



Audit Committee Annual Reports for the year 2016

AUDIT COMMITTEE

Annual Report to the Board of Governors

For the 2016 financial year

AUDIT COMMITTEE**ANNUAL REPORT TO THE BOARD OF GOVERNORS****For the 2016 financial year****Table of Contents**

EXECUTIVE SUMMARY	3
1 INTRODUCTION	4
2 KEY OBSERVATIONS.....	5
3 OUTCOME OF EXTERNAL AUDITING ACTIVITIES.....	7
4 INTERNAL AUDIT, INSPECTORATE GENERAL, RISK MANAGEMENT AND COMPLIANCE	9
5 EIB COMPLIANCE WITH BEST BANKING PRACTICE	11
6 FOCUS AREAS LOOKING FORWARD	14
7 CONCLUSION.....	15

EXECUTIVE SUMMARY

The Audit Committee is responsible by EIB Statute for the auditing of the EIB's financial statements, verification of the Management's implementation of Best Banking Practice ('BBP'), and oversight that the activities of the Bank are conducted in a proper manner, in particular with regards to risk management and monitoring. This report, addressed to the Board of Governors, provides details on the work performed by the Audit Committee and its key observations, recommendations and conclusions, since the date of its previous annual report, May 2016.

The Audit Committee carried out its work during 11 meetings held over 19 meeting days. During its meetings regular discussions took place with representatives from across 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, Personnel, as well as the external auditors, KPMG. The Audit Committee also met on 3 occasions with the Audit Board of the European Investment Fund. Matters presented to the Audit Committee by EIB services were corroborated by the Audit Committee's own review of supporting documentation deemed necessary together with, where required, the Audit Committee's own analyses of matters presented and feedback.

The Audit Committee, as a result, raises its key observations in this report, namely the importance of ensuring the long term soundness of the EIB and maintaining the AAA rating. A necessary pre-condition is the accomplishment of full implementation of BBP where pervasive compliance gaps remain, the need to review and enhance where necessary existing internal processes and risk management practices at both the level of the EIB and at that of the EIB Group, and to see that the unorthodox combinations of responsibilities of Management Committee members, such as the responsibility for the oversight of both first and second line of defence activities, should cease.

This report also sets out in more detail progress made together with the work still to be carried out to achieve full compliance with BBP, in relation to Anti Money Laundering – Combatting the Financing of Terrorism (AML-CFT), Prudential Risk Management and Corporate Governance.

Finally the conclusion at the end of this report presents the outcome of the Audit Committee's work and recommendations thereon in relation to the three areas within its responsibility, the auditing of the EIB's financial statements, verification of the Management's implementation of Best Banking Practice ('BBP'), and oversight that the activities of the Bank are conducted in a proper manner, in particular with regards to risk management and monitoring. The conclusion also summarises the main actions the Audit Committee requests of the Bank's Management Committee.

1 INTRODUCTION

The Audit Committee is established under European Investment Bank (EIB) Statute as a committee independent from the Board of Directors. Its Members (and Observers, as the case may be) are appointed by, and report directly to, the Board of Governors.

This report is addressed to the Board of Governors in accordance with the EIB Statute and Rules of Procedure. This report provides details on the work performed, key observations, recommendations and conclusions, by the Audit Committee since the date of its previous annual report, May 2016. The Audit Committee held 11 meetings over 19 days in 2016 (2015: 9 meetings over 15 days).

1.1 Composition and competence of the Audit Committee

At the date of this report the Audit Committee comprises six members and one observer. Members and observers are appointed for a non-renewable mandate of six consecutive financial years, on the basis of their qualifications.

Both the members of, and the observer to, the Audit Committee demonstrate the pre requisite experience in the fields of financial, audit or banking supervisory expertise, in both the private and public sector. The CV's of the members of, and observer to, the Audit Committee are available on the EIB's website.

1.2 Outcome of Audit Committee Work

As required by Article 12 of the EIB Statute the Audit Committee:

- *EIB's financial statements*

Issued and submitted to the Board of Governors its Annual Statements for the financial statements as at 31 December 2016, and listed below:

European Investment Bank

1. EIB, under the general principles of the Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions, as amended by Directive 2001/65/EC of 27 September 2001, by Directive 2003/51/EC of 18 June 2003 and by Directive 2006/46/EC of 14 June 2006 ('EU Directives');
2. EIB Group¹ consolidated, under the general principles of the EU Directives;
3. EIB Group consolidated, prepared in accordance with IFRS as adopted by the EU.

Based on the statutory governance structure of the EIB and European Investment Fund, the Audit Committee stresses its work, and its Statement on the EIB Group Consolidated Financial Statements thereon, is formed solely upon the work performed by the external auditor and the respective external audit opinion issued by KPMG on the EIB Group Consolidated Financial Statements.

Mandates and trust funds

4. Investment Facility;
5. EU Africa Infrastructure Trust Fund; and
6. Neighbourhood Investment Facility (NIF) Trust Fund.

- *Verification of Best Banking Practice*

Verified the extent to which activities of the Bank conform to Best Banking Practice ('BBP') applicable to it, hereafter referred to as the 'BBP Framework'.

¹ At 31 December 2016 the EIB Group is composed of the EIB and its subsidiaries, the European Investment Fund and EU Microfinance Platform FCP FIS.

Further information on the composition of the EIB Group is available in note E.1 to the EIB Group Consolidated Financial Statements, prepared under the general principles of the EU Directives and note B.4 to the EIB Group Consolidated Financial Statements, prepared in accordance with IFRS, as adopted by the EU.

2 KEY OBSERVATIONS

The Audit Committee, in accordance with the responsibilities assigned to it by the EIB Statute, highlights its key observations as follows:

2.1. Maintaining the AAA rating is paramount

The long term soundness of the EIB and maintaining the AAA rating is paramount, it is safeguarded in part by the implementation of best banking practice which serves to protect the EIB and keep it safe, and in part by the risk profile of the EIB's operations and products. The implementation of BBP includes the requirement for sound risk management and compliance practices and the establishment and effective segregation of the three lines of defence.

The task and mission of the EIB, according to Article 309 of the Treaty on the Functioning of the European Union ('TFEU') is to contribute to the balanced and steady development of the internal market in the interest of the European Union. The EIB's strategy is driven by EU public policy objectives. The EIB generally provides financing to projects on reasonable terms, in relation to which, the needed funds are not available from other sources.

The EIB is a market driven banking institution. The EIB has two funding sources, its own funds and borrowings mainly in the form of bonds. In order to fund its lending activities, it issues in the international capital markets a very wide range of debt products, in terms of size, currencies, maturities and structures. Its debt issues are bought by institutional and retail investors around the world. Any downgrade will affect debt holders, many of whom are banks and other financial institutions. At the end of 2016 outstanding debt securities in issuance held by the EIB's investors amounted to EUR 485bn, disbursed loans amounted to EUR 471bn.

The Audit Committee considers that the maintenance of the EIB's AAA rating is paramount, and is a precondition to the EIB being able to sustainably deliver its Treaty based task and mission. The EIB's AAA rating is a central pillar to the EIB's business model of raising funds and lending at attractive rates. The EIB's varied investor base also seeks to ensure that it retains access to the high quality, AAA rated, liquid assets it subscribed to. The implementation of BBP is a statutory requirement for the Bank, and provides the necessary framework within which the EIB may ensure its long term soundness and maintain its AAA rating. By complying with this BBP Framework the EIB implements the most up to date regulatory banking practices normally mirroring those required of commercial banking peers, unless exempted by EIB Statute or Rules of Procedure.

The Audit Committee welcomes the review of the BBP process initiated by the Management Committee. The Audit Committee understands that this review aims to take stock of the various aspects of BBP and their applicability to EIB, taking into account both the EIB's specificity of being an EU Institution enshrined in TFEU as an instrument for supporting EU policy, and that the EIB is a market driven bank. The review serves as a means to providing clarification to key stakeholders of the purpose and applicability of BBP, once endorsed and approved by the Management Committee, the Board of Directors and the Board of Governors.

The Audit Committee expects that the conclusion of this aforementioned BBP review should see the continued close focus by Management on fully implementing the BBP Framework, and to ensuring that all necessary actions are undertaken to close existing BBP gaps. Certain EIB practices do not yet fully comply with the requirements of corresponding best practice, and in some areas pervasive compliance gaps remain. Further information on the status of implementation of the BBP Framework by the Management of the EIB is disclosed in Section 5.

2.2 Internal Control and Risk Management Environment

The EIB Group has seen a substantial increase over a short period of time to both the volume and nature of its operations. Existing internal processes and risk management practices should be reviewed and enhanced to ensure that they continue to meet the needs of a changing EIB Group.

The deployment of the European Fund for Strategic Investments (EFSI) has seen a marked change in the nature of the business undertaken by the EIB, together with an increase of mandates under management by the EIB on behalf of third parties such as the European Commission. As a result further demands have been placed on the EIB's staff, infrastructure, IT system requirements, processes and controls. To sustain this

growth the EIB has, in addition, recruited additional staff with approximately one third of the EIB's employees having joined the EIB within the last two years.

The Audit Committee considers that EIB's internal control and risk management environment needs to continue to meet the demands of this fast paced change and be adequately resourced, both in terms of staff numbers, skills and competence.

Management of the EIB should ensure that a risk culture is promoted where all EIB employees are aware of their own responsibilities in relation to risk management, compliance and internal control environment. The Audit Committee retains its recommendation from its 2015 Annual Report, that the Management of the EIB should look to establishing a complete map of risks and responsibilities and see that the three lines of defence model is effectively deployed across the Bank.

Furthermore the Prudential Risk Appetite Framework approved by the Board of Directors in December 2015 should be extended to a full Risk Appetite Framework which considers non-prudential risks (such as conduct, cyber risk, AML). Risk appetite limits set out in the Risk Appetite Framework ought to be effectively translated into first line of defence activities, so as to embed prudent risk taking into the EIB's risk culture and day to day management of risk. Group risk requirements in relation to the EIF should also be incorporated.

With reference to group risk considerations, the European Investment Bank is the majority shareholder of the European Investment Fund ('EIF'). Together the EIB and the EIF form the main part of the EIB Group. The EIF deploys, in addition, various mandates on behalf of the EIB, including the Risk Capital Resources (RCR) and EIB Group Risk Enhancement Mandate (EREM). The combination of both EIB's shareholding in the EIF and the management by EIF of EIB funds under mandate represent approximately 10 percent of the EIB's total regulatory capital requirements as a result of higher risk profile of these operations in relation to other credit risk exposures of the EIB Group. To this end a risk volume trade off exists between the operations of the EIF and other operations of the EIB Group.

The EIB is obliged through the implementation of BBP to play its role as majority shareholder of the EIF by seeking ways to enhance the management of risk, processes and internal controls from a Group perspective. To this end, and in order for the EIB to comply with BBP which includes EIB Group related requirements, the Audit Committee recommends that a review of the terms of reference of the Bank's control and risk functions be initiated and that this review extends to EIB Group considerations. To achieve this, any existing barriers to the sharing of information necessary for the effective consolidated oversight of the EIB Group shall be promptly removed.

2.3 Combination of responsibilities amongst the Management Committee

The Audit Committee retains its view reported in its prior year 2015 Annual Report, that the existing combination of responsibilities amongst the Management Committee should be reconsidered. The Audit Committee believes that members of the Management Committee should be able to act objectively, critically and independently and, that unorthodox combinations of responsibilities, such as the responsibility for the oversight of both first and second line of defence activities, should cease.

3 OUTCOME OF EXTERNAL AUDITING ACTIVITIES

3.1 Audit Committee Review of external audit work

In its work, the Audit Committee relies on the external and internal auditors and where appropriate, the work of external experts, from which it receives assurance on the accuracy of financial reporting and confirmation of the effectiveness of the internal control processes and procedures.

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 framework, as well as its responsibility for the preparation and fair presentation of the financial statements.

3.1.1 Audit Committee oversight of the external audit process

As set out in the Article 26.2 of EIB Rules of Procedure the audit of the financial statements of the EIB is assigned by the Audit Committee to the external auditor. The external auditor of the EIB appointed by, and reporting directly to, the Audit Committee is KPMG.

The Audit Committee took note of the audit methodology and approach set out in KPMG's annual audit plan, where the following priority audit areas were identified:

- lending, including valuation of the loan portfolio;
- treasury, including valuation of the Bank's treasury assets, borrowings and derivatives portfolios and related disclosures in the financial statements;
- the controls surrounding the financial reporting process, including the proper application of both new and revised accounting standards.

The Audit Committee:

- monitored the execution of this audit plan through regular meetings with senior members of the audit team, including the lead audit engagement partner. The Audit Committee met with KPMG at 7 of the 11 Audit Committee meetings held;
- was briefed on the progress and outcome of the audit procedures, in particular in relation to the priority audit areas set out as well as the follow up of the implementation of prior year external auditor recommendations, as reported in KPMG's Management Letter to the Bank;
- ensured that the external auditor submitted regular written reports to it on significant matters arising from the audit process, in accordance with the prevailing requirements of International Standards on Auditing;
- received assurance from the external auditor that the audit process was achieved as planned, with support from the Bank's services.

The Audit Committee was satisfied with the results of the external audit work, which enabled it to formulate its own conclusions, as enumerated in its Statements to the Board of Governors that accompany the Bank's financial statements, listed in Section 1 above.

3.1.2 Audit Committee monitoring of external auditor independence

The Audit Committee is responsible for reviewing and monitoring the independence of the external auditor, in line with the requirements of prevailing EU Regulation². The Audit Committee was presented with, and discussed, the various safeguards in place at KPMG to maintain auditor independence. The Audit Committee 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.

As an additional safeguard to maintaining auditor 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. The Audit Committee confirms that KPMG was not engaged to perform non-audit services for the Bank during the year ended 31 December 2016.

² Regulation EU No 537/2014 OF The European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public interest entities.

3.1.3 Appointment of the external auditor

The mandate of the incumbent external auditor, KPMG, is due to expire on approval of the 2016 financial statements listed in Section 1, by the Board of Governors in 2017. KPMG has been the EIB's auditor for a period of 8 years.

A competitive, joint public call for tender process, facilitated by the EIB and the EIF under the direct oversight of the Audit Committee and Audit Board of the EIF respectively, was concluded in 2016. In accordance with the Rules of Procedure, the Audit Committee, in consultation with the EIB's Management Committee, subsequently designated KPMG as external auditor of the EIB for a further period of five years, from 2017.

3.1.4 Facilitating the future rotation of the external auditor

EU audit reform entered into force in June 2016. The reform introduced further restrictions on the provision of non-audit services by audit firms to audit clients. Professional service firms in the market place are increasingly facing the choice between bidding to provide external audit services or for other and sometimes potentially more financially interesting, consulting contracts.

To facilitate the process for the future and timely rotation of the EIB's external auditor, the Audit Committee recommends that the EIB Group establishes:

- a list of the contracts that professional service firms, typically eligible to tender for external audit services, are providing to the EIB Group. The duration of such contracts should also be compiled;
- a process addressing how the EIB Group may best balance its approach towards the use and management of contracts awarded to these professional service firms for consultancy work, and the need for external audit firms to adhere to rules regarding rotation.

3.1.5 Cooperation with the Audit Board of the European Investment Fund

The Audit Committee met on three occasions with the Audit Board of the EIF. The two statutory bodies discussed specific areas of audit focus and shared matters of interest, which included the coordination and conclusion of the joint external audit tender, and where appropriate, common working practices and the coordination of external audit mandate.

In light of the growth the EIB and the EIF, together with the increased volume of business under mandate managed by the EIF on behalf of the EIB, the Audit Committee and Audit Board have committed to further increasing cooperation between both bodies.

The Audit Committee and Audit Board signed a 'Cooperation Paper' which sets out a framework for discussing common issues and coordinating actions that have an impact on the consolidated financial statements of the EIB Group and group policies. The Cooperation Paper also formalises the ways in which the Audit Committee and Audit Board cooperate and transparently communicate on the activity, governance and control environment of both institutions.

4 INTERNAL AUDIT, INSPECTORATE GENERAL, RISK MANAGEMENT AND COMPLIANCE

4.1 Internal Audit

In October 2016 the Internal Audit ('IA') Department became an independent function within the EIB with a direct reporting line to the Bank's President. Internal Audit was formerly part of the Bank's Inspectorate General Directorate. The Audit Committee supported and welcomed this change.

The Head of IA retains unrestricted access to the Audit Committee, and may request private sessions. The Head of IA met on two such occasions with the Audit Committee. The Audit Committee met with the Head of IA at 9 of the 11 meetings held. The salient features of IA reports issued and received were examined and discussed with the Head of IA, and updates of the status of implementation of the related agreed action plans (AAPs) given. The draft IA work plan for 2017-2019 was also discussed. The status of implementation of IA AAPs was monitored closely, a key indicator that the internal control environment is updated and maintained to reflect the recommendations of the third line of defence, internal audit.

The Audit Committee notes with regret the sudden decline in the timely implementation of internal audit AAPs at the end of the year. The Audit Committee asks that Management of the Bank take action to ensure the timely implementation of these AAPs by the Bank's services.

4.2 Inspectorate General

The Inspectorate General (IG) comprises three lines of service, fraud investigations, operations' evaluations and the complaints mechanism.

The Inspector General retains unrestricted access to the Audit Committee, and may request private sessions. The Audit Committee met with the Inspector General at 7 of the 11 meetings held to examine and discuss with the Fraud Investigations Division the on-going cases under their remit, the feedback loop where lessons learned from these investigations are reported back to EIB services, and the outcome of selected operations' evaluations and proactive integrity reviews.

A review of the Bank's whistleblowing policy and reporting lines, which dates from 2009, has been initiated by the main parties concerned which include IG.

4.3 Risk Management

With reference to the monitoring of risk management activities, the Audit Committee draws up its work plan with the objective of obtaining a thorough understanding of the Bank's activities throughout the year.

The Audit Committee requests and reviews specific analyses to assess the risk impact of external developments and conditions, such as the changing macro-economic environment including the interest rate environment as well as various internal developments in the Bank, including the launch of new products and initiatives, including those within the EFSI mandate.

4.3.1 Review of Risk Management work

The Audit Committee dedicated significant time during the reporting period, at each meeting, to discuss, evaluate and assess the Bank's risk management practices. The Audit Committee met at 9 of the 11 meetings held with the Director General of Risk Management (RM) and Transaction Monitoring and Restructuring (TMR). In obtaining assurance in relation to risk management activities, discussed and made recommendations to the Bank's RM and TMR Directorates at these Audit Committee meetings.

The Audit Committee discussed specific different aspects of risk management, together with the regular reviews of the monthly risk reporting and dashboard, together with the quarterly risk outlook. The Audit Committee also received presentations of the Bank's Pillar 3 report, the Internal Capital Adequacy Assessment Process, economic capital planning, projected large exposures and the outcome of the EIB replication of EBA stress tests. Audit Committee focussed on topics such as credit risk assessment and monitoring, liquidity risk management and capital adequacy requirements and operational risk assessment and monitoring.

A request to see that forward looking elements be added, to the extent applicable, to the risk data and analysis presented, which include forward looking large exposures and capital adequacy projections, was addressed to Risk Management.

4.3.1.1 Credit risk

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, with regards to internal models the use of and modelling assumptions applied, together with the maintenance of internal models and review of effectiveness including the comparison of expected to actual losses, large exposures, the quality of the loan origination process based on a specific case study and lessons learned exercise, concentration risk, non-compliance events, 'watch list' loans, and loan arrears.

The Audit Committee sought further explanations concerning the monitoring of operations reported on the 'watch list', loans where specific provisions had been established and loans where contractual clause related events had occurred. The Audit Committee continues to expect that the same credit risk management standards be applied to the awarding and monitoring of loans within the EFSI framework.

4.3.1.2 Liquidity risk

A signed agreement is in place between the Bank and the Banque Centrale du Luxembourg ('BCL') establishing the framework for the assessment of the Bank's liquidity situation and liquidity risk management by the BCL, as the Bank participates in the Euro System liquidity operations.

The Audit Committee was briefed on of the results of BCL's onsite liquidity assessment at the EIB in 2015, reported in 2016. The assessment included a review of the EIB's implementation of the Liquidity Coverage Ratio methodology, as well as a review of the EIB's Contingency Liquidity Plan testing. The Audit Committee reviewed and discussed the results of the Bank's key liquidity risk metrics throughout the reporting period, which include Liquidity Coverage Ratio. In addition, the Audit Committee received an overview of updates to the Bank's Liquidity Risk Framework, which included the status of the Bank's implementation of the Net Stable Funding Ratio ('NSFR'), which will become a minimum standard for credit institutions by 1 January 2018.

4.3.1.3 Capital planning and capital requirements

The Audit Committee met with Risk Management staff at each meeting to monitor and discuss the evolution of the Bank's Capital Adequacy ratio ('CAD').

With the objective of facilitating forward capital planning and managing expectations with regards to expected evolution of the CAD ratio, the Audit Committee received from RM a presentation of the CAD impact of implementing regulatory and on-going modelling developments. The Audit Committee subsequently asked that the capital impact of implementing remaining BBP Framework gaps also be considered.

Further detail on the work performed by the Audit Committee in relation to the prudential risk related requirements together with our assessment of the status of implementation of BBP Framework is detailed in section 5.2.1, below.

4.4 Compliance

The Audit Committee, at 6 of the 11 meetings held, met with the Group Chief Compliance Officer to discuss, amongst other matters, progress with the implementation of the AML-CFT Framework, respective revisions to processes, workflows and IT upgrades, and to monitor the status of the 'legacy' project, where a comprehensive revision of the Know Your Customer ('KYC') records of existing counterparties was launched in 2016. The Audit Committee also received with interest a presentation of Office of Chief Compliance Officer's ('OCCO') revised risk scoring tool used to establish compliance opinions on EIB operations applying a 'risk based' approach, together with updates on key opinions issued by OCCO on EIB operations. The Audit Committee was kept updated on EIB Group approach to regulatory developments and international standards in the area of tax transparency, tax good governance.

5 EIB COMPLIANCE WITH BEST BANKING PRACTICE

5.1 Verification by the Audit Committee of EIB implementation of the BBP Framework

The effective implementation of BBP serves to protect the EIB and keep it safe and sound. The implementation of procedures to ensure EIB Compliance with Best Banking Practice is in the first instance, the responsibility of the EIB's Management Committee. The Audit Committee, in accordance with the responsibilities assigned to it by the EIB's Statute, verifies the Bank's compliance with Best Banking Practice.

The Audit Committee, the Bank's Management and the services jointly established the BBP Framework which sets out the Best Banking Practice reference documents considered applicable to EIB, against which EIB's compliance with Best Banking Practice is assessed. The BBP Framework is based on a hierarchical set of reference documents (e.g. EU Treaty, the Bank's Statute, EU Directives, international standards, guidance and principles issued by regulatory bodies – collectively referred to as “standards” in this report) that are considered relevant. 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 BBP Framework, as well as assesses and verifies its implementation on an annual basis, the outcome of which is provided below in a summary form.

In 2016, the Audit Committee carried out its annual verification exercise by reviewing and discussing the outcome of the annual self-assessment of compliance with the BBP Framework, drafted and presented to, the Audit Committee by the EIB services concerned. In addition to verifying the on-going maintenance of areas where the Bank achieves full compliance with the BBP Framework, discussions of the self-assessment of compliance between EIB services and the Audit Committee aimed at highlighting:

- areas where full compliance had not been achieved at the last self-assessment, the progress made to fulfil it for each applicable standards, towards its full implementation;
- developments in standard setting, including new standards and reformed standards; and
- new EIB internal developments and their possible relevance to the standards, namely to identify and decide whether new standards become relevant to EIB as new products and/ or initiatives are developed or whether there is a change in compliance.

The Audit Committee considers that compliance with the BBP Framework constitutes an integral part of the internal control environment, including processes and working procedures, as well as the daily working practices of the Bank.

To complement the self-assessments reported by Directorates, the Audit Committee has requested that IA includes within Internal Audit Annual Plan the audit of at least one area of the BBP Framework each year, with the specific objective of providing assurance regarding the integration of Best Banking Practice into the corresponding internal written procedures of the Bank.

Furthermore, when planning and performing individual audit assignments, the Audit Committee asked IA to incorporate and perform tests of controls linked to specific BBP standards, with a view to providing further assurance in the form of an opinion on compliance.

The Bank's services are required to propose the inclusion of new or revised practices to the BBP Framework and to ensure that the EIB is compliant from the date such requirements become effective. In 2016, the Audit Committee carried out its annual verification exercise by reviewing and discussing the outcome of the annual self-assessment of compliance with the BBP Framework, established and presented to, the Audit Committee by different EIB services.

5.2 Areas where full compliance has not yet been achieved

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

Areas where full compliance has not yet been achieved are as follows:

5.2.1 Prudential Risk Management

Areas under responsibility of the Risk Management ('RM') Directorate include compliance with the CRD/CRR, and current guidelines and practices adopted by the Basel Committee on Banking Supervision (BCBS), as well as the European Banking Authority (EBA).

The Audit Committee commends the work carried out by RM during the reporting period to see the closure of some acute compliance gaps. This includes the first iteration of a bank wide Recovery Plan, the elaboration and external publication of a Group Risk Disclosure ('Pillar 3 Report') as well as the preparation and completion of the periodic Internal Capital Adequacy Assessment Process ('ICAAP') document.

Pervasive compliance gaps do however remain. The most recent version of RM's BBP work plan presented to the Audit Committee identified 24 projects, with 15 projects considered to be high priority, 6 medium and 3 low.

Projects that remain to be implemented to address existing BBP requirements include:

- enhancements to the stress testing framework and internal stress testing capacities,
- the completion of an Internal Liquidity Adequacy Assessment Process ('ILAAP');
- the expansion of the Prudential Risk Appetite Framework to cover non-financial risks,
- enhancements to processes and IT capacity to capture connected clients,
- the reflection of the results of economic capital planning in core Bank strategy documents such as the operational plan;
- implementing a compliant interest rate risk in the banking book framework.

Projects that remain to be implemented to address future BBP requirements include:

- refinements to the Net Stable Funding Ratio calculation to be based on EU parametrisation.

The Audit Committee urges the Bank's Management Committee to ensure that momentum gained by Risk Management over recent years is maintained, and that efforts to implement key BBP projects are continued. The EIB should also begin to perform impact assessments and prepare for the forthcoming requirements of EU banking reform, as presented by the European Commission in November 2016, as well as closely monitor the finalization of post-crisis reform agenda of BCBS. The Audit Committee will continue to monitor progress with RM's work plan during the forthcoming reporting period.

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

The Audit Committee received updates during the reporting period from the Office of the Chief Compliance Officer (OCCO) on the work underway to close remaining compliance gaps in the field of AML-CFT compliance. The Audit Committee considers that in order to report full compliance with the Best Banking Practice Framework, namely with the AML-CFT Directive, EIB has to maintain Know Your Customer (KYC) records of all counterparties, including for its existing stock of loans, as well as for new business and operations.

In early 2016 an IA report highlighted the need to address 'KYC' requirements of a number existing counterparties, where AML/KYC documentation had not always been consistently obtained or appropriately maintained. A project is currently ongoing to address the KYC requirements of this existing portfolio of counterparties and operations. The Audit Committee, acknowledges the progress made, but considers that the conclusion of this project during 2017 is critical, and urges the Management Committee to see it is achieved.

The Audit Committee welcomes the timely completion at the end of 2016 of a two year work plan to implement a revised AML-CFT Framework. The Audit Committee expects that by applying this revised AML-CFT Framework from 2017 onwards new counterparties of the EIB will be fully KYC compliant going forward. Finally, the Audit Committee encourages close cooperation with the EIF on AML CFT related policies and

procedures, to ensure that a coherent approach to matters concerning regulatory developments and international standards in the area of tax transparency, tax good governance, AML-CFT is applied across the EIB Group.

5.2.3 Corporate Governance

The Audit Committee is aware that the Bank's Statute retains precedence to the BBP Framework with regards to the organisation, composition and nomination to the Bank's governing bodies. The general orientation of the Bank therefore is to apply the BBP requirements to the extent possible, when not contradictory to the Bank's legal texts.

The Audit Committee encourages the EIB to proactively bridge the respective Best Banking Practice gaps, whilst being mindful of the primacy of the Bank's Statute.

The Audit Committee regrets that progress has not been made by the EIB to change the existing combination of responsibilities amongst the Management Committee. The Audit Committee retains its prior year recommendation, that Members of the management body should be able to act objectively, critically, independently and avoid potential conflicts of interests. In order to achieve that, unorthodox combinations of responsibilities, for example responsibility for the oversight of both first and second line of defence activities, should cease.

5.3 EIB oversight of Best Banking Practice

The application and assessment of compliance with the BBP Framework is an iterative process. The Bank's services are required to propose the inclusion of new or revised practices to the BBP Framework and to ensure that the EIB is compliant from the date such requirements become effective.

In the wake of the financial crisis a wave of new regulations has been developed to promote the stability of financial institutions. The Audit Committee is conscious that the implementation of new Best Banking Practice requirements can be resource intensive, involve extensive inter service consultation and cooperation, and requires an effective, demanding, and timely change management programme.

In the context of the EIB's current review of the BBP process the Audit Committee reiterates its recommendation from the prior year that, the EIB should seek to implement a holistic and forward looking oversight of Best Banking Practice. The oversight function should ensure that impact assessments and the on boarding of new requirements as well as the central maintenance of a full overview of adherence to Best Banking Practice requirements, are carried out.

6 FOCUS AREAS LOOKING FORWARD

The EU is facing a crucial year of unprecedented challenge. Several key elections will be held in EU Member States, Britain has invoked article 50 of the Treaty on the Functioning of the European Union and has consequently started the task of leaving the EU.

The outcome of these, as of yet, uncertainties will undoubtedly shape the future orientation of EIB. The Audit Committee will follow these developments carefully.

With regards to EIB's compliance with BBP, the Audit Committee will continue to monitor and review the actions undertaken by the EIB's services to close the remaining compliance gaps. Furthermore, in November 2016 the EC presented the EU banking union reform package, and as a result additional BBP requirements will enter into force in the coming years, which the EIB will need to comply with from the outset. EIB is also invited to closely monitor the progress of the BCBS in the implementation of its post-crisis agenda.

In terms of financial reporting and external audit related considerations, new International Financial Reporting Standards (IFRS) will enter into force, notably IFRS 9 Financial Instruments which will apply as of financial year beginning 1 January 2018. The new IFRS 9 standard includes revised guidance on the classification and measurement of financial assets, a new expected credit loss model for calculating impairment and new hedge accounting principles. Preparing for the impacts of these changes will demand considerable time and resource efforts from the EIB. The Audit Committee will liaise with both the EIB's services and the external auditor to monitor the implications for the Bank's processes, including IT system or data configuration requirements, as well as to oversee the Bank's readiness from the date of application.

Finally the new audit regulation foresees enhanced audit reporting requirements applicable for the first time for the financial year ending 31 December 2017. The Audit Committee has started to engage with the external auditor, KPMG, to prepare for these upcoming changes.

7 CONCLUSION

The Audit Committee was able to carry out its work at EIB to fulfil its statutory mandate under unrestricted conditions.

With reference to the financial statements, the Audit Committee is satisfied that the audit assurance obtained during the meetings, corroborated by the review of the documentation deemed necessary, 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 of the financial statements by the Board of Directors.

Furthermore, based on work undertaken and the information received, including an unqualified opinion from the external auditors on the EIB's financial statements as set out in section 1, and a representation letter from the Management Committee of the Bank, the Audit Committee concludes that the financial statements, as set out in section 1, drawn up by the Board of Directors give a true and fair view of the financial position of the Bank as of 31 December 2016 and of the results of its operations and cash-flows for 2016 in accordance with the applicable accounting framework.

The Audit Committee is able to extend the same conclusion to the financial statements, as of the same date, 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.

With reference to the Audit Committee's verification of the Bank's compliance with Best Banking Practice, the Audit Committee, dedicated significant time throughout the year to oversee the work performed by the Bank, under the responsibility of the Management Committee. Attention is raised to the following BBP related matters raised in this main body of this report, where action is required from by the Management Committee:

- The long term soundness of the EIB and maintaining the AAA rating is paramount, it is safeguarded in part by the implementation of best banking practice which serves to protect the EIB and keep it safe and sustainable, and in part by the risk profile of EIB's activities. The conclusion of the ongoing BBP review should, therefore, see the continued close focus by Management on fully implementing the BBP Framework.
- Certain EIB practices in the areas of EIB Group oversight, prudential risk management, corporate governance and AML-CFT do not yet fully reflect the requirements of corresponding best banking practice, and in some areas pervasive compliance gaps remain. The Management Committee should ensure that all necessary actions are undertaken to close existing BBP gap. The EIB should seek to implement a holistic and forward looking oversight of Best Banking Practice.
- With reference to group risk considerations, the EIB is the majority shareholder of the European Investment Fund ('EIF'). Together the EIB and the EIF form the main part of the EIB Group. The EIF deploys, in addition, various mandates on behalf of the EIB, including the Risk Capital Resources (RCR) and EIB Group Risk Enhancement Mandate (EREM). The combination of both EIB's shareholding in the EIF and the management by EIF of EIB funds under mandate represent approximately 10 percent of the EIB's total regulatory capital requirements as a result of higher risk profile of these operations in relation to other credit risk exposures of the EIB Group. The EIB is obliged through the implementation of BBP to play its role as majority shareholder of the EIF by seeking ways to enhance the management of risk, processes and internal controls from a Group perspective. To this end, and in order for the EIB to comply with BBP which includes EIB Group related requirements, the Audit Committee recommends that a review of the terms of reference of the Bank's control and risk functions be initiated and that this review extends to EIB Group considerations. To achieve this, any existing barriers to the sharing of information necessary for the effective consolidated oversight of the EIB Group shall be promptly removed.
- The Audit Committee encourages the EIB to continue to investigate ways in which can proactively bridge the respective Best Banking Practice gaps, whilst maintaining the primacy of the Bank's Statute. The Audit Committee regrets that progress has not been made by the EIB to change the existing combination of responsibilities amongst the Management Committee.

With reference to the Audit Committee's oversight of the internal control and risk management environment of the EIB as well as the mandate of the external auditor, attention is drawn to the following matters raised in the main body of this report, where action is required from the Management Committee of EIB:

- The EIB's internal control and risk management environment needs to continue to meet the demands of this fast paced change and be adequately resourced, in terms of staff numbers, skills and competence.

- Management of the EIB should ensure that a risk culture is promoted where all EIB employees are aware of their own responsibilities in relation to risk management, compliance and internal control environment. The Management of the EIB should look to establishing a complete map of risks and responsibilities and see that the three lines of defence model is effectively deployed across the Bank.
- The Audit Committee notes with regret the sudden decline in the timely implementation of internal audit AAPs at the end of the year. The Audit Committee asks that Management of the Bank take action to ensure the timely implementation of these AAPs by the Bank's services.
- The Prudential Risk Appetite Framework approved by the Board of Directors in December 2015 should be extended to a full Risk Appetite Framework which considers non-prudential risks (conduct, cyber risk, AML). Risk appetite limits set out in the Risk Appetite Framework ought to be effectively translated into the first line of defence activities, so as to embed prudent risk taking into the EIB's risk culture and day to day management of risk. Group risk requirements in relation to the EIF should also be incorporated accordingly.

In order to facilitate the process for the future and timely rotation of the EIB's external auditor, the EIB Group should:

- establish a list of the contracts that professional service firms, typically eligible to tender for external audit services, are providing to the EIB Group. The duration of such contracts should also be compiled.
- address how the EIB Group may best balance its approach towards the use and management of contracts awarded to these professional service firms for consultancy work, and the need for external audit firms to adhere to rules regarding rotation.

Finally, the Audit Committee considers that it has adopted a balanced work approach during the year in terms of focus, objectives and means utilised to obtain the necessary assurance, believes that it has retained appropriate standing within the Bank and has maintained appropriate relations with the Management Committee and the Bank's Staff, as well as external auditors and consultants, while remaining independent at all times. In 2016 the Audit Committee received the expected full support from the Bank's Management and services, thus the Audit Committee being able properly to discharge its responsibilities.

Luxembourg, 23 May 2017

Signed by:

JH. LAURSEN

P. KRIER

D. PITTA FERRAZ

J. SUTHERLAND

J. DOMINIK

M. MACIJAUSKAS

U. CERPS

AUDIT COMMITTEE

Annual Report to the Board of Governors

Investment Facility

For the 2016 financial year

AUDIT COMMITTEE**ANNUAL REPORT TO THE BOARD OF GOVERNORS
ON THE INVESTMENT FACILITY****For the 2016 financial year****Table of contents:**

1.	INTRODUCTION - the role of the Audit Committee	19
2.	AUDIT COMMITTEE REVIEW	19
3.	THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2016 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE	20
4.	CONCLUSION	20

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 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 ('IF') 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 shares a number of systems with the Bank, notably those involved in 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 Investment Facility activities.

Meetings with Management

The Audit Committee has met during the past year with the Management of the IF, 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.

External auditors (KPMG)

The external auditors responsible for the audit of the Investment Facility'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 has properly monitored KPMG's 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 conflicts of interests.

Internal Audit

In October 2016 the Internal Audit ('IA') Division became an independent function within the EIB with a direct reporting line to the Bank's President. Internal Audit was formerly part of the Bank's Inspectorate General Directorate. The Head of IA retains unrestricted access to the Audit Committee, and may request private sessions.

The Audit Committee met on 9 occasions during the reporting period with the Head of Internal Audit. We discussed 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.

Inspector General

The internal oversight function at the Bank is headed by the Inspector General (IG) and 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 IA reports and ongoing cases with the Fraud Investigations Division.

The Audit Committee held met on 7 occasions during the reporting period with the Inspector General to examine and discuss with the Fraud Investigations Division the on-going cases under their remit, the feedback loop where lessons learned from these investigations are reported back to EIB services, and the outcome of selected operations' evaluations and proactive integrity reviews.

The Audit Committee is also informed about any alleged cases of wrongdoing and ongoing investigations relating to Bank projects, including IF operations.

European Court of Auditors

The Audit Committee understands that the European Court of Auditors did not perform any audits related to the Investment Facility during the year ended 31 December 2016.

3. THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2016 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE

The Audit Committee examined the 2016 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.

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 financial statements is International Financial Reporting Standards (IFRS) as adopted by the European Union.

4. CONCLUSION

In meeting its responsibilities in 2016 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), the Audit Committee confirms that the financial statements of the Investment Facility, which comprise the statement of financial position as at 31 December 2016, 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 2016, 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, we signed our annual statement as of 9 March 2017, the date on which the EIB Board of Directors has approved the submission of the Investment Facility financial statements to the Board of Governors.

Luxembourg, 23 May 2017

Signed by:

JH. LAURSEN

P. KRIER

D. PITTA FERRAZ

J. SUTHERLAND

J. DOMINIK

M. MACIJAUSKAS

U. CERPS

AUDIT COMMITTEE

Response of the Management Committee

To the Annual Reports of the Audit Committee

For the 2016 financial year

**RESPONSE OF THE MANAGEMENT COMMITTEE
TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE
FOR THE 2016 FINANCIAL YEAR**

Table of Contents

1	INTRODUCTION	24
2	RESPONSE TO KEY AUDIT COMMITTEE OBSERVATIONS.....	24
3	INTERNAL CONTROL – AUDITING & RELATED ACTIVITIES.....	26
4	RISK MANAGEMENT	27
5	BEST BANKING PRACTICE	28
6	THE INVESTMENT FACILITY	31
7	LOOKING AHEAD	31
8	CONCLUSION.....	32

1 INTRODUCTION

- 1.1 In line with its responsibilities assigned in the Bank's Statute, the Board of Directors has overall responsibility for maintaining a sound system of internal control that supports the achievement of the Bank's policies, aims and objectives while safeguarding its funds and assets. The Management Committee, under the supervision of the Board of Directors, has the day-to-day responsibility for the system of internal control based on ongoing identification, evaluation and management of the principal risks to the achievement of policies, aims and objectives.
- 1.2 The Audit Committee of the EIB is responsible for the auditing of the financial statements as well as verifying that the activities of the Bank conform to Best Banking Practice (BBP) applicable to it.
- 1.3 The Annual Reports of the Audit Committee are prepared annually in line with the Statute of the Bank and the Rules of Procedure. The Audit Committee reports are addressed to the Bank's Board of Governors and cover the results of its work since the date of the previous annual reports.
- 1.4 This document presents the response of the Bank's Management Committee to the points raised by the Audit Committee in its annual reports for the 2016 financial year.

2 RESPONSE TO KEY AUDIT COMMITTEE OBSERVATIONS

- 2.1 The Operational Plan for 2016-2018 reframed the way in which the EIB would contribute and fulfil its role as a major component of the EU response to create growth, employment and competitiveness. The operational challenges of delivering on the European Fund for Strategic Investment (EFSI) and maintaining high levels of traditional core activities were considered unprecedented. Yet as 2016 progressed it became a year of profound change both within the EU and on a global scale, including the migration and refugee crisis and the continuing uncertainty surrounding the UK's vote to leave the EU.
- 2.2 Notwithstanding the major evolution in the Bank's business activities, the Bank maintains 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, are appropriately reviewed and that systems, policies and/or procedures have been established to manage those risks. The Bank's 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.
- 2.3 Nevertheless, such rapid growth and change indeed places further demands on the EIB's resources, infrastructure, IT systems, processes and controls, and in its annual report the Audit Committee highlighted observations related to three key areas on which the Management Committee elaborates as follows:

Retention of the Bank's Credit Standing

- 2.4 The Bank's commitment to maintaining the highest credit standing (AAA rating) remains uncompromising and is a key focus for the Bank when defining its lending programme: at the same time it strives for stability of earnings and preservation of the economic value of own funds, in order to ensure the self-financing of the Bank's growth in the long term. The Bank must manage its own available resources and risk bearing capacity, so as not to endanger its credit rating which is at the very core of the Bank's business model and is the fundamental basis of its ability to lend at favourable conditions.
- 2.5 The EIB's high credit standing is mainly driven by its solid capital position, robust asset quality and evidence of shareholder support. Furthermore, the Bank's management shares the Audit Committee's view that the maintenance of the highest credit standing is inextricably linked to the implementation of BBP and sound risk management practices. As such, critical importance is placed on the adherence to those BBP applicable to the Bank.

- 2.6 During 2016, the Bank initiated a project to establish a holistic and forward looking oversight of BBP taking into account its role as a Treaty-based policy institution; details of this project as well as actions, reviews or investigations underway to address elements for further compliance with BBP applicable to the Bank are included in section 5.

Review and Enhancement of the Internal Control and Risk Management Environment

- 2.7 In line with the “Three Lines of Defence for Effective Risk Management and Control” (*Three Lines of Defence*) model, the Bank considers that risk management is the responsibility of all services, i.e. all Directorates and not just of the risk and control functions. Against a backdrop of substantially increased lending and related activity, in terms of financing volume, risk profile and numbers of transactions, the Management Committee remains committed to maintaining and strengthening the Bank’s internal control and risk management environment and promoting a risk awareness culture amongst its employees.
- 2.8 The Management Committee concurs with the Audit Committee’s view that the promotion of a risk awareness culture throughout the organisation is paramount. In line with Audit Committee recommendations, a review on the alignment with the Three Lines of Defence model within the Bank is nearing conclusion which will also make recommendations on how to strengthen the risk management framework in particular for the lending business. Such reviews serve to clearly map risks and to document responsibilities of first, second and third line of defence functions with the aim of further promoting a risk awareness culture throughout the Bank.
- 2.9 In addition, in the context of the BBP project mentioned in 2.6 above, the respective responsibilities of all services in relation to each BBP applicable to EIB are also being referenced according to the Three Lines of Defence model.
- 2.10 In 2015, the Board approved the Bank’s Risk Appetite Framework (RAF) which formally defines and documents the level of risk that it is able and willing to incur in pursuing its activities in the context of its mandate and objectives. This was a first major step towards building a comprehensive and effective RAF. In order to further align to best banking practice and embed prudent risk taking into the EIB’s risk awareness culture and day to day management of risk, improvements to the Risk Appetite Framework including the addition of non-financial/conduct risks and the cascading down of the Bank’s Risk Appetite Framework metrics were initiated in 2016. A bank-wide project led by the Risk Management Directorate and involving the Compliance function for non-financial/conduct risk and external consultants is underway with an implementation period until 2018.
- 2.11 The Management Committee is also supportive of the Audit Committee’s recommendation to review the terms of reference of the Bank’s control and risk functions including EIB Group considerations. As part of on-going effectiveness and efficiency streamlining efforts, the responsibilities of the control and risk functions and related internal committees are also being reviewed.
- 2.12 As highlighted in the Audit Committee report, the combination of both EIB’s shareholding in the European Investment Fund (EIF) and the management by EIF of EIB funds under mandate consumes around 10% of EIB’s capital requirements at the end of 2016. The enhancement of risk management processes and internal controls from a Group perspective is therefore very much in the interest of the EIB, being the majority shareholder of the EIF. In this respect the Bank is seeking to continue recent collaboration initiatives between EIB and the EIF, such as joint EIB/EIF senior management meetings, enhanced collaboration of the control functions and an increased number of group wide internal audits.

Combination of Oversight of Members of the Management Committee

- 2.13 The Bank acknowledges the Audit Committee's view that members of the Management Committee should be able to act objectively, critically and independently in relation to joint oversight of first and second line of defence activities. The Management Committee members' oversight is from time to time subject to review. The combination of the statutory collective decision-making responsibilities vested in the various governing bodies of the Bank, form a framework to mitigate possible risks arising from the oversight of Management Committee members vis-a-vis first and second line of defence activities.

3 INTERNAL CONTROL – AUDITING & RELATED ACTIVITIES

- 3.1 The Bank is subject to significant independent review throughout the year, as well as at the year end. 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.
- 3.2 In 2015, the Management Committee, in collaboration with the Audit Committee, initiated a restructuring of the EIB's control and compliance functions. These changes ensured a more holistic Compliance and Control Framework across the Bank's various Directorates, also re-enforcing responsibilities according to the Three Lines of Defence model, as adapted for EIB. This restructuring has continued into 2016 with the establishment of Internal Audit as an autonomous department with direct reporting of the Head of Internal Audit to the President. The Head of Internal Audit retains unrestricted access to the Audit Committee, including private sessions if requested.
- 3.3 The 2016 Internal Audit Plan has been broadly achieved. In response to emerging business needs, reprioritisations were made to the Audit Plan to cater for three special requests; these were endorsed by the Audit Committee following approval by the Management Committee. As a consequence, three assignments originally planned to commence in 2016 have been postponed to 2017/2018, namely; audits of the management of outsourced services, measures supporting business plan implementation and the EIB website. In addition, the audit of Best Banking Practices – the Bank's General Approach, originally planned for 2016 has been postponed pending the outcome of the BBP Project mentioned in 2.6 above and elaborated in Section 5.
- 3.4 As in prior years, the Management Committee continues to place strong emphasis on the timely clearance of Agreed Action Plans (AAPs), particularly those relating to high priority matters. The Management Committee have raised the matter directly with the Directors General and significant improvement is expected, particularly in relation to overdue or high risk points. A long overdue high risk AAP was raised by the external auditors and the necessary work to close the point has been undertaken, confirmation of closure is expected from KPMG during Q2 2017.
- 3.5 The 2017-2019 Internal Audit plan was approved by the Management Committee following consultation with the Audit Committee. The Audit Plan is derived from a bank-wide risk assessment, which seeks to ensure periodic audit coverage of all major risk areas. Audits are targeted at prioritising the main risks facing the Bank while at the same time providing broad coverage of the main areas of activity. Aspects to be covered in 2017 include reviews of the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). The inclusion of audits related to the Bank's role in the Investment Plan for Europe will continue, with audits on the EFSI Risk Sharing Instruments and the New Products Processes anticipated.

4 RISK MANAGEMENT

General Risk Management Approach

- 4.1 In pursuit of its business strategy, the Bank accepts to take credit, market and liquidity risk up to the level where it remains aligned with its risk appetite and public mission. The Bank aims to retain its high credit standing, which is at the core of its business model. At the same time, it aims for stability of earnings and preservation of the economic value of own funds, in order to ensure the self-financing of the Bank's growth in the long term.
- 4.2 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 monthly Risk Reports and a quarterly Risk Management Outlook and Dashboard Report. Within the Board of Directors, the Risk Policy Committee meets no less than four times per year (in 2016, 9 times) to review the Bank's policies with regard to credit, market and liquidity risks. The Risk Reports are reviewed and discussed by the Risk Policy Committee as well as with the Audit Committee.

Specific Risk Management Activities

Capital Planning and Capital Requirements

- 4.3 The Bank uses a CRD IV/CRR compliant methodology to measure its capital adequacy (CAD). The CAD ratio and other capital and leverage metrics are monitored on an on-going basis to ensure that the risk profile of the EIB is maintained within its risk appetite limits.
- 4.4 To the extent possible, depending on the status of existing and forthcoming prudential regulation and related guidance, the Bank assesses its capital adequacy on a forward looking basis as well as at a particular point in time. As recommended by the Audit Committee, the Bank will continue to quantify the impact upon CAD of implementing the remaining known areas for compliance with BBP applicable to it as well as forthcoming BBP requirements. Further information on the Bank's work plan with respect to capital adequacy requirements is also provided in section 5 below.

Credit Risk Monitoring

- 4.5 For the coming years, the Bank will sustain high levels of more traditional lending whilst at the same time increasing higher risk activities under EFSI as well as continuing to undertake further higher risk activities under own risk. Control and monitoring functions have been strengthened to ensure that activity levels are and will continue to be financially sustainable in an uncertain economic environment. The focus on continuous assessment of credit risk is evidenced by low levels of impaired loans.

Liquidity Risk Monitoring

- 4.6 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 other indicators, which have to remain within conservative pre-defined limits. As part of the liquidity risk management process, the Bank monitors its prospective cumulative funding gaps, leading to funding recommendations to limit annual re-financing needs. Within the framework of its eligibility for Eurosystem operations, the Bank provides information on liquidity matters to the Central Bank of Luxembourg in order to assess its compliance with relevant best banking practices.
- 4.7 Work is continuing on the implementation of the Net Stable Funding Ratio (NSFR), which becomes a minimum standard for credit institutions from January 2018. The EIB started reporting on the NSFR in October 2015, with a simplified calculation based on the standards of the Basel Committee on Banking Supervision (BCBS) pending parametrisation of EU regulatory standards. Further work to refine the calculation methodology is ongoing.
- 4.8 To further strengthen its liquidity resilience, the Bank began implementing a collateral management system in 2015 which is expected to be completed in 2018/2019. The system will allow the Bank to enlarge its liquidity sources, in line with Central Bank of Luxembourg (BCL) recommendations made

in 2013 and with BBP applicable to the Bank. So far the project has delivered selected inventory and margining functionalities.

- 4.9 During 2016, a first Internal Liquidity Adequacy Assessment Process (ILAAP) exercise was conducted with the assistance of external consultants. The resulting ILAAP report, drafted according to the applicable guidelines published by European Banking Authority (December 2016) is planned to be finalised in 2017.

5 BEST BANKING PRACTICE

- 5.1 The Bank is committed, through Article 12 of its Statute, to conform its activities to Best Banking Practice (BBP) - as defined within a framework established jointly by the Audit Committee and the Bank's Management since 2010. The framework establishes a hierarchy of the main legal and regulatory texts that are relevant and should be followed by the Bank. Flowing from this hierarchy, precedence is given to the "core EU legislation" including the EU Treaty, the Bank's Statute and the Rules of Procedure over other provisions such as EU Directives, Regulations or guidelines.
- 5.2 Also pursuant to Article 12 of the Statute and Article 24 of the Rules of Procedure, the Audit Committee is responsible for verifying that the activities of the Bank conform to BBP applicable to it.
- 5.3 The best banking practice environment has evolved significantly since the introduction of the statutory requirement for EIB to conform to BBP applicable to it with an increasing number of new regulations, standards and implementing guidelines having been issued. Not only has the scope of BBP evolved, so too has the complexity. However, whilst the statutory requirement for EIB to conform to the BBP applicable to it is without question, it is also important to underline that there are a number of other significant strategic and business benefits for EIB in having a transparent and proactive approach to conforming to those BBP applicable to it, including but not restricted to the following:
- assurance to Members (i.e the Member State shareholders) and other stakeholders that the EIB, as an EU body as well as a bank, is paying appropriate due diligence to EIB own funds and, as requested by the providers of, third party funds managed by it;
 - enhanced governance, transparency, accountability and control framework of the EIB in line with the expectations of the European Parliament;
 - the long-term financial sustainability and soundness of the EIB as a bank, as well as the stability and integrity of financial markets; and assurance to Members and other stakeholders that EIB's sustainability forecasts are measured according to industry norms;
 - asset quality assurance through stress testing referenced to standards applied in other supervised EU financial institutions;
 - enhanced strategic profiling with which to reinforce EU institutional strategic partnerships notably with the European Commission;
 - enhanced reputation and credibility among stakeholders in general, and in particular counterparts and other partners who may have obligations to only do business with entities who adopt certain best banking practice (e.g., other banks and other international financing institutions).

Implementation and Verification Methodology

- 5.4 The application of regulatory and other BBP requirements in the same manner as applied to commercial banks may not always be appropriate for the EIB considering its specificities and policy mission and its status as a bank with a public policy mission and International Financial Institution/Multilateral Development Bank. However, not conforming with the BBP applicable to EIB could severely damage the EIB's reputation as well as hinder the fulfilment of its mission.
- 5.5 To consolidate the various BBP initiatives already undertaken by the Bank and in line with Audit Committee recommendations, the Management Committee initiated a project during 2016 to

establish a holistic and forward looking oversight of Best Banking Practice which will codify the BBP requirements applicable to EIB, and also to document the implementation thereof as well as more formally defining the respective roles of the governing bodies, the Audit Committee and the services of the Bank vis-à-vis this important subject.

- 5.6 The project, coordinated by the Secretariat General, will therefore lead to the establishment of a set of high level BBP Guiding Principles to set forth the principles and the applicability assessment criteria for determining BBP legislations, banking industry standards and guidelines (“Rules”) that shall be applied to EIB. Additionally a BBP ‘Rule Book’ will identify all relevant Rules that EIB applies, adapts or which are not applicable to the Bank. The scope of Rules to be considered encompasses the following prudential and non-prudential regulatory areas:
- Governance and Culture
 - Prudential requirements
 - Data and Reporting
 - Business and Market conduct
- 5.7 To ensure the assessment of Rules and the Rule Book are kept up-to-date, a relevant applicability assessment procedure for internal use is being developed in parallel and the creation of a dedicated multidisciplinary watch team responsible for co-ordination of impact assessments and the on boarding of new requirements at a Bank-wide level, together with the central maintenance of a full overview of adherence to Best Banking Practice requirements across the organisation is under consideration.
- 5.8 Given that the regulatory requirements generally apply to financial institutions not only at an individual level, but as importantly at a group level, the EIF may also be subject to best practice as a consolidated entity of the EIB. Consequently, should it be considered that whilst the EIF does not need to comply with best banking practice at an individual level, it is recognised that the EIF still may need to be equipped to support regulatory compliance at the EIB Group level (e.g. provide necessary information and data).
- 5.9 Regular feedback and guidance has been sought from the Audit Committee during the project, and it is anticipated that the Board of Governors will be requested to approve the Guiding Principles during 2017. Subject to the approval of the Guiding Principles, the Board of Directors will be requested to approve the Rule Book also in 2017.
- 5.10 To successfully conform with the BBP applicable to it, EIB will need to ensure sufficient budgetary resources are made available and utilised for this purpose. The resource needs will continue to be identified and approved by the Board of Directors on an annual basis, normally in the context of the approval of the Operational Plan or the related mid-year review.
- 5.11 Until the BBP Guiding Principles, the Rule Book and related procedures are in place, the Bank’s existing BBP framework will nevertheless still be maintained, including the annual self-assessment exercise conducted by each Directorate. Elements for further compliance by the Bank have been identified in 2016 and actions, reviews or investigations are underway to address them (see § 5.12 – 5.20 for further details).

Prudential Risk Management

- 5.12 The Bank remains broadly compliant with the qualitative and quantitative elements of the CRD IV/CRR, current Basel Committee on Banking Supervision and European Banking Authority guidelines and practices. Since 2014, in order to address remaining areas for compliance, a specific BBP programme and target road map has been drawn up and continually updated and additional internal and external resources allocated to BBP. The prudential BBP programme is run under the supervision of a dedicated Steering Committee, comprising senior managers from the Bank’s first and second lines of defence as well as from IT. Progress is reported regularly, both to the Management Committee and to the Audit Committee.

- 5.13 As of December 2016, 50 projects have been initiated since the beginning of the programme in 2014, 25 have been closed and 25 remain active. During 2016 the following major steps were completed in high priority projects; the first EIB Group Risk Management Disclosure report (Pillar III report) was published on the Bank's external website, new internal guidelines on the Large Exposure Framework came into force, the Bank's Recovery Plan was approved by the Management Committee and new procedures for the identification and management of the Internal Default Event Counterparts (IDE-C), Special High Risk Counterparts (SHR-C) and Forbearance came into force.
- 5.14 During 2017, the following high priority projects are scheduled to be completed: the identification and reporting of Large Exposures; the running of the first internal macro-economic stress test exercise; the enhancement of the Risk Appetite Framework; better embedding of economic capital planning in the Bank's core strategy documents; further refinement of the NSFR calculation; finalisation of the first ILAAP report and further progress towards a compliant interest risk in the banking book framework. In order to maintain the momentum of delivering the prudential BBP programme, additional dedicated resources will be recruited in all services involved.
- 5.15 In addition to the identification and review of BBP applicable to the Bank embedded into all phases of the audit, each year Internal Audit perform a specific review of aspects of the credit risk framework in order to comply with the requirements of CRD IV/CRR. The 2016 review focussed on (i) the credit risk model review for Banks, Corporates and Project Finance; (ii) the ICAAP 2015 review; and (iii) the compliance of EIB loan substitute exposures with CRD IV/CRR. Furthermore, as part of the review of the risk management BBP projects, a review of the Large Exposures Framework project was finalised in Q1 2017. The focus of the 2017 review has been discussed and agreed with the Audit Committee.

Corporate Governance

- 5.16 The Bank applies the BBP applicable to it in the field of corporate governance and transparency to the extent possible, given the precedence of the Statute in respect of the organisation, composition and nomination to the governing bodies. There were no new reference documents added to the framework for corporate governance during 2016.
- 5.17 In 2016, the Bank has proactively continued to further align as far as possible, whilst maintaining the primacy of the Bank's Statute, its corporate governance practices with EU Directives and other BBP related guidance. Following discussions with the Bank's Ethics and Compliance Committee (ECC) and the Board's Working Group on Governance, at the end of 2015 the Board of Directors submitted to the Board of Governors proposals to strengthen governance at the EIB.

These changes received the necessary qualified majority approval and became effective as of 1 September 2016. The changes implied (i) a revised set of Operating Rules for the ECC of the Bank, (ii) a set of Operating Rules for a new Appointment Advisory Committee, and (iii) certain amendments to the Bank's Rules of Procedure; that in essence translate into:

- An enlargement of the scope of the ECC to all ethical matters and not only to conflicts of interest; an expansion of its composition from 3 to 4 members, and the setting of a three year rotation of the ECC Chairman;
 - The introduction of a suspension procedure for members of the Management Committee. Such procedure respects the principles of due process and right of defence;
 - The creation of the new Appointment Advisory Committee, providing non-binding opinions before the formal appointment of Members of Management Committee, according to best banking practice ("fit and proper").
- 5.18 In response to the European Ombudsman's suggestion and in order to promote further transparency, the EIB decided in late 2016 to proactively publish on its website the minutes of the meetings of its Board of Directors from 2017 onwards. Similarly, it is envisaged to consider publishing the minutes of the meetings of its Board of Governors.

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

- 5.19 Following the Management Committee's approval of the EIB Group AML-CFT Framework in 2014, the Bank has developed the revised AML-CFT processes, workflows and IT upgrades, to ensure the implementation of the AML-CFT framework. These processes and controls are outlined in the EIB AML-CFT Procedure, with specific responsibilities assigned to first and second line of defence functions. The EIB AML-CFT Procedure was approved by the Management Committee in October 2016 and is applicable from 1 January 2017. To ensure alignment with the requirements of the 4th AML Directive, a revised EIB Group AML-CFT Framework was also approved by the Management Committee in October 2016 and published on the EIB website.
- 5.20 An AML-CFT Steering Committee has been created in order to coordinate the implementation of the revised EIB Group AML-CFT Framework and AML-CFT Procedure. The Group Compliance function will continue discussions with the Compliance function of the EIF to ensure Group alignment, to the extent applicable, on AML-CFT procedures and processes.
- 5.21 At the request of the Audit Committee, the "legacy" portfolio project was brought forward from 2017. A comprehensive revision of the KYC records of the existing Relevant Counterparties was launched in 2016, with progress closely monitored by the AML-CFT Steering Committee. The Audit Committee and the Management Committee have been kept informed of the implementation status, and the project is expected to conclude in 2017.

6 THE INVESTMENT FACILITY

- 6.1 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, 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 own resources supported operations.
- 6.2 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.

7 LOOKING AHEAD

- 7.1 Following the unprecedented scale and complexity of the Bank's activities in 2016 and the significant challenges presented on an EU and global level, the 2017-2019 Operational Plan remains ambitious in order to respond to these urgent challenges and to meet the sustained demand for EIB financing in the markets.
- 7.2 In the rapidly evolving regulatory environment, ensuring compliance with existing and emerging BBPs which are applicable to the Bank has an impact on Bank-wide business processes per se which should not be under-estimated. Continuing to achieve and maintain compliance with the prudential and non-prudential BBP requirements poses a material challenge to the Bank in terms of dedicated human resources available as well as systems and data capabilities. Whilst compliance with BBP has continued to progress throughout the years, it is highlighted that further additional regulatory developments may impact not only the processes but also the Bank's operational and policy targets.
- 7.3 In November 2016, the Commission published its proposals to revise CRD IV/CRR and the Banking Recovery and Resolution Directive as part of the EU Banking Reform. The proposals, if approved, would incorporate into existing EU regulation some of the outstanding Basel III changes still to be

implemented. The impacts for EIB would be wide ranging and significant at both a strategic and operational level.

- 7.4 These regulatory developments are expected to increase the Bank's capital requirements and therefore reduce its risk bearing capacity. The magnitude of the impact for the EIB could be significant and will depend on the final content of the EU regulation and its applicability to the EIB. Additionally, the reform currently discussed at the Basel Committee on the use of internal models for banks and corporates may also impact negatively the Bank's capital adequacy. In addition to CAD impacts, the Bank could also be affected by possible changes such as minimum liquidity ratios.
- 7.5 The Bank will continue to monitor the evolving regulatory landscape and report on its findings, possible mitigation, and expected impact on EIB processes and targets and not least on key risk indicators, with a view to preserving its credit standing and business model.
- 7.6 IFRS 9 was published by the International Accounting Standards Board in July 2014 and after endorsement by the EU in November 2016, requires application for the first time from 1 January 2018 onwards. In this context, a bank-wide project is underway to implement the necessary changes to IT applications, processes and operations with a view to ensuring full compliance as from 2018. First simulations indicating how the volatility of EIB's overall results under IFRS could be reduced by the introduction of hedge accounting and the new expected loss model are anticipated to be available in the second half of 2017.
- 7.7 During 2016, the Bank facilitated a competitive public call for tender process, overseen by the Audit Committee, in order to appoint the Bank's external auditor from 2017. In accordance with the Bank's Rules of Procedure, the Audit Committee in consultation with the Management Committee appointed the incumbent external auditor KPMG as external auditor for a further period of 5 years from 2017.
- 7.8 The European Audit Reform which entered into force in June 2016 imposed further restrictions on the provision of non-audit services by audit firms to audit clients. In order to facilitate the process for future external auditor rotation in light of these increased restrictions and as recommended by the Audit Committee, the Bank will monitor in a timely manner consultancy contracts awarded to potential external audit firms.
- 7.9 Looking ahead, further strengthening of the Bank's processes and procedures is also envisaged in the areas of compliance and mitigation of reputational risks, transparency and accountability, in order to promote the EIB as a responsible and responsive institution. In particular, in 2017, improvements to the complaints mechanism and enhanced regular disclosure of documents are foreseen.

8 CONCLUSION

- 8.1 The Bank's 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 Management Committee is supportive of the ongoing co-operation between the Audit Committee and the Audit Board of the EIF.
- 8.2 The constructive feedback provided by the Audit Committee during 2016 is highly appreciated by the Management Committee and the increased level of commitment in terms of meeting days (19 days in 2016, 2015:15) was noted. It was also pleased to note that the Audit Committee has already begun to engage with the external auditor to prepare for extended audit opinion disclosure requirements due to come into force for the financial year ended 31 December 2017.
- 8.3 The Management Committee retains confidence in its policies, procedures and staff to succeed in both delivering the operational plan, responding to other complex emerging business needs and, in parallel in ensuring effective risk management and control mechanisms.



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