch Team will lead to a more stable regulatory EIB environment and will be the basis for updating the living BBP Book, in case adaptations are required.

48. The MC is ensuring the appropriate support for the organizational and logistical aspects of this process, notably the setting up of the EIB REP team. The MC would like to underline that further clarifications and fine-tuning may be

necessary during the implementation phase to ensure that the EIB-REP team can work in an independent manner under the authority of the AC. The MC will also engage with the AC to discuss whether any aspects of the approach warrant adaptations to the EIB specificities – notably its public mission and unique governance arrangements.

## BBP Implementation

49. In terms of BBP implementation, it is worth mentioning the augmented workload arising from an increasingly demanding regulatory environment. In this context, the Prudential BBP Programme has significantly expanded its portfolio of projects in 2019 and constitutes a large part of the overall roadmap to address the AC recommendations. Despite progress made in 2019, the following initiatives remain key priority projects throughout 2020: BCBS 239, Interest Rate Risk in the Banking Book (IRRBB, which includes the ongoing implementation of the management framework into a new IT platform), Intraday Liquidity Risk and RAF 2.0. Meanwhile, the BBP Programme has expanded to cover areas where compliance needs to be improved such as: operational risk, model risk management and model governance, gradual implementation of the stress testing framework, along with a number of foundational “BBP enabling” projects related to master and counterparty data management and data virtualisation. The frequency of reporting to the EIB governing bodies will also increase from bi-annually to quarterly as part of reporting on the overall roadmap to address the AC recommendations. Further projects are expected to be added stemming from the completion of BBP applicability assessment procedures for a number of upcoming regulations part of CRRII/Basel IV.

## Liquidity

50. In 2019, the EIB closed recommendations from the Banque Centrale du Luxembourg (BCL) within the timelines set in the roadmap agreed between the Bank and the BCL in April 2019.

51. The implementation of the Prudential BBP project on Intraday Liquidity Risk has proceeded in line with the timeline communicated to the AC. In December 2019, the first reporting on intraday liquidity risk exposures went live bringing the Bank in compliance with BCBS 248 reporting requirements. The project will be complemented in 2020 with the development of projections capabilities and stress testing. Under another Prudential BBP project, following approval of Regulation (EU) 2019/876, the existing NSFR ratio was revised to reflect the latest applicable EU methodology, one year and a half in advance of the entry into force of the ratio in the EU.

52. Since June 2019, the consolidated Group LCR is calculated on a monthly basis. The consolidated NSFR will be calculated on a semi-annual basis starting in 2020, with the intention of progressively increasing the frequency to quarterly in future years. The consolidated LCR and NSFR will be proposed for inclusion in the Group RAF, which is planned to be operational in 2021.

53. As mentioned above the ILAAP 2019 was the first Group ILAAP, enhancing the compliance of the process with applicable best practices. In the context of the 2019 ILAAP Group, the Bank has furthermore integrated its liquidity stress test library with the impact on liquidity of the 2019 Macroeconomic Stress Test (MEST) and with the replication of the Liquidity Stress Test (LiST) promoted by ECB among the 103 principal banks of the Eurozone in 2019. The results of the two stress tests will be reported in the 2019 ILAAP Group on top of all the existing EIB and EIF liquidity stress testing.

54. The second line of defence for liquidity risk is highly dependent on the data quality of the systems used for monitoring and reporting, as well as on the operational effectiveness of the latter. This is particularly true in the case of Group risk exposures, which are not yet consolidated in one dedicated data repository. In 2020, the Bank will conduct a study to identify the best solution to enhance the robustness of its monitoring and reporting capabilities in the area of liquidity risk.

## Stress Testing

55. The Board approved a new Group Stress Testing Framework in December 2019, after AC consultation. The framework sets out the ambition of the EIB Group in terms of development of stress testing capabilities aligned with best banking practice. It also strengthens the governance of stress testing activities at the EIB Group level. In addition, the Bank has clearly set out in its capital planning and management framework (notably through its ICAAP and RAF documents)

how stress testing results are reflected in its capital planning. The Bank considers its current stress testing exercises aligned with EBA and BCBS principles for stress testing.

56. The MC acknowledges that parts of the Group Stress Testing Framework remain to be implemented, in particular with respect to reflecting a broader set of methodological principles and stress testing practices other than EBA and BCBS, and integration of stress testing results in decision-making processes. The Bank is committed to fully implementing all aspects of the Stress Testing Framework in the next 3 years, as part of the overall roadmap to address AC recommendations.

## **COREP and FINREP**

57. At present, the BBP Book approved by the Board of Directors in May 2019 exclude the adoption of COREP and FINREP. Nevertheless, the Bank acknowledges the need to enhance its data and systems integration across the Group and is committed to align its data structures and taxonomy with the banking industry and to further developing its reporting capabilities. The Bank has already launched several projects addressing these topics as part of the roadmap to address the AC recommendations and conducted initial analysis on a sample of reports with the help of external consultancy. The BCBS 239 project currently underway will provide substantial enhancements of data management and of the IT infrastructure, thereby laying down the necessary foundation for further developing the Bank's reporting capabilities. The Bank will carefully reconsider the need to produce COREP and FINREP reporting, taking into account the requirements of the upcoming EIB-REP and any other arrangements put in place including agreed access to EU supervisory data by the EIB-REP team.

## **Risk Reporting and Stress Testing results on an IFRS basis**

58. The MC takes note that the AC reiterates its recommendation for the Bank to build-up the capability to calculate prudential ratios and stress testing results on an IFRS basis. Whilst the Bank acknowledges that IFRS reporting is used by most banks of comparable importance, the production of risk metrics under IFRS would imply a fundamental strategic change for the Bank, which supports mainly long-term investment, given that the current monitoring and decision making process of the Bank is based on reporting under EU accounting directives.

59. A change to IFRS-based risk reporting would require an adaptation of the EIB accounting systems (including the development of an IFRS Dual Ledger fit for IFRS risk reporting), internal financial and risk reporting, risk models, policies and procedures to enable the steering of the Bank under IFRS. It would also coincide with other multi-year transformational projects like BCBS 239.

60. Should dual reporting of risk metrics under EU AD and IFRS be introduced, it would require an adaptation of the decision making process to include considerations of the evolution of risk metrics under IFRS. Such parallel run would also entail the deployment of considerable additional resources and IT investments required by the maintenance and the production of a dual reporting framework.

61. The MC, in close co-ordination with the EIF's management, will therefore carefully consider the costs and benefits of producing risk metrics under IFRS, and the related implication for decision making, including whether to abandon EU AD risk reporting and risk metrics altogether in favour of IFRS, giving due regard to the policy objectives of the Bank.

### III. THE INVESTMENT FACILITY

62. The Bank is entrusted with the management of the Investment Facility (IF), including also the sub-envelope Impact Finance Envelope ('IFE'), financed by the EU Member States' budgets through the European Development Funds. Resources from the IF, alongside the Bank's own resources under the Cotonou Mandate, are utilised in the finance of operations in the African, Caribbean and Pacific Countries (ACPs) and in the Overseas Countries and Territories (OCTs). The operations flowing from the IF (and from the IFE) and the Bank's own resources are complementary in nature. Operations under the Bank's own resources under the Cotonou Mandate focus on public sector projects (e.g. sovereigns). In comparison thereto, IF operations typically focus on the riskier market segment of private sector projects and in specific cases also cover high-risk public sector operations. IFE operations focus on high-risk high-impact projects that would normally not meet the prudential requirements set under the financing of own resources supported operations.

63. The key transactions and internal activities related to the management of the IF (and of IFE operations with financial institutions) are handled by the same processes, procedures and infrastructure of the Bank. Hence, key management and internal controls, particularly concerning risk management, internal audit, human resources, treasury and financial reporting are the same as those applied to the operations of the EIB. Operations pursued under the Impact Finance Envelope of the IF other than loans to financial institutions follow the provisions laid down in the general mandate risk principles for impact finance mandates, included in the relevant section of the Bank Risk Guidelines. The internal processes of the Bank are complemented by an external governance structure in the form of the IF Committee, which is the forum in which representatives of the Member States and the European Commission set the policies and operational guidelines of the IF and give an opinion on operations. External mandates, including those of the IF, are subject to external audit.





# Audit Committee Annual Reports

for the year 2019



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