



European Investment Bank

Audit Committee Annual Reports for the year 2012



AUDIT COMMITTEE

Annual Report to the Board of Governors

For the 2012 financial year

AUDIT COMMITTEE**ANNUAL REPORT TO THE BOARD OF GOVERNORS****For the 2012 financial year****Table of Contents****AUDIT COMMITTEE**

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1. INTRODUCTION

The Audit Committee is established under EIB Statute as a committee independent from the Board of Directors, both Members and Observers are appointed by, and report directly to, the Board of Governors.

The Audit Committee is responsible for the auditing of EIB's financial statements and verifies that the activities of the Bank conform to best banking practice.

The Audit Committee held meetings over twelve days in 2012.

This report is addressed to the Board of Governors, in accordance with the Statute and Rules of Procedure, and provides details on the work of the Audit Committee in relation to the audit of the 2012 financial statements, as well as on other activities performed since the date of the previous Annual Report.

In relation to our responsibility for auditing the EIB's accounts, we have issued the Audit Committee's Annual Statements for the following financial statements as at December 31, 2012:

- Bank statutory;
- EIB Group consolidated under the general principles of the EU Directives;
- EIB Group consolidated according to IFRS;
- Investment Facility;
- EU Africa Infrastructure Trust Fund; and
- Neighbourhood Investment Facility (NIF) Trust Fund.

In the statements, the Audit Committee confirms, that to the best of its knowledge and belief, the financial statements prepared for the entities listed above give a true and fair view of their financial position, of the results of their operations and cash flows for the year under review.

Besides financial reporting, and audit matters, we focused our attention on the progress made by the EIB in complying with best banking practice and on the risk management activities of the Bank. The following sections of this report provide further detail in this respect.

2. AUDITING ACTIVITIES

2.1 Review of Audit Work

In its work, the Audit Committee relies on the external and internal auditors, from which it receives assurance on the accuracy of financial reporting and confirmation of the effectiveness of the internal control processes. In addition, the Audit Committee obtains a representation letter from the President of the Bank, which is itself based on internal support letters from the Bank's services, confirming management's responsibility for establishing and maintaining an efficient internal control structure and its responsibility for the preparation and fair presentation of the financial statements.

2.1.1. *External auditors*

The day-to-day audit work is delegated to the external audit firm, KPMG, designated by, and reporting directly to, the Audit Committee.

KPMG confirmed to the Audit Committee that the audit methodology and approach applied was substantially consistent with that of 2011, therefore in the context of planning of the 2012 audit, KPMG's priority audit areas were also consistent with those of the prior year, as follows:

- lending, including valuation of the loan portfolio taking into account an increase in credit risk (confirmed by the Bank's internal credit risk indicators) and the audit of the continued migration of loan contracts transferred to a new IT application as at the year end,
- treasury, including valuation of the Bank's portfolios and treasury disclosures in the financial statements,

- the controls surrounding the financial reporting process, where specialist input was used for the financial statements, where due attention was given to ensure disclosures are in line with best practices and prevailing accounting standards.

We were briefed at length, throughout the year, on the progress and outcome of the audit procedures, in particular in relation to the priority audit areas. We ensured that the external auditor reported to us in writing on significant matters arising from the audit process in accordance with the requirements of International Standards on Auditing.

Our regular meetings with, and reports received from, the external auditor, meant that we were able to closely monitor audit progress and the timely resolution of any issues, resulting in a no surprises audit.

We received assurances that the audit process went as planned, with full support from the Bank's services. The Audit Committee was satisfied with the results of the external audit work, which enable it to formulate its own conclusions to the Board of Governors.

The Audit Committee is also responsible for ensuring the external auditors' independence. The Bank's general policy is to not allow the incumbent external auditor to undertake work outside the scope of the Framework agreement for audit services. Consequently, KPMG was not engaged to perform non audit services for the Bank during the year ended December 31, 2012.

In 2012 the Audit Committee, in consultation with the Management Committee of the Bank, and both the Audit Board and Chief Executive of the European Investment Fund, agreed to the renewal of KPMG's initial four year term as Group external auditor for one additional and final period of three years, in accordance with the provisions of the joint tender process undertaken in 2008.

2.1.2. Inspectorate General

The internal oversight function at the Bank is headed by the Inspector General (IG) and comprises four lines of service: internal audit (IA), fraud investigation, operations evaluations and complaints mechanism. Although the direct reporting line is to the President of the Bank, the Audit Committee has a privileged relationship with the Inspector General and the Head of Internal Audit who may request private sessions with the Audit Committee and have unrestricted access to it.

The Audit Committee has met regularly with IG to examine and discuss the salient features of IA reports issued and has received updates of the status of implementation of agreed action plans (AAPs) with a specific focus on the implementation high risk points, and discussed with the Fraud Investigations Division the on-going cases under their remit.

The Audit Committee was consulted on the drafting of the Internal Audit work plan for 2013-2015. We asked that an audit of the 'qualitative' elements of the Internal Ratings Coverage process, i.e. that an assessment of the methodology applied, with a focus on the quality of the internal ratings established, be performed in the coming year. Further detail is given on the outcome of the internal ratings exercise in section 4 below.

During the reporting period we were pleased to note that an external Quality Assurance Review of Internal Audit took place in accordance with the requirements of the Institute of Internal Auditors. The report concluded positively on the Internal Audit activity, with some recommendations for improvement which include measures to ensure the timely closure of AAPs.

The Audit Committee has noted progress over recent years with the timely implementation of AAPs, in particular the resolution of high priority matters. The Audit Committee has, however, asked that a review of the process itself be undertaken, in consultation with the Management of the Bank, in order that the necessary actions are determined to resolve the matter definitively.

A formal action plan for implementation of the recommendations will be established by the Inspector General and communicated to the Audit Committee.

In last year's Annual Report we highlighted our intention to closely monitor progress made in respect of the implementation of IA's recommendations concerning the derivative valuation process. The Audit Committee took note that remedial measures concerning enhanced segregation of duties,

formalised updates to existing procedures and a strengthening of the related control environment, were implemented during the year.

Finally the Audit Committee has received full support from the internal audit division in relation to the verification of best banking practice implementation (see section 4 below). An internal audit review addressing the integration of best banking practice in the field of Risk Management was performed during the reporting period.

2.1.3. European Court of Auditors

The Audit Committee had its annual meeting with the European Court of Auditors, a useful occasion for exchanging information on the progress of various audits undertaken by the Court.

Discussions covered subjects of common interest such as the status of current as well as future Court audits concerning the operations under mandate of the Bank, internal organisational changes within the Court, the use and scope of the Court's special reports as well as the foreseen implications for both the Bank and the Court of the Multiannual Financial Framework.

2.1.4. Cooperation with the Audit Board of the European Investment Fund

The Audit Committee meets at least once per year with the Audit Board of the European Investment Fund in order that the two respective bodies may discuss specific areas of audit focus and share matters of interest including where possible, common working practices.

2.2 The Financial Statements as at 31 December 2012

The Audit Committee has examined the three sets of accounts issued by the EIB and those of the Investment Facility, the EU-Africa Infrastructure Trust Fund, and the NIF Trust Fund for 2012.

The key elements of the various financial statements are presented below.

2.2.1. EIB

Statutory financial statements (non-consolidated):

The Audit Committee noted that the total balance sheet as at December 31, 2012 amounts to EUR 508 billion, an increase of EUR 36 billion, +8%, compared to the previous year (December 31, 2011: EUR 472 billion). Total own funds at December 31, 2012 have increased by EUR 12.7 billion to EUR 55.2 billion, +30%, from EUR 42.5 billion at December 31, 2011.

The evolution of the balance sheet can be largely explained by a year on year increase in the volume of loans to customers of EUR 26 billion to EUR 276 billion (2011: EUR 250 billion) and in the loans to credit institutions, mainly financed by an increase in debts evidenced by certificates on the liabilities side of EUR 24 billion to EUR 425 billion (2011: EUR 401 billion). The remaining change in the Bank's balance sheet results from a decision of the Board of Governors on December 31, 2012 to Bank's the Bank's subscribed and called capital by EUR 10 billion.

The net surplus for the financial year ended December 31, 2012 stands at EUR 2,740 million, an increase of EUR 448 million, +20%, compared with 2011 (2011: 2,292 million).

Consolidated financial statements prepared in accordance with EU Accounting Directives.

The consolidated financial statements prepared in accordance with EU Accounting Directives comprise those of the Bank and those of its subsidiary, the European Investment Fund, the financial statements of the Fund are prepared for the same reporting year as the Bank, using consistent accounting policies.

The total balance sheet of the consolidated financial statements prepared in accordance with EU accounting directives amounts to EUR 509 billion at December 31, 2012 (2011: EUR 472.5 billion).

We note total consolidated net profit of EUR 2,797 million, slightly higher by EUR 57 million than the net profit of the unconsolidated financial statements which amounts to EUR 2,740 million, the

difference is explained by consolidation adjustments, the impact of a change in group accounting policy to apply market values to all transferable securities not held as financial fixed assets and related hedging derivatives, and EIF's result for the year.

Consolidated financial statements prepared in accordance with IFRS.

The consolidated financial statements prepared in accordance with IFRS comprise those of the Bank and those of its subsidiary, the European Investment Fund, the financial statements of the Fund are prepared for the same reporting year as the Bank, using consistent accounting policies.

The consolidated result for the year ended December 31, 2012 stands at EUR 279 million, the year on year variance in the IFRS financial statements amounts to EUR 3,464 million. At the end of 2011 the IFRS financial result for the year was EUR 3,743 million.

The variation of the financial result between EU Accounting Directives and IFRS, as well as the IFRS result year on year, is mainly explained by the variation of the fair value option accounted for in relation to loans, borrowings and ALM swaps in accordance with the requirements of IAS 39 'Financial Instruments Recognition and Measurement.' In this respect the application of fair value accounting means that the accounting value recognised in the balance sheet evolves from one period to another in line with variations in either publicly available, or deemed fair market values, of the instruments. As the policy of the Group is to hold financial instruments designated with the fair value option to maturity, positive or negative income statement impacts are neutralised by the end of the lifecycle of the respective financial instruments.

2.2.2. Trust Funds

EU-Africa Infrastructure Trust Fund:

The total comprehensive loss of the EU-Africa Infrastructure Trust Fund for the year ended December 31, 2012 is EUR 16.1 million compared to a total comprehensive loss of EUR 17.6 million in 2011.

The NIF Trust Fund:

The total comprehensive loss of NIF Trust Fund for the year ended December 31, 2012 amounts to EUR 6.1 million compared to EUR 6 million in 2011.

3 RISK MANAGEMENT ACTIVITIES

We draw up our work plan with the objective of obtaining a thorough understanding of the Bank's activities throughout the year. We then formulate questions and request specific analyses in order to assess the risk impact of various external developments such as the evolving financial crisis as well as various internal developments in the Bank, including the launch of new products and initiatives.

During the past year, as a result of the sustained economic crisis the Audit Committee has continued to dedicate significant time at each meeting to discuss, evaluate and assess with the services responsible the Bank's risk management practices, the potential impacts of external economic developments together with the corresponding risk monitoring and mitigating techniques employed. We meet with the Bank's Risk Management ('RM') and Transaction Monitoring and Restructuring ('TMR') Directorates at every Audit Committee meeting.

In obtaining our assurance in relation to risk management activities we concentrated our attention on specific technical points in addition to regular reviews of various monthly, quarterly and annual risk reports. In particular over the past period the Audit Committee has focussed on topics such as credit risk assessment and monitoring, impact of the on-going financial crisis, operational risk assessment, liquidity risk management and capital adequacy requirements. Key elements are presented below.

Credit risk monitoring

The Audit Committee held discussions throughout the year with Management concerning the trends of key risk indicators such as the capital adequacy ratio, evolution of loan gradings, large exposures, concentration risk and 'watch list' loans with a view to establishing that Risk Management is actively assessing and managing risks during challenging economic times.

The Audit Committee sought further explanations and assurances concerning the monitoring of specific operations where contractual clause related post signature events had occurred together with the monitoring and eventual specific provisions established for operations reported on the 'watch list'.

We received explanations from the Bank's services concerning the Bank's credit risk assessment process and provisioning policy.

In response to the current crisis the Bank foresees a significant increase in lending activity over the next three years and will be entering into new business activities and offering new products.

The Audit Committee considers that the Bank may be exposed to new types of credit risks. As a result we have recommended that the Bank performs a 'health check' of the current credit risk assessment process to ensure that procedures will effectively meet the needs of both the potential changing credit risk profiles of the Bank's counterparties, as well as the economy in general.

Liquidity Risk Monitoring

We have discussed and reviewed with RM the results of a sample of liquidity reports.

The EIB's participation in Eurosystem liquidity operations resulted in an agreement being signed between the EIB and the Banque Centrale du Luxembourg ('BCL') which established a framework for the assessment by the BCL of the liquidity situation and liquidity risk management of the EIB.

We took note of the written report issued by the BCL, as a result of a follow-assessment performed to analyse and assess progress made on observations they initially reported in 2010.

We were pleased to note that the report concluded positively. The Bank has addressed the various issues raised in the 2010 report, liquidity risk management procedures within the Bank are considered by the BCL to be well established.

The BCL noted that the governance aspects of liquidity risk management pertaining to the seniority and independence of the risk management function as well as its control over liquidity risk management processes had been enhanced. This matter was also verified by the Audit Committee during our annual verification of best banking practice.

Limited additional observations were made which relate to certain elements within the liquidity risk management framework as well as the risk profile and liquidity situation of the EIB in the current market environment. The Audit Committee will monitor progress of the implementation of necessary actions over the coming year.

EIB Cartography of Risk

The Audit Committee discussed with RM the annual update of the Bank's Cartography of Risks (CARE). The scope of the CARE document, initially established in 2010, was extended to cover compliance and legal risks, in addition to the assessment of credit, operational and market risks previously carried out.

The cartography identified certain gaps to be addressed in the near future such as further standardisation of derivative counterparty contracts, certain input data quality problems identified upon the analysis of market risks and a need to ensure that sufficient resources are available to meet the increased demands upon the risk function as a result of the economic crisis.

The Audit Committee asked for further development of the document regarding the effective and complete capture of all relevant information across the Bank's services which may contribute to the assessment of operational risk, together with further coherence checks to be made between the gaps reported in the BBP self-assessment and the corresponding CARE risk assessment.

Capital adequacy requirements

We have met with the persons responsible from the Bank's services throughout the reporting period and reviewed the outcome of the analysis performed.

We also reviewed and discussed the results of two capital adequacy related IA reports that were issued. The first, the annual audit of Basel II/ Capital Requirements Directive ('CRD'), where the main elements of the corporate model used for credit risk and the methodology used for market risk were reviewed. The scope of the second audit included the verification of the integration of CRD related Best Banking Practices (BBP) into the Bank's operational guidelines and procedures' manuals.

We took note of the respective findings raised, that certain parameters of the market risk methodology should be reviewed, the need to ensure a sufficient allocation of resources to CRD related processes, and with reference to operational risk, the need for the Bank to formalise the Advanced Measurement Approach validation exercise.

Further detail on the work performed by the Audit Committee in relation to the capital adequacy ratio together with our response to the status of implementation of best banking practice and the aforementioned recommendations made by IA, is detailed in section 4.2, 'Follow up Capital Requirements', below.

4 EIB COMPLIANCE WITH BEST BANKING PRACTICE

The Audit Committee, in accordance with the responsibilities assigned to it by the Bank's Statute, has carried out the annual exercise of verifying the EIB's compliance with best banking practice.

The Framework for EIB conformity with best banking practice ('the Framework') was jointly established by the Audit Committee and the Bank's services in 2010. The Bank's services are required to proactively consider and propose the inclusion of new or revised standards within the Framework.

4.1 Implementation and verification methodology

The Framework is based on a hierarchical set of reference documents (e.g. EU Treaty, including the Bank's Statute, EU Directives, international standards, guidance and principles issued by regulatory bodies – collectively referred to as "standards" further in this report) that are considered relevant at a certain point in time, EIB compliance is measured against the requirements of these reference documents.

On the basis of proposals from the Bank's services, the Audit Committee approves updates to the Framework, its' implementation and verification of best banking practice, on an annual basis, details of which are provided below.

During the year the Audit Committee has reviewed the annual self-assessment of compliance with the Framework established, with each of the Directorates concerned. In addition to verifying the ongoing maintenance of areas where the Bank achieves full compliance with BBP, the meetings aimed at highlighting:

- (i) The areas where full compliance had not been achieved at the last self-assessment and the progress made, for each of the applicable standards, towards full implementation;
- (ii) Developments in standard setting (new standards and reformed standards); and
- (iii) New EIB internal developments and their possible relevance to the standards (e.g. to see whether new standards become relevant to EIB as new products or initiatives are developed or whether there is a change in compliance).

The Audit Committee considers that compliance with the Framework is a natural process which should form an integral part of written procedures, the internal control environment and daily working practices of the Bank.

To complement the self-assessments reported by Directorates, the Audit Committee has requested that IA includes within its annual work plan an audit of one area of the Framework each year, with the specific objective of providing assurance regarding the integration of best banking practices into the corresponding internal written procedures of the Bank's services.

In addition, when planning and performing individual audit assignments, we have asked IA to incorporate and perform tests of controls linked to the reference standards, with a view to providing further assurance in the form of an opinion on compliance.

4.2 Review of specific areas in 2012-2013

The Audit Committee has met and discussed at length with the Bank's services the status of implementation of best banking practice and the results of the annual verification process, focussing in particular on progress made during the year in closing remaining compliance gaps.

In the areas of market operations, payment systems and rogue trading, measures were taken to address the few remaining compliance gaps during the year. As a result an assessment of full compliance with requirements of best banking practice was reported.

Capital requirements

The Bank remains broadly compliant with the qualitative elements of the prevailing CRD.

The Audit Committee was pleased to note that the Bank delivered on its commitment to implement full coverage of internal ratings, as envisaged, by the end of 2012. The further development and validation of internal models, together with enhancement of the documentation, validation and implementation of the Bank's derivatives valuation and counterparty credit risk calculation methodology was also achieved.

Progress was also reported with the work necessary to improve the large exposures framework and to formalise the Bank's Internal Capital Adequacy Assessment Process ('ICAAP') document and stress testing framework, while further work in relation to the full implementation of the advanced internal ratings based approach remains to be carried out. The completion date of these projects, initially foreseen for 2012, was revised to 2013.

In order to achieve full compliance additional work will also be undertaken in respect of the Bank's securitisation framework, policies concerning counterparty credit risk on derivatives and securities financing transactions and enhancing the oversight of the management of interest rate risk.

The Audit Committee has highlighted the resource implications associated with not only achieving full compliance with CRD, but with the effective maintenance and development of internal capital adequacy processes and models, as well as the demands arising from emerging regulatory requirements. We are also aware of the constraints the Bank's services have faced over the past year as result of prioritisations related to the crisis, the capital increase and related strategy adaptation of the Bank.

It is within our Statutory remit to verify the Bank's full application of best banking practice and to ensure that the work plan established to do so is both achievable and achieved. As a result the Management of the Bank has agreed to the allocation of additional resources. These additional resources will be used to both undertake the work necessary to achieve full compliance with CRD and to analyse and address the requirements of forthcoming regulations.

Closing CRD related compliance gaps has become a key priority of the Audit Committee. We intend to closely monitor the timely achievement of the related milestones established by the Bank's services in the forthcoming year.

Corporate governance

The Bank follows corporate governance standards established by the EU, the OECD and the Basel Committee on Banking Supervision ('BCBS'). In addition, the EBA Guidelines on Internal Governance which entered into force in the first quarter of 2012 were incorporated into the Framework, the Bank's compliance with which was therefore assessed for the first time during the reporting period.

The Audit Committee retains the finding reported in last year's Annual Report, whilst we acknowledge that coordination between the EIB and EIF risk functions exists, we recommend that, in order to further enhance compliance with the Framework, the Bank considers enhancing the oversight of risk at group level.

We have asked the Bank to formalise a position on the matter and substantiate the actions that will be undertaken for presentation to the Audit Committee during the second quarter of 2013.

Anti-Money Laundering and Combating the Financing of Terrorism (AML-CFT)

The Audit Committee received regular updates throughout the reporting period on the work underway to close remaining compliance gaps in the field of AML-CFT.

The Bank took measures to reinforce resources in the compliance function, which included the appointment of a new Group Chief Compliance Officer and, as a result, a subsequent reorganisation of certain roles, responsibilities and objectives of the Directorate. We were pleased to note the progress made during the reporting period and that the findings reported, in particular in relation to the provision of AML-CFT training and implementation of a new IT filtering tool, have now been largely addressed.

New developments in best banking practices

The application and assessment of compliance with the Framework is an iterative process. Underlying best banking practice standards evolve over time and as such the Audit Committee requires the Bank's services to proactively consider and propose the inclusion of new or revised standards within the Framework.

The EBA Guidelines on Internal Governance which entered into force in the first quarter of 2012 were incorporated into the Framework during the reporting period.

The Bank's services have not identified nor proposed any other significant changes to the Framework during the year. We will, however, continue to monitor developments in the regulatory environment with a view to ensuring that the Framework remains up to date and that, going forward, it continues to reflect prevailing best banking practices.

4.3 Conclusions

The Audit Committee regards the proper implementation and verification of compliance with best banking practice an explicit requirement of the Bank's Statute, to be of paramount importance. We have, together with the Bank's services, dedicated significant time throughout the year to focus on the status of implementation of the actions necessary to close remaining compliance gaps.

As a result of the work we have performed during the reporting period we consider that the Bank is largely compliant with requirements of the Framework, with the exception of certain points brought to your attention, and detailed above.

We have been pleased to note the considerable effort and evident progress made by those concerned to largely deliver on their prior commitments to the Audit Committee, notably with regards to the achievement of full internal ratings coverage and the reinforcement of resources in the Compliance function, as a result of which significant progress was made in closing compliance gaps in the field of AML-CFT.

There remains, however, further work to be done, in particular in relation to the full compliance of BBP requirements in respect of the qualitative elements of the CRD. We will closely follow the progress made by the Bank's services in this respect during the coming year.

5. ISSUES OF FOCUS FOR THE AUDIT COMMITTEE LOOKING FORWARD

We understand in the coming years that the Bank will significantly increase its activity in response to exceptional times of a deep and on-going crisis.

The Bank's Operational Plan 2013-2015 was prepared on the basis of an anticipated (and since approved) increase in share capital from Member States of EUR 10bn. We understand that increased lending activity will be targeted towards priority objectives, projects which will help foster growth and employment within the EU and which collaborate strongly with EU policy. In order to meet these objectives the Bank is looking to seek out market demand in new areas, in new sectors, with new counterparts and with new products.

In reply to a call from the EC for enhanced EIB involvement in support of EU spending plans, the Bank will expand its advisory role using technical assistance expertise and will continue to develop products blending EU grants and loans. EU leaders are also seeking to build upon this, and through even stronger collaboration with the European Commission, there is likely to be a significant increase in the third party resources/ external actions managed by the Bank.

We appreciate that the Bank will gear up its processes to address these challenges and will need to mobilise the necessary additional resources. We also acknowledge that the Bank will seek to ensure the credit quality of its portfolio is maintained and prudential standards, are complied with, in line with the Bank's objective to maintain its status as prime issuer on the capital markets.

Our role will be to establish that the Bank's control environment, regardless of significantly increased operational demands, continues to remain sound and will be properly designed to meet the needs of the Bank's changing business activities in these unprecedented times.

Given the current economic climate we will also continue to devote significant attention to the effective oversight of the management of risks, in particular the management of credit and liquidity risk.

With regards to EIB's compliance with best banking practice, we will continue to concentrate on monitoring and reviewing the actions undertaken by the Bank's services to close the remaining compliance gaps, in particular with regards to achieving full compliance with the qualitative elements of CRD, as well as continuing to oversee the annual verification exercise.

Within the context of compliance with best banking practice, the EIB's preparations to meet requirements of the forthcoming suite of banking regulatory reforms, will figure highly on our agenda. We will continue to meet regularly with the services concerned to monitor and review the outcome of impact assessments as well as the status of implementation plans, in order to ensure the EIB's readiness for compliance from the outset.

With reference to banking oversight we will also carefully follow the status of implementation of a Single Supervisory Mechanism for banks under the authority of the European Central Bank and any implications the banking union may have for the Bank.

We are aware of the forthcoming revisions to international financial reporting standards (IFRS), in particular in relation to various standards effective from 2013 and 2014, relating to the accounting treatment of employee benefits, fair value measurements and the Bank's investments in other entities. We will liaise with the Bank's services to understand the potential implications for the financial reporting process, including any IT system or data configuration requirements, as well as to ensure the EIB's readiness for first time application of these standards in the coming year.

Finally we will continue to closely follow developments with respect to proposed reforms to the audit profession in order that the impact of any future reforms on the current external audit arrangements and practices in place at the EIB may be established, responsibility for which falls directly within the remit of the Audit Committee.

6. CONCLUSIONS

Based on work undertaken and the information received (including an unqualified opinion from the external auditors on the financial statements and a representation letter from the Management of the Bank), the Audit Committee concludes that the financial statements drawn up by the Board of Directors give a true and fair view of the financial position of the Bank and of the results of its operations and cash-flows for 2012, in accordance with the applicable accounting framework.

The Audit Committee is able to extend the same conclusion to the financial statements of the EU-Africa Infrastructure Trust Fund and the Neighbourhood Investment Facility Trust Fund as these are covered to a large extent by the EIB's own risk control systems and internal and external audit arrangements.

The Audit Committee was able to carry out its work to fulfil its statutory mandate under normal, unrestricted conditions. The Audit Committee is satisfied that the audit assurance obtained during the meetings, corroborated by the review of the documentation presented, and its own analyses sustain its conclusions. On this basis, the Audit Committee issued its annual statements as of the date of signature of the audit report by the external auditors and of the adoption by the Board of Directors.

The Audit Committee had a balanced work approach during the year in terms of focus, objectives and means utilised to obtain the necessary assurance. The Audit Committee believes that it has retained appropriate standing within the Bank, and that it has maintained appropriate relations with management and Bank staff, while remaining independent from the Bank at all times. In 2012 the Audit Committee received the expected full support from the Bank's Management and services, thus being able properly to discharge its responsibilities.

Date, 14 May 2013

Signed by:

J. RODRIGUES DE JESUS, Chairman

D. NOUY, Member

M. MATEJ, Member

M. ÜÜRİKE, Member

B. JAKOBSEN, Member

J.N. SCHAUS, Member

J. VESALA, Observer



AUDIT COMMITTEE

Annual Report to the Board of Governors

Investment Facility

For the 2012 financial year

AUDIT COMMITTEE**ANNUAL REPORT TO THE BOARD OF GOVERNORS
ON THE INVESTMENT FACILITY****For the 2012 financial year****Table of contents:**

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1. INTRODUCTION - the role of the Audit Committee

The statutory role of the EIB's Audit Committee is to verify that the Bank's operations have been conducted and its books kept in a proper manner, as defined in the Statute and Rules of Procedure. The Financial Regulation of the Cotonou Agreement provides for the audit and discharge procedures of the Investment Facility to be the same as those defined for the Bank.

The Audit Committee issues a statement each year confirming, to the best of its knowledge and belief that the financial statements prepared for the Investment Facility give a true and fair view of its financial position, the results of its operations and of its cash flows for the respective year, in accordance with the accounting framework applied by the Bank (see section 3 for more details).

The Audit Committee is established under the EIB Statute as a committee completely independent from the Board of Directors, with the Members and Observers being appointed directly by the Board of Governors. 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.

2. AUDIT COMMITTEE REVIEW

The assurance expressed by the Audit Committee is based essentially on the external audit performed by KPMG, but also on the fact that the Investment Facility (IF) shares a number of systems with the Bank, notably those involved in risk management, human resources management, treasury management and financial reporting. The Risk Report for the Investment Facility prepared by the Bank services was also shared with us. The Audit Committee obtains an understanding of the activities and risks associated with the various developments by reviewing regular management reports and by interacting regularly with the relevant Bank services involved in the IF activities.

Meetings with Management

The Audit Committee has met during the past year with the Management of the Investment Facility, who offered details about the recent developments and future orientations for the IF and the Bank's activities in the ACP region in general. The IF portfolio, including the watch list, together with current project trends was discussed.

Monitoring Aspects

Continuing to build on progress made over the last few years with regards to enhancing the due diligence process and the control environment, the Bank has re-enforced the monitoring of operations by creating a segregated function tasked with the monitoring and post signature follow up of both loan and equity investments.

The Audit Committee followed up on the status of implementation of recommendations reported in 2011 as a result of a mid-term evaluation of the overall performance of the Investment Facility foreseen as foreseen in the Cotonou Agreement.

External auditors (KPMG)

The external auditors report to the Committee, which delegated to them the day-to-day work concerning the audit of the financial statements. In order to be able to rely on the work performed by the external auditors, the Audit Committee has properly monitored their activity, by requesting oral and written reports, by reviewing the external auditor's deliverables and making further inquiries and through a formal interview before the sign-off of the accounts.

We held discussions with the auditors throughout the year, in order to keep ourselves briefed on the audit progress and the audit and accounting issues. We conducted a private interview with KPMG before giving our clearance on the various financial statements. We received assurances that the audit process went as planned, with full support from the Bank services.

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

Inspector General

The internal oversight function at the Bank is headed by the Inspector General (IG) and comprises four lines of service: internal audit, fraud investigation, operations evaluations and complaints mechanism. Although there is no direct reporting line, the Audit Committee has a privileged relation with the Inspector General and the Head of Internal Audit who may request private sessions with the Committee and have unrestricted access to it. The Audit Committee meets regularly with IG and examines IA reports and ongoing cases with the Fraud Investigations Unit.

The Audit Committee is also informed about any alleged cases of wrongdoing and ongoing investigations relating to Bank projects, including Investment Facility operations. We also discuss with Internal Audit all the significant audit recommendations and agreed action plans, together with the unit responsible for implementation. No specific audits in relation to the Investment Facility have been performed by the EIB Internal Audit during the reporting period.

European Court of Auditors

The Audit Committee has not received from the European Court of Auditors any audit reports or audit notifications related to the Investment Facility in 2012.

3. THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2012 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE

The Audit Committee examined the 2012 financial statements of the Investment Facility and has interviewed 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.

The Committee noted, in relation to the 2012 financial statements:

- **Income statement:** The Investment Facility recorded a profit of 19 million in 2012 compared to a profit of EUR 61 million in 2011. This change is mainly due to a reduction in the year on year net result on financial operations of EUR 22.3 million and the positive impact of reversal of impairments in 2011 which amounted to EUR 27.5 million in 2011 compared to only EUR 0.6 million in 2012.
- **Balance Sheet:** The Balance Sheet total increased from EUR 1,825 million at December 31, 2011 to EUR 2,133 million at December 31, 2012.
- **Credit risk:** The Investment Facility had disbursed exposure totalling EUR 1,479 million at the end of 2012, increasing from EUR 1,285 million at the end of 2011.
- **Impairment:** Certain impairment adjustments on loans recorded in previous years were reversed, reducing the balance of impairments from EUR 49 million at the end of 2011 to EUR 45 million at the end of 2012.

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 (Article 7, paragraph 3 of the Agreement). The accounting framework applied to the financial statements is International Financial Reporting Standards (IFRS) as endorsed by the EU.

4. CONCLUSION

In meeting its responsibilities in 2012 the aim of the Audit Committee was 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. We have received full cooperation from the Investment Facility during the reporting period.

Based on the work undertaken and the information we have received (including the opinion from the external auditor on the financial statements and a representation letter from the Management of the Bank), we conclude that the 2012 financial statements of the Investment Facility have been drawn up

correctly and that they give a true and fair view of the 2012 results and financial status according to the accounting principles applicable to the Investment Facility. On this basis, we signed our annual statement as of 14 March 2013, the date on which the EIB Board of Directors has approved the submission of the IF financial statements to the Board of Governors.

Date, 14 May 2013

J. RODRIGUES DE JESUS, Chairman

D. NOUY, Member

M. MATEJ, Member

M. ÜÜRRIKE, Member

B. JAKOBSEN, Member

J.N. SCHAUS, Member

J. VESALA, Observer



AUDIT COMMITTEE

Response of the Management Committee To the Annual Reports of the Audit Committee For the 2012 financial year

**RESPONSE OF THE MANAGEMENT COMMITTEE
TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE
FOR THE YEAR 2012**

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1 CORPORATE GOVERNANCE AND INTERNAL CONTROL

The Board of Directors has the overall responsibility for maintaining a sound system of internal control that supports the achievement of Bank's policies, aims and objectives while safeguarding the funds and assets of the Bank in accordance with the responsibilities assigned to the Board of Directors within the Statute of the European Investment Bank.

The Management Committee, under the supervision of the Board of Directors, has the day-to-day responsibility for the system of internal control which is based on an ongoing process designed to identify the principal risks to the achievement of policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively, and economically. In this regard, the Management Committee continues to seek measures to enhance the risk management, audit and other internal control structures of the Bank.

The Management Committee and Bank services meet with the Audit Committee during the year and the Bank endeavours to respond promptly to requests of the Audit Committee. The Bank services have maintained a collaborative approach in supporting the work of the Audit Committee and continue to foster mutually constructive, yet appropriately independent, relationships between the Management Committee, Audit Committee, the internal auditors and external auditors. The Bank commits to maintain this collaborative approach to enable the Audit Committee to execute its responsibilities in line with its statutory provision and respecting the areas of focus identified by the Audit Committee.

In addition to an annual external audit of the financial statements under the discharge rules of the Statute, a number of the Bank's activities under partnership agreements are also subject to separate external audit scrutiny. Furthermore, various audit procedures are required in connection with certain bond issues. As both a Community body and a financial institution, the Bank also cooperates with other independent control bodies such as the European Court of Auditors, European Anti-Fraud Office (OLAF) and the European Ombudsman. As such, the Bank is subject to significant independent review throughout the year, as well as at the year end. In 2012 the term of the external auditor KPMG was extended for a further 3 years, in accordance with the provisions of the EIB/European Investment Fund (EIF) tender process undertaken in 2008.

During 2012 the Bank's Internal Audit function was subject to a periodical external Quality Assurance Review in accordance with the requirements of the Institute of Internal Audit standards. The report concluded positively, with some recommendations for improvement, for example, to ensure timely closure of Agreed Action Plans (AAPs). A review of the existing follow up process for AAPs has been undertaken and it is proposed to formally strengthen senior management involvement on a timely basis, with associated procedures to be in place by end April 2013. A formal action plan to address other recommendations of the Quality Assurance Review has been developed, and issued to the Management Committee and Audit Committee in Q1 2013. The various proposed actions will be discussed directly with the Audit Committee and all actions are foreseen to be completed by end 2013.

The Bank has a balanced approach to 'risk taking' and adopts an active approach to the mitigation of risk. The Management Committee remains satisfied that the major risks to which the Bank is exposed, as identified through the risk management and internal control framework, have been reviewed and systems, policies and/or procedures have been established to manage those risks. Overall internal controls and procedures are effectively designed and operated to provide proper assurance on the integrity, legality and timeliness of the underlying transactions and processes of the annual financial statements. Further comments on governance are given in the context of the Best Banking Practices framework in Section 3 below.

2 RISK MANAGEMENT

2.1 General Risk Management Approach

As a matter of priority, the Bank continues to focus on the assessment of new lending operations and the monitoring of the credit quality of its existing loan portfolio. Furthermore, it reviews and seeks to improve its risk management framework on an on-going basis, with particular focus on compliance with Best Banking Practices and the requirements of the Capital Requirements Directive (CRD).

The EUR 10bn increase in the Bank's paid in capital will have a positive impact on the Bank's capital adequacy and leverage ratios and will therefore strengthen its risk bearing capacity. This will allow the Bank to increase the volume of new operations. The Bank will also remain attentive to prudential liquidity standards. As such, risk taking will continue to be exercised in a prudent and controlled manner, in line with the Bank's objective to maintain its credit standing and status as prime issuer on the capital markets - all of which have been anticipated in the Bank's Operational Plan for 2013-2015.

The Board of Directors is kept informed of the on-going risk related developments including the potential impact of changes in market circumstances on EIB's financial stability and overall business model through the monthly Risk Reports. Within the Board of Directors, the Risk Policy Committee meets no less than four times per year to review the Bank's policies with regard to credit, market and liquidity risks. The Risk Report is reviewed and discussed by the Risk Policy Committee as well as with the Audit Committee.

2.2 Specific Risk Management Activities

Credit risk monitoring

The capital increase has also strengthened the EIB balance sheet allowing for ambitious operational lending targets which are notably higher than were foreseen pre-capital increase. In the current crisis environment this will require exceptional efforts. Nevertheless, the continuous assessment of credit risk remains a key priority. It is undertaken through close monitoring of key indicators including Basel II capital adequacy ratios, review of asset quality distribution for existing portfolio and new business, managing the evolution of the Watch List, risk concentration measures and activity impact on the leverage ratio.

The Bank has continued to strengthen its ability to monitor its counterparts and respond to contractual covenant breaches and distressed situations resulting from deteriorating financial and economic conditions. Regular status reports regarding internal rating coverage were provided to the Audit Committee throughout the year and, by end 2012, full coverage for all counterparts had been achieved. Impaired loans have remained low and stable, demonstrating the continued strong asset performance. This combined with effective risk management has contained the financial impact of the continued but moderate deterioration in the Bank's loan portfolio. As requested by the Audit Committee, an audit of the 'qualitative' elements of the internal ratings process has been included in the Internal Audit plan for 2013.

Following the transposition of the Basel III requirements into EU law (expected to enter into force in 2013), the Bank is adjusting its capital adequacy model to include the impact of Basel III into the minimum regulatory requirements.

Liquidity Risk Monitoring

Liquidity risk is managed prudently in order to ensure the regular functioning of the Bank's core activities in both normal and stressed conditions. The adequacy of the Bank's liquidity buffer is monitored through liquidity ratios and indicators, which have to remain within prudential pre-defined limits.

During 2012 the Banque Centrale du Luxembourg (BCL) conducted a follow up review to monitor progress on observations made during their 2010 assessment. The report was positive and concluded that liquidity risk management framework within the Bank were well established. The liquidity risk management framework will continue to be monitored for relevance and effectiveness and the Audit Committee will be appraised of enhancements on an on-going basis.

EIB Cartography of Risk (CARE)

In 2012 the scope of the CARE document has been extended to cover compliance and legal risk, in addition to the assessment of credit, operational and market risks previously carried out. In line with guidance provided by the Audit Committee, Risk Management will undertake a consistency check to ensure that the Best Banking Practice self-assessment and the CARE risk assessment are aligned.

3 BEST BANKING PRACTICE

3.1 Implementation and verification methodology

The Bank is committed, through its Statute, to the implementation of relevant accepted best banking practices as defined within a framework established by the Audit Committee in consultation with the Bank's services in 2010. The European Banking Association (EBA) Guidelines relating to Internal Governance which came into force during 2012 have been included in the Bank's framework and compliance with requirements was therefore assessed. These best practices are complementary to the legislation and rules that are directly applicable to the Bank.

The Bank continually seeks full compliance with current relevant best banking practices, as defined within the framework, and elements for further compliance have been identified and actions, reviews or investigations are underway to address them. In 2013 and thereafter on an annual basis, Internal Audit will perform a specific review of an aspect of the credit risk framework in order to comply with the requirements of Basel II and the Capital Requirements Directive. The 2013 review will focus on the methodology used for project finance and developments within EIB to address counterparty credit risk and credit value adjustments which are foreseen under Basel III.

It should be noted that the identification and review of Best Banking Practice is now embedded in all phases of the audit alongside normal risk and control based activities (ie. planning, fieldwork / testing, reporting).

The Bank reiterates its recognition that evolution in banking activities will require continuous review of the best banking practices and commits to the revision, if necessary, of the Bank's associated compliance measures.

3.2 Capital Requirement Directive (CRD)

As reported by the Audit Committee, the Bank remains broadly compliant with the qualitative elements of the prevailing CRD. Although significant progress was made in 2012, full compliance was not achieved as a result of the exceptional demands on resources which arose from the crisis, the capital increase and related strategy adaptation of the Bank.

Nevertheless, the Bank is fully committed to addressing the remaining areas in order to ensure full compliance with the CRD by the end 2014. Additional resources will be allocated to undertake the required work and also to analyse and address the requirements of forthcoming regulations.

3.3 Corporate governance

Oversight of risk at a group level

From an industry best practice perspective, banking and fund management are fundamentally different businesses.

Within the EIB Group, the EIB and EIF have different missions, structures and instruments. EIB provides financing (mainly loans) to private and public undertakings for investment projects in the EU and Candidate & Potential Candidate countries, as well as projects outside the EU on the basis of dedicated mandates and facilities. EIF provides risk capital and credit enhancements for SMEs financings with a focus on EU and Candidate & Potential Candidate countries – overlaps of market and product between EIB and EIF are limited to Asset Backed Securities (ABS) operations, albeit with different roles (funding provider vs. guarantor); EIF

generally has recourse to the ABS and not to the banks, who are important counterparts for EIB.

The Bank acknowledges the need to take a holistic view of risk at group level in order to conform to best practise. Indeed, some methodologies stemming from best banking practices have been adapted to the monitoring and evaluation of funds management and some common objectives underline the definition of the risk appetite of both institutions. A joint EIB-EIF working group is looking at other synergies identified between the two entities.

The Bank will outline its approach to Group Risk Policy in a presentation to the Audit Committee, together with an overview of the respective risk exposures by end Q2 2013.

4 THE INVESTMENT FACILITY

The Bank is entrusted with the management of the Investment Facility (IF), financed by the EU Member States' budgets. Resources from the IF, alongside the Bank's own resources (OR), 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 the Bank's own resources are complementary in nature. IF operations typically focus on the riskier market segment of private sector projects that would normally not meet the prudential requirements set under the financing of OR supported operations.

4.1 Common platform for Management and Internal Controls

The key transactions and internal activities related to the management of the IF are handled by the same processes, procedures and infrastructure of the Bank. Hence key management and internal controls, particularly in regard to risk management, internal audit; human resources, treasury and financial reporting are the same as those applied to the operations of the EIB. External mandates, including those of the IF, are subject to external audit.

5 LOOKING AHEAD

A substantial investment has been made to address the Internal Rating Coverage. The Bank has decided to allocate further resources to its risk team in order to achieve and maintain compliance with the CRD requirements. These will be in addition to the resources required in the context of the capital increase for risk aspects on the lending, financing and treasury operations. The Audit Committee will receive and monitor the related work plan.

The Bank's risk processes to assess proposals for new operations and the resolution of credit events on outstanding exposures are well established and have served during the Bank's first crisis response starting in 2009. In view of the further effort the Bank has been asked to undertake during 2013-2015 in terms of its operational lending plan, the continuing appropriateness of these processes will be reviewed.

The Bank is also assessing possible implications which the Single Supervision Mechanism under the European Central Bank may have.

The Bank has already made significant plans in anticipation of the forthcoming revisions to International Financial Reporting Standards as summarised in Annex 1.

6 CONCLUSION

The Management Committee is appreciative of the feedback and support from the Audit Committee during 2012 and shares its concerns regarding adherence to Best Banking Practice particularly in the light of increased lending volumes. However, the Management Committee continues to be confident in its policies, procedures and people to succeed in both delivering the operational plan and ensuring effective control mechanisms.

ANNEX 1 - Activities in Preparation of Revisions to International Financial Reporting Standards

The Bank has assessed the implications for the financial reporting process in relation to standards which become applicable for the first time in 2013 namely;

IAS 19 Revised for Employee benefits – Effective date 1 January 2013

The revision introduces certain amendments to the accounting for employee pensions, including recognition of defined benefit liability re-measurements in other comprehensive income and enhanced disclosure requirements for defined benefit pension plans. It also modifies accounting for termination benefits.

IFRS 10, 11 and 12 Consolidated financial statements, Joint arrangements and disclosure of interests in other entities – Effective date 1 January 2014

These standards establish (i) the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities (ii) the framework for determining the type of joint arrangements that an entity has with another entity and (iii) the requirements to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities. An impact assessment is currently carried out jointly by the relevant EIB and EIF services with conclusions expected to be available in July 2013 for discussions with the EIB group auditors. The implementation is foreseen on the 1st January 2014.

IFRS 13 Fair value measurement – Effective date 1 January 2013

This standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. An initial impact assessment has been carried out by the relevant EIB services (RM and FC) and the approach and findings will need to be discussed and agreed by the EIB group auditors, before an implementation is carried out on the 1st quarter 2013 financial statements.

IFRS 9 Financial Instruments – Effective no earlier than 2015

The Bank continues to closely follow the finalisation of the IFRS 9 components with a view to ensuring proper implementation once the standard becomes applicable in the European Union. The new standard could offer opportunities to better control the considerable volatility currently experienced by the EIB in its IFRS consolidated results.



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