

CORPORATE

# Audit Committee Annual Reports

for the year 2018



European  
Investment  
Bank

*The EU bank* 



**AUDIT COMMITTEE**  
**OF THE EUROPEAN INVESTMENT BANK**

**ANNUAL REPORT TO THE BOARD OF GOVERNORS**  
**FOR THE 2018 FINANCIAL YEAR**

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**MESSAGE FROM DUARTE PITTA FERRAZ, CHAIRMAN OF THE AUDIT COMMITTEE**

This report provides a summary of the results of the Audit Committee's work in 2018. It is intended to convey to the Board of Governors of the European Investment Bank, the EU taxpayers, other stakeholders and readers, a perspective and an understanding of the actions undertaken, as well as the challenges to fulfil the Audit Committee's mandate. The AC formulates five key observations and recommendations along the following themes: 1) sustainability and business model, 2) group alignment, 3) risk management and internal control, 4) best banking practice, and 5) culture, conduct, resources and remuneration, for which the Audit Committee expects timely action to be undertaken.

The Audit Committee would like to underline the importance of maintaining the EIB Group's financial strength and sustainability, which are essential to preserving the Bank's AAA rating, maintaining investors' confidence, as EIB is not a European Union budget institution, but is reliant on confidence-sensitive capital markets funding. Unless the Bank's profitability is enhanced, the annual net surplus will be negatively impacted, thus affecting the increase of own funds, serving as a second source of funding and capitalisation for the Bank.

The operating environment was marked by geopolitical events, regulatory changes, data privacy legislation, increased cyber security threats, as well as by the changing business model of the Bank, factors which could potentially affect its sustainability and risk profile. The announced withdrawal of the United Kingdom from the European Union and, consequently, the end of its membership in the EIB remained a factor of uncertainty. Against those challenges, the Bank and the EIB Group should ensure their preparedness and resilience, and in particular, the Bank's governing bodies must approve the UK capital replacement before Brexit becomes effective.

The Audit Committee expects timely implementation of its recommendations and requests that the Management Committee establishes a Roadmap, including milestones, resources and timeline for their implementation. The Audit Committee also recommends that the timely closure of the outstanding Agreed Action Plans of Internal Audit be expedited. Last but not least, the Audit Committee would like to encourage the Bank to achieve further progress in improving diversity and gender balance notably at senior management levels, as well as within the EIB's governing bodies. The AC does not agree with the way gender pay gap has been interpreted.

The Audit Committee continued its cooperation with the Audit Board of the European Investment Fund in order to strengthen the EIB Group oversight. In 2018, the AC met with the European Central Bank – ECB Banking Supervision to exchange views on topics of supervisory priority. For the evaluation of the Bank's liquidity, the Banque Centrale du Luxembourg annually provides an assessment of the Bank's liquidity adequacy and liquidity risk management. The Audit Committee expects that the recommendations of Banque Centrale du Luxembourg in view of the management of liquidity be fully addressed in 2019.

The AC met the Audit Board of the European Stability Mechanism, being part of an EU strategy to safeguard financial stability.

In view of reinforcing its ability to oversee the EIB and the EIB Group, the Audit Committee intends to intensify further its work with the establishment of the EIB-Review and Evaluation Process based on the four pillars (Business Model and Sustainability, Governance and Risk Management, Risk to Capital and Risk to Liquidity and Funding) known under the Supervisory Review and Evaluation Process. The Audit Committee intends to continue to collaborate more closely with the ECB Banking Supervision, and with non-Euro and Euro zone National Supervisory Authorities.

As per the EIB's Statute and Rules of Procedure, the mandate and scope of the EIB's Audit Committee's work encompasses three responsibilities: i) the auditing of the EIB and the EIB Group's accounts, for which the Audit Committee largely relies on the external auditor; ii) the verification on an annual basis that the operations of EIB are conducted and its books kept in a proper manner in particular with regard to risk management and monitoring, as well as the monitoring of the internal control environment, risk management, compliance and internal audit activities; and iii) the verification that the Bank's activities conform to best banking practice.

In 2018, the Audit Committee fulfilled its responsibilities by: i) the issuance of the Audit Committee's Statements on the EIB and EIB Group's Financial Statements as at 31 December 2018, which are delivered to the Board of Governors and form an intrinsic part of the EIB Group Annual Report, and (ii) the preparation of this Annual Report.

The Audit Committee would like to thank the EIB's President Dr. Werner Hoyer, the Management Committee, and especially the Bank's Services with which the Audit Committee interacts regularly, for the dedication, transparency, and continuous support provided. I wish also to thank my colleagues of the Audit Committee for their dedication, commitment, knowledge and time invested to achieve the key outcomes of the Audit Committee's work for 2018.

## EXECUTIVE SUMMARY

### *Audit Committee Responsibilities for External Audit*

In relation to its responsibilities for the auditing of the European Investment Bank ('EIB', or the 'Bank') and EIB Group's Financial Statements, which is assigned to the external auditors, KPMG Luxembourg, Société coopérative ('KPMG'), the Audit Committee issues Statements on the EIB and EIB Group's Financial Statements, prepared in accordance with the applicable accounting framework (Annex A.1.). The Audit Committee's Statements are delivered to the Board of Governors and form an intrinsic part of the EIB Group's Annual Report.

Based on the work undertaken and the information received, including unqualified auditors' reports from the external auditors KPMG, the Audit Committee has concluded that:

- *the Financial Statements adopted by the Board of Directors, present a true and fair view of the financial position of the Bank and of the EIB Group, as at 31 December 2018, and of the results of its operations and cash-flows for 2018, in accordance with the applicable accounting framework, and*
- *the results of the external audit work and the work completed by the Audit Committee, enabled it to formulate the conclusions detailed in its Statements, issued to the Board of Governors, as of the date of signature of the audit report by the external auditors.*

In terms of the external audit activities (Annex A.3.), the Audit Committee recommends that:

- *enhanced reporting is provided by KPMG to the Audit Committee to assess whether there are any material gaps in the Bank's internal control systems, and*
- *the rotation of the external auditor is managed closely by the Bank's Management in order to avoid conflicts in awarding consulting contracts due to the restricted availability of audit companies, which are not conflicted.*

### *Audit Committee Responsibilities for the review and monitoring of the internal control environment, risk management, compliance, the inspectorate general and internal audit, and the verification of Bank's compliance with Best Banking Practice*

This Annual Report is prepared to present the results of the Audit Committee's work in relation to the above responsibilities<sup>1</sup>. The Audit Committee formulated key observations and recommendations, which are intended to foster a group approach, to promote a sound risk culture across all lines of defence and to support the full deployment of BBP within the EIB and the EIB Group.

The key observations of the Audit Committee encompass the following themes:

1. *Sustainability and Business Model*
2. *Group Alignment*
3. *Risk Management and Internal Control*
4. *Best Banking Practice, and*
5. *Culture, Conduct, Resources and Remuneration.*

### *Sustainability and Business Model*

In 2018, the Bank's business model continued to evolve and is now more diversified due to the growth of activities under the European Fund for Strategic Investment ('EFSI'), which are more complex in nature, and due to transactions, which are of smaller size and higher risk profile (Section 1.1). In addition, equity and quasi-equity transactions

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<sup>1</sup> The role and responsibilities of the Audit Committee, one of the four governing bodies of the Bank, are defined in the Statute and Rules of Procedure. The Audit Committee has a supervisory capacity over the EIB and the EIB Group in terms of its responsibilities to: review and monitor the internal control environment, risk management, compliance, inspectorate general and internal audit, and in view of its tasks to verify the Bank's compliance with BBP. The Audit Committee provides key observations and can extend recommendations to the Bank. More detail on the Audit Committee's work in view of the verification of the Bank's compliance with BBP is also available in the BBP Guiding Principles, published on the Bank's website.

continued to increase in importance and share of total operations while new products and initiatives were added to the Bank's activities. EFSI activities are not fully cost covering and other mandates and products are insufficiently profitable or even are loss making, thus affect negatively net surplus and cash-flows. In 2018, the Bank has adjusted downwards its lending volumes against an evolving political and economic environment, and in particular, in relation to the implications and uncertainties related to the announced withdrawal of the UK from the European Union ('EU').

The lower lending volumes adopted under the Operational Plan for 2018, coupled with the pressure on net surplus, need to be carefully balanced against the need for the EIB to preserve a sustainable level of profitability. In addition, the Bank's AAA rating is anchored on the financial strength of the EIB and the support of the EU Member States as shareholders. In that context, the Bank's governing bodies must approve the UK capital replacement before Brexit becomes effective. The Audit Committee recommends that: i) the viability of the evolving and more diversified business model of the Bank is monitored closely, ii) a strategic review of profitability per product and per mandate is prepared, and iii) the Bank shall develop further the capacity to analyse revenue and expense drivers as well as cost coverage with the aim to ensure adequate profitability per product and per mandate in order to ensure its financial sustainability. Therefore, Bank's profitability is key.

### *Group Alignment*

In view of the growth in equity and quasi-equity activities within the EIB Group and in the absence of a systematic, group-wide approach as well as the prospective evolution of its mandate business, the Audit Committee recommends that the group alignment be further strengthened and enhanced (Section 1.2). The Bank must ensure a group alignment by creating a genuine group structure with the parent company exercising effective oversight of the European Investment Fund ('EIF'), and of any future subsidiaries, and including group control (second and third lines of defence) and support functions. As a matter of priority, the EIB needs to ensure that the three lines of defence model functions in the existing structure, and to ensure the group oversight of risk management, as well as the establishment of group control functions going forward. Regarding the equity and quasi-equity activities, a coordinated approach within the EIB Group should be ensured, avoiding an overlap within the group, and clearly defining the roles and responsibilities within the EIB and the EIF for these activities.

In view of advancing the group alignment further, the EIB Group should ensure its capability to capture and aggregate data at a group level, and should develop a common data warehouse and group IT policies. The group approach to risk management should become a priority in 2019, as well as the establishment of a group Risk Appetite Framework ('RAF') and group risk management processes and documents, such as the Internal Capital Adequacy Assessment Process ('ICAAP'), the Internal Liquidity Adequacy Assessment Process ('ILAAP'), the stress testing framework, the liquidity and capital contingency plans, and the Recovery Plan. More details are provided in Section 1.2 and Annexes A.4. and A.5.

### *Risk Management and Internal Control*

Regarding Risk Management and Internal Control (Section 1.3), the Audit Committee highlighted in the 2017 report the findings of an Internal Audit ('IA') review of the Bank's lending appraisal and approval process, and recommended that this process be reviewed and revamped. The weaknesses and deficiencies that need to be addressed, relate to the governance and the decision-making of the credit approval process, the split of responsibilities between the first and second lines of defence, the comprehensiveness of the analysis underlying the credit granting and the consistency of the financial information. As credit is a core process of the Bank, it is important that this recommendation is treated as a priority in 2019. Another repeated recommendation of last year, is for the Bank to review the terms of reference of the control functions. The AC has explicitly requested that IA perform an assessment of the quality and outcomes of the creditworthiness assessments made by the EIB.

In view of the changing business model of the Bank, the Audit Committee recommends that the internal control framework ('ICF') to be further developed to ensure that it is sufficiently robust, by integrating and enhancing the ICFs in each Directorate. The Audit Committee underlines the importance of strengthening the cyber security preparedness of the EIB Group. The cyber security and operational resilience continue to be a strategic priority for the Audit Committee.

The Audit Committee regularly monitored the status of implementation of the Agreed Action Plans issued by IA. The timely implementation of Agreed Action Points ('AAP') is a key indicator that the internal control environment is



adequate and effective and is evidence of a sound risk culture in a financial institution. The Audit Committee highlights this to underline that the timely implementation of IA AAPs must remain a management priority.

#### *Best Banking Practice*

During 2018, the EIB has formally documented and defined in detail the holistic best banking practice ('BBP') Framework (Section 1.4). The Audit Committee recommends the Bank to: i) fully develop and operationalise the holistic BBP Framework within the EIB Group, ii) close the remaining compliance gaps with applicable BBP, iii) address fully the recommendations of Banque Centrale du Luxembourg ('BCL') related to liquidity adequacy, liquidity risk management, systems integration and risk data aggregation, liquidity stress-testing and the ILAAP document, as well as the development of group approach to liquidity management, iv) enhance the management and prioritisation of the Prudential BBP Programme, v) develop a common data warehouse, and vi) develop the capability to calculate the stress testing results and prudential ratios on an International Financial Reporting Standards ('IFRS') basis.

The Audit Committee takes note that the Bank is in the process of implementing the governance related proposals, part of the July 2018 decisions of the Board of Directors, which include the establishment of the function of a Group Chief Risk Officer ('GCRO') to oversee all risks at the EIB Group. The Audit Committee underlines its recommendation for the Bank to fully deploy the three lines of defence model and complete the review of the responsibilities of the Members of the Management Committee ('MC') in accordance with best banking practice and regulations.

#### *Culture, Conduct, Resources and Remuneration*

The EIB needs to foster a sound risk culture across all lines of defence and to ensure that best practices are followed including relevant regulatory guidelines, thus contributing to the Bank's and EIB Group's sustainability and mission (Section 1.5). The elements of a sound risk culture in a bank include sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak up. The Audit Committee recommends that the Code of Conduct of the Management Committee and the Board of Directors be reviewed.

The Audit Committee underlines that the Bank needs to ensure the adequate and sufficient staffing of the control functions in order to allow these functions to perform effectively their duties. Any existing recruitment gaps in the control functions need to be addressed as a matter of priority. The Audit Committee also encourages the Bank to improve the diversity and gender balance, in particular at the senior management level and within the EIB Group's governing bodies, i.e. the Management Committee and the Board of Directors.

In addition, the remuneration practices at the EIB need to be aligned with relevant best banking practices and at present, the Audit Committee observes significant gaps in that regard. The Bank needs to close the existing gaps in remuneration governance, structure and performance assessment, as well as in the identification of material risk-takers and disclosure requirements, as these are evidence of a sound risk culture within the EIB Group. The Audit Committee does not agree with the way the gender pay gap has been interpreted and has not been satisfied with the EIB Group's approach to remuneration. Last but not least, the Audit Committee recommends that findings of the IA and the Task Force reports on the gaps related to the inefficient and complex administration of staff benefits be addressed by the development of an action plan, which must be implemented quickly.

#### *Looking Forward*

Looking forward, the Audit Committee expects that the Management Committee and the Board of Directors fully address the recommendations under the key observations of this Annual Report. The response of the Management Committee should also state whether the Management Committee accepts or not the Audit Committee's recommendations. In the past, the implementation of the Audit Committee's recommendations has been too slow. The Audit Committee expects that the Management Committee develop a Roadmap, including milestones, resources and timeline for the implementation of the recommendations, (Annex A.7. includes a summary table of Audit Committee's 23 recommendations). The Audit Committee also recommends that the timely closure of outstanding Agreed Action Plans issued by IA be expedited.

The Audit Committee is strongly committed to continue its cooperation with the Audit Board of the European Investment Fund in order to strengthen further the group oversight of the EIB and the EIF activities in terms of risk management, equity and quasi-equity operations, operational resilience, IT and cyber security, data warehouse, single

data policy and financial control. The Audit Committee will continue to have regular exchanges with the other governing bodies of the EIB, including through the meetings with the Risk Policy Committee ('RPC') and the Working Group on Governance ('WGG') of the Board of Directors.

In view of reinforcing its ability to oversee the EIB and the EIB Group, the Audit Committee intends to intensify further its work with the establishment of the EIB-Review and Evaluation Process based on the four pillars (Business Model and Sustainability, Governance and Risk Management, Risk to Capital and Risk to Liquidity and Funding) known under the Supervisory Review and Evaluation Process. The Audit Committee also intends to continue to collaborate more closely with the ECB Banking Supervision in 2019, and with non-Euro and Euro zone National Supervisory Authorities. Finally, the Audit Committee has adopted a focused approach during 2018 in terms of objectives and means utilised to obtain the necessary assurances and achieve the results of its work. The Audit Committee received the expected full support of the Bank's Management Committee and Services, which are essential for the proper discharge of its responsibilities. The AC expects the same support from the Management Committee and the Bank going forward.

## 1 KEY OBSERVATIONS AND RECOMMENDATIONS

These recommendations should be considered as priorities for the Management Committee, the Board of Directors and the Board of Governors.

### 1.1 Sustainability and Business Model

#### Introduction

Over 2018, the Bank's core business activities of lending have continued to evolve with the growth of EFSI transactions which are more diversified, of smaller size and higher risk profile. The Bank is engaged in inherently higher risk projects which after mitigating factors, such as the EC guarantee, result in a level of risk, which is broadly comparable to the risk of the core loan portfolio. The EFSI activities are not fully cost covering and other mandates and some products are insufficiently profitable or even loss making, thus affecting negatively the net surplus and cash-flows. Although the EIB is a public policy bank and is not a profit maximizing institution, it needs to ensure a sustainable level of profitability in order to be able to deliver on its mission. In addition, in view of an evolving political and economic environment, in particular related to the announced withdrawal of the UK from the EU, the Bank adjusted downwards its lending volumes for 2018 and has adopted similar lending orientations in its 2019 Operational Plan. If the trends affecting profitability and cash-flows are not addressed, they will likely have an impact on the Bank's long-term sustainability.

The lower lending volumes and pressure on net surplus from insufficient cost coverage of products and operations need to be carefully balanced against the need for the EIB to preserve a sustainable level of profitability. The EIB is not an EU budget institution and is reliant on confidence-sensitive capital markets funding. Thus, the Bank needs to preserve investor confidence (institutional and private investors) and maintain its AAA rating, which is at the core of its changing business model. The Bank's AAA rating is anchored on the financial strength of the EIB and the support of the EU Member States as shareholders. In that context, the Bank's governing bodies must approve the UK capital replacement before Brexit becomes effective.

#### AC Assessment

Similar to the last year's observation, the Audit Committee would like to underline the importance of maintaining the EIB Group's financial strength and sustainability which are essential for preserving the Bank's AAA rating and ensuring the viability of its evolving business model.

Some idiosyncratic trends have become more visible over 2018 such as: the significant pressure on net surplus and insufficient cost coverage of some mandates and products. Future strategic initiatives to develop operations outside of the EU, as well as, the expected transformation of EFSI into InvestEU post-2020, present additional profitability challenges to the changing business model of the Bank. The Bank needs to analyse carefully the revenue and expense drivers per product and mandate and to centralize reporting in that regard. Therefore, Bank's profitability is key.

#### Recommendations

The above observations have led the Audit Committee to recommend that the Management Committee prioritise the following:

- *monitor closely the viability of the evolving and more diversified business model of the Bank, as well as the trends in margin, profitability, cash-flows and asset quality as contributing factors to the Bank's sustainability,*
- *prepare a strategic review of profitability per product and per mandate, and*
- *develop further the capacity to analyse revenue and expense drivers as well as cost coverage with the aim to ensure adequate profitability per product and per mandate and ensure the Bank's financial sustainability.*

### 1.2 Group Alignment

#### Introduction

The EIB Group comprises the EIB, which supports sustainable projects in the EU and beyond, and the EIF, majority-owned by the EIB and focused on innovative financing for Small Medium Enterprises ('SMEs'). Over the past few years, the business model of the Bank has evolved with the growing importance and share of the equity and quasi-equity operations of the EIB and the EIF compared to the core business activities of the Bank. The EIB Group's total regulatory

capital requirement, which comprises the EIB's share in the EIF and the EIB funds, managed by the EIF, amounted to 13% in 2018, an increase of 2%-age points compared to 2017. It is expected that this percentage will continue to increase in the coming years due to the EIB Group's deployment of EFSI 2 and the prospective engagement of the Bank in the InvestEU initiative post-2020.

#### *AC Assessment*

In view of the continuing change in the Bank's business model and risk profile of operations and in the absence of a systematic, group-wide approach within the EIB Group for the growing equity and quasi-equity activities, as well as the prospective evolution of the Bank's mandate business and operations outside of the EU, the Audit Committee considers that the group alignment must be strengthened and enhanced. In addition, a different organisational set-up of the EIB Group will be required in the long-term to ensure a continued and enhanced group oversight.

The governance changes requested by the Board of Directors in July 2018 foresee further group alignment in terms of risk management, and the establishment of a Group CRO function. Group alignment has improved during 2018, as noted by the Audit Committee, in the areas of Compliance and Internal Audit. The focus in 2019 should be on Risk Management, the establishment of group oversight of all risks, which is the first necessary step towards ensuring oversight of the subsidiary focusing on the business delivery and building-up the group control and support functions. Further information is provided in Annex A.4.

#### *Recommendations*

These observations have led the Audit Committee to recommend that the Management Committee and the Board of Directors prioritise the following:

- *group alignment within the EIB Group by creating a genuine group structure with the parent company exercising effective oversight of the EIF, and of any future subsidiaries, and including group control (second and third lines of defence) and support functions. As a matter of priority, the EIB needs to ensure that the three lines of defence model functions in the existing structure, and to ensure the group oversight of risk management and the establishment of group control functions. The AC recommends that the focus of the group alignment in 2019 be on Risk Management,*
- *ensure a coordinated approach within the EIB Group of the equity and quasi-equity operations as these activities have grown in importance over the past few years. This approach should aim to avoid an overlap of product offerings between EIB and EIF and to ensure a clear delineation of roles and responsibilities within the EIB Group,*
- *develop the capability within the EIB Group to capture and aggregate all material risks, enhance group reporting and build a common data warehouse, as well as establish group IT policies; invest in appropriate IT infrastructure as the current state of such group infrastructure also poses increased operational risks, and*
- *extend the EIB Risk Appetite Framework to a group dimension in order to steer the risk profile of the EIB and the EIF within the group, as well as develop the ICAAP, ILAAP, stress testing framework, liquidity, capital contingency plans and recovery plan at a group-level.*

### **1.3 Risk Management and Internal Control**

#### *Introduction*

In its 2017 report, the Audit Committee highlighted the findings of an IA review of the Bank's lending appraisal and approval process and recommended that this process be reviewed and revamped. As credit is a core process of the Bank, it is important that this recommendation is treated as a priority. Specific high risk rated findings of the IA report were as follows: (i) governance of the credit approval and related decision making process; (ii) split of responsibilities between Operations and Risk Management Directorates; (iii) comprehensiveness of the analysis underlying the decision-making process and the extension of loans; and (iv) lack of industrialisation and standardisation of the credit process. In addition, the AC has explicitly requested that IA perform an assessment of the quality and outcomes of the creditworthiness assessments made by the EIB.

Another recommendation from last year, reiterated by the Audit Committee this year, was that the Bank should review the terms of reference of the control functions, the roles and responsibilities within each control function in order to ensure that the three lines of defence model is effectively deployed across the EIB Group.

In terms of the IA function, the Audit Committee took note of the proposed actions and areas for improvement based on the 2017 external quality review of the function, and noted the enhancement of the IA Plan for 2019-2020. In addition, the Audit Committee monitored the status of implementation of IA Agreed Action Plans. The timely implementation of AAPs is a key indicator that the internal control environment is adequate and effective and is evidence of a sound risk culture in a bank. The Audit Committee highlights this to underline that the timely implementation of IA AAPs must remain a management priority.

With regard to the cyber security landscape and the need for enhanced cyber-resilience, the IA performed a review at both the EIB and the EIF, and produced a joint Internal Audit report. The Audit Committee notes the reinforcement of the group-level information security frameworks, including the development of an Information Security Steering Committee, and the establishment of Information Security Officers in both the EIB and the EIF. Nevertheless, the IA report highlighted the need for further strengthening the group approach and oversight of this risk, as well as the management and reporting of information security matters and the need to establish a group data warehouse. The cyber-resilience in terms of definition, strategy, risk governance and implementation is also relatively new for the Bank and within the EIB Group. Further information is provided in Annexes A.4. and A.5.

#### *AC Assessment*

The Audit Committee is aware that the Bank has initiated projects to review the credit appraisal and approval process, as well as to review the terms of reference of the control functions. However, these are also repeated recommendations.

The Audit Committee notes that the Bank is making progress with the internal control framework, which is essential in view of its evolving business model and more diversified product mix with higher risk profile.

With regard to the operational resilience and cyber security risk, the Audit Committee has underlined the importance of strengthening the management in these areas including at a group level, in light of the findings of the IA report on group cyber security. The cyber security and operational resilience continue to be strategic priorities for the Audit Committee.

#### *Recommendations*

These observations have led the Audit Committee to recommend that the Management Committee and the Board of Directors prioritise the following:

- *address the findings in the IA report on the credit appraisal and approval process,*
- *complete the review of the terms of reference of the control functions, of the roles and responsibilities within each control function and across the EIB Group,*
- *ensure that the ICF is further developed and is sufficiently robust, by integrating and enhancing the ICFs in each Directorate,*
- *ensure the timely closure of outstanding IA AAPs, and*
- *enhance the oversight and control of IT, cyber security and operational risks preparedness in view of increased operational threats and elevate cyber security within the Bank and the EIB Group by adopting a group approach and policies.*

### **1.4 Best Banking Practice**

#### *Introduction*

During 2018, the EIB formally documented and defined in detail the holistic BBP Framework, which encompasses four elements (the BBP Guiding Principles, the BBP Book, the Applicability Assessment Procedure, and the BBP rules repository, Annex A.5.). The Audit Committee has been consulted during the review of the BBP Guiding Principles and is in the process of providing its review on the three remaining elements of the BBP Framework (the BBP Book, the Applicability Assessment Procedure, and the BBP rules repository), as they become available.

The Prudential BBP Programme, within the responsibilities of the RM Directorate, which has improved in terms of management, is focused mainly on four high priority projects due to the lack of IT support and resources, including in IT. Further information is provided in Annex A.5.

### AC Assessment

The Bank has committed itself to timely identification of new applicable best banking practice. The Bank needs to comply with these new applicable BBP requirements from the date when such requirements become effective. The Audit Committee takes note that the Bank is in the process of preparing the BBP Book, the Applicability Assessment Procedure and BBP rules repository, which will allow it to map the applicable rules, against which compliance needs to be achieved.

The Audit Committee takes note that the Bank is in the process of implementing the governance related proposals, part of the July 2018 decisions of the Board of Directors, including the function of a Group CRO. These proposals include a clear delineation of the roles and responsibilities of the Management Committee in line with the full deployment of the three lines of defence model and the EU requirements for their collective and individual skills, knowledge and experience.

However, the Audit Committee notes that there are still remaining gaps in the Bank's compliance with applicable BBP, in the prioritization of the BBP Programme and that the implementation of BBP is not fully integrated within the EIB Group. Some examples of remaining compliance gaps with BBP where further progress is expected in 2019 include: i) the full implementation of BCL's recommendations in relation to the Bank's liquidity adequacy and liquidity risk management, and in particular, regarding systems integration and risk data aggregation capacity, liquidity stress testing and the ILAAP document, as well as the development of a group approach to liquidity management ii) the closure of the gaps identified in view of the on-going implementation of the Anti-Money Laundering ('AML') Monitoring Framework, and iii) ensuring sufficient analysis and reporting on cost accounting and profitability at the EIB.

In addition, the Bank needs to: i) ensure that the stress testing exercises are performed in line with prudential requirements of the European Banking Authority ('EBA')/ECB, including the calculation of stress-testing results and prudential ratios on an IFRS-basis, in order to ensure comparability between the risk profile of the Bank and other financial institutions, ii) advance the RAF 2.0 project beyond the design phase, and iii) extend the RAF to a group dimension.

### Recommendations

These observations have led the Audit Committee to recommend that the Management Committee and the Board of Directors prioritise the following:

- *complete the development and fully operationalize the holistic BBP Framework by implementing the necessary processes and procedures within the EIB and the EIB Group,*
- *close the remaining BBP compliance gaps, including the closure of the BCL's recommendations in relation to systems integration and risk data aggregation, liquidity stress testing and the ILAAP document, as well as the development of a group approach to liquidity management,*
- *enhance the management of the prudential BBP Programme and its implementation within the right scope, timeline and resourcing, including in IT, as well as the right prioritisation of BBP projects with a view to anticipate and proactively manage upcoming regulatory changes impacting the EIB and the EIB Group,*
- *develop a common data warehouse,*
- *develop the capability to calculate prudential ratios and stress testing results on an IFRS basis,*
- *in terms of best governance practices and the full deployment of the three lines of defence at the Bank, complete the review of the responsibilities of the Members of the Management Committee, and ensure that the requirements of EU law are applied to their collective and individual skills, knowledge and experience<sup>2</sup>; the review should be completed in conjunction with the review of the terms of reference of the control functions (referred to under AC's recommendations for Risk Management and Internal Control).*

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<sup>2</sup> Joint ESMA and EBA Guidelines on suitability and ECB Guide on fit and proper assessments, May'18.

## 1.5 Culture, Conduct, Resources and Remuneration

### Introduction

The EIB needs to foster a sound risk culture across all lines of defence and to ensure that best practices are followed including relevant regulatory guidelines, thus contributing to the Bank's and EIB Group's sustainability and mission. The Audit Committee notes the progress achieved in relation to updates in some core documents of the Bank such as the Staff Code of Conduct and Whistleblowing Policy.

The Audit Committee has monitored the effectiveness and resourcing of the control functions as well as the remuneration practices within the Bank in view of the evolving business model of the Bank, the higher risk profile of operations and the need to maintain a strong control environment. The Audit Committee has reviewed the IA and Task Force reports on the administration of staff benefits highlighting a wide range of weaknesses. Further information is provided in Annex A.5.

### AC Assessment

The Management needs to continue to encourage and implement a sound risk culture within the EIB and the EIB Group and to ensure that the risk culture includes such features as accountability, sufficient challenge from the second line of defence, a clear tone from the top and incentives to speak up.

In order to foster a sound risk culture within the EIB Group, the remuneration practices need to be aligned with the relevant best banking practices and EBA Guidelines<sup>3</sup> and at present, the Audit Committee observes significant gaps in that regard. The Bank needs to close the existing gaps in remuneration governance, structure and performance assessment, as well as in the identification of material risk-takers and disclosure requirements. In its last year's report, the Audit Committee recommended that the remuneration policies of the Bank are more balanced to reflect not only volume-based Key Performance Indicators ('KPI') as a driver of objectives setting. The Audit Committee reiterates that recommendation in this year's report. Last but not least, the AC does not agree with the way the gender pay gap has been interpreted.

In addition, the control functions of the Bank need to be appropriately and sufficiently staffed in terms of both financial and human resources. Existing vacancies in the control functions need to be filled and the recruitment process needs to be streamlined to ensure appropriately staffing and decrease excessive reliance on consultancy contracts.

The Audit Committee considers that the Code of Conduct of the Management Committee and of the Board of Directors be reviewed.

In addition, the Audit Committee expects that the Bank develops and implements in an expedient manner an action plan to address the findings in the IA and Task Force reports related to the administration of staff benefits with the aim to strengthen the control environment and to simplify the system as much as possible.

### Recommendations

These observations have led the Audit Committee to recommend that the Management Committee and the Board of Directors prioritise the following:

- *encourage a sound risk culture within the EIB Group in order to ensure that it includes such features as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak-up,*
- *review the Code of Conduct of the Management Committee and the Board of Directors,*
- *ensure the appropriate, efficient and effective pace of hiring of the second and third lines of defence within the Bank to enable them to perform effectively their duties and to deliver high quality work; close any recruitment gaps in the control functions as a matter of priority,*
- *address the gaps identified in remuneration policies in order to foster sound risk culture within the EIB Group, and ensure that remuneration practices are better balanced to reflect not only volume-based KPIs as a driver*

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<sup>3</sup> Relevant best banking practice in the area of remuneration practices include the Capital Requirements Directive IV and EBA Guidelines (EBA Guidelines on internal governance). <http://www.fsb.org/wp-content/uploads/P200418.pdf> Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors, April 2018.

- of objectives setting; enhance the remuneration governance, remuneration structure, performance assessment, and remuneration disclosure requirements in line with best banking practice, and*
- *ensure that the findings of the IA and the Task Force reports on the gaps related to the inefficient and complex administration of staff benefits be addressed by the development of an action plan, which must be implemented quickly.*



## 2 LOOKING FORWARD

Looking forward, the Audit Committee expects that the Management Committee and the Board of Directors fully address the 23 recommendations under the key observations of this Annual Report, which are also summarised in a table in Annex A.7. In the past, the implementation of the Audit Committee's recommendations was too slow.

The Audit Committee requests that the Management Committee, in its response to the recommendations of this Annual Report, develops a Roadmap, including milestones, resources and timeline for the implementation of the recommendations of this year's Report. The response of the Management Committee about each recommendation should also state whether the Management Committee accepts or not the Audit Committee's recommendations. In addition, the Audit Committee also underlines its expectation that the closure of IA Agreed Action Plans be expedited.

In view of reinforcing its ability to oversee the EIB and the EIB Group, the Audit Committee intends to intensify further its work with the establishment of the EIB-Review and Evaluation Process based on the four pillars (Business Model and Sustainability, Governance and Risk Management, Risk to Capital and Risk to Liquidity and Funding) known under the Supervisory Review and Evaluation Process. The Audit Committee intends to continue to collaborate more closely with the European Central Bank Banking Supervision in 2019. The Audit Committee will also focus on strengthening its oversight capacity by involving experts from National Supervisory Authorities seconded to the Audit Committee and in obtaining a long-form report from the external auditors on the review of the Bank's compliance with BBP.

The Audit Committee is strongly committed to continue its cooperation with the Audit Board of the European Investment Fund in order to strengthen further the group oversight of the EIB and the EIF activities in terms of risk management, equity and quasi-equity operations, operational resilience, IT and cyber security, data warehouse, single data policy and financial control. The Audit Committee will also continue to build on the group dimension of the work completed during 2018 by the Internal Audit and Compliance functions.

In 2019, the Audit Committee will have regular exchanges with the Board of Directors, including through the meetings with the Risk Policy Committee and the Working Group on Governance, in order to coordinate common objectives and priorities for the Bank.

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

In 2018 the Audit Committee received the expected full support from the Bank's Management Committee and Services, thus the Audit Committee was able to properly discharge its responsibilities. The Audit Committee expects similar support from the Management Committee and the Bank's Services going forward.

**Luxembourg, 14 June 2019**

**Signed by:**

**D. PITTA FERRAZ**

**J. SUTHERLAND**

**L. BALOGH**

**CHAIRMAN**

**M. MACIJAUSKAS**

**V. IUGA**

**P. KRIER**

**U. CERPS**

**J.H. LAURSEN**

## ANNEXES

### A.1. MANDATE, SCOPE AND OUTCOMES OF AUDIT COMMITTEE'S WORK IN 2018

The Audit Committee is established under European Investment Bank Statute as one of the EIB's four governing bodies, which is independent from the Board of Directors and reports directly to the Board of Governors. The Members and the Observers of the Audit Committee are appointed by the Board of Governors and are independent experts and professionals with knowledge, expertise and skills in finance, banking, accounting and auditing, risk management and banking supervision in both the private and public sectors. At the date of this report, the Audit Committee comprised six Members and two Observers.

In June 2018, the Chairmanship passed from Mr. Pierre Krier to Prof. Dr. Duarte Pitta Ferraz. In addition, one new member joined the Audit Committee, Mr. Laszlo Balogh, replacing the outgoing Audit Committee Member, Mr. Jacek Dominik. The CV's of the Members of, and Observers to, the Audit Committee are available on the EIB's website. In 2018, the Audit Committee held 10 meetings over 24 business days (2017: 10 meetings over 20 business days).

During its meetings in 2018, the Audit Committee had regular discussions with representatives from the Bank's Services, including Members of the EIB's Management Committee, the Secretary General, Risk Management, Transaction Management and Restructuring, Internal Audit, Inspectorate General, Compliance, Financial Control, Operations, Finance, IT, Legal, Personnel, as well as the external auditors, KPMG.

#### *Fostering sound risk management and governance practices*

The Audit Committee advances work practices and a balanced approach anchored on reviewing and monitoring in particular the work performed by external and internal audit. In relation to the following, the AC forms an opinion on risk to capital, risks to liquidity, as well as forming a view on the internal control framework overseen by the Internal Controls and Assertions ('ICA') Division. In addition, the Audit Committee forms a view on the following documents within the responsibility of the Risk Management ('RM') Directorate, namely, the ICAAP, ILAAP, stress testing, liquidity and capital contingency plans, recovery planning. The Audit Committee also reviews the relevant risk management and monitoring reports, and reports related to compliance and investigation topics. The Audit Committee fosters further integration of the work and topics it discusses with the work of the Board of Directors, thus playing a key role in contributing to the enhancement of the EIB's risk management and governance practices.

#### *Mandate and scope of the Audit Committee's responsibilities*

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

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

#### *Outcomes of the Audit Committee's work*

The outcomes of the Audit Committee's work comprise the following:

- the issuance of the AC's Statements on the Bank's and the EIB Group's annual Financial Statements, which are delivered to the Board of Governors; and
- the preparation of an Annual Report.

#### Audit Committee Statements on the EIB and the EIB Group's Financial Statements

The Statements of the Audit Committee are prepared in line with its obligation under Article 12 of the EIB Statute. Based on the statutory governance structure of the EIB and the EIF, the Audit Committee underlines that its work and its Statements on the EIB and EIB Group Consolidated Financial Statements thereon, are formed largely upon the work

performed by the external auditor and the respective external audit opinion issued by KPMG on the EIB Group Consolidated Financial Statements.

The Audit Committee has issued and submitted to the EIB Board of Governors the Annual Statements on the Financial Statements of the EIB and the EIB Group as at 31 December 2018 in respect of the following:

- *EIB Group Financial Statements*<sup>4</sup>:
  - *EIB stand-alone and EIB Group consolidated, prepared under the general principles of the EU Directives*<sup>5</sup>, *and*
  - *EIB Group consolidated, prepared in accordance with International Financial Reporting Standards, as adopted by the EU.*
- *Mandates and Trust Funds Financial Statements*:
  - *Investment Facility, EU-Africa Infrastructure Trust Fund, and Neighbourhood Investment Facility ('NIF') Trust Fund, prepared under IFRS, as adopted by the EU.*

In view of the responsibilities of the Audit Committee related to the external auditing activities, further information is provided in Annex A.3.

#### The Annual Report of the Audit Committee

The Audit Committee prepares an Annual Report on the work performed during the previous year in relation to the monitoring of the internal control environment, risk management, compliance and internal audit activities, as well as the verification of the Bank's compliance with best banking practice. Further information on the Audit Committee's work in relation to the work completed in that regard is provided in Annexes A.4. and A.5.

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<sup>4</sup> EIB's Financial Statements under the EU Directives comprise each unconsolidated and consolidated the balance sheet as at 31 December 2018, the profit and loss account and the cash flow statement for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies and other explanatory information. The EIB's consolidated Financial Statements under IFRS comprise the consolidated balance sheet as at 31 December 2018, the consolidated income statement, the consolidated statement of profit and loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and notes to the consolidated Financial Statements, including a summary of significant accounting policies and other explanatory information.

<sup>5</sup> 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').

## A.2. OPERATING ENVIRONMENT

During 2018 and until the issuance of this report, the operating environment of the EIB has been marked by unprecedented pace of change and geopolitical uncertainty. Some significant developments in the external environment include the withdrawal process of the UK from the EU, geopolitical risks, on-going negotiations on global trade, uneven growth in the global economy and tightening of the financial conditions in some markets. While these downside risks were outside of the control of the EIB, they have continued to be present in the external operating environment.

### *Withdrawal of a major shareholder*

The announced withdrawal of the United Kingdom from the European Union and, consequently, the end of the United Kingdom's membership in the EIB<sup>6</sup> remained the major uncertainty affecting the EIB over the course of 2018<sup>7</sup>. The Bank had to adjust its operating plan and business volumes and to manage closely its risk profile and key risk metrics, notably the S&P RAC ratio and the statutory gearing ratio.

In addition, the Board of Directors approved in July 2018 the proposals for the Bank's capital replacement, which included related governance changes ("July package"). Overall, the proposals would strengthen EIB's governance and are expected to be implemented in 2019. In this context, the Bank's governing bodies must approve the UK capital replacement before Brexit becomes effective.

### *Negotiations at EU level*

In addition, the outcome of negotiations at EU level on the future direction of the EU, including on the Multiannual Financial Framework ('MFF') for 2021-27, remains uncertain and could influence the related mandate management business of the EIB, including the future InvestEU mandate, expected to replace some of the existing mandates. These uncertainties might introduce further changes to the EIB's operations and business model, the Bank's engagement with other financial institutions, including the National Promotional Banks.

### *Best Banking Practice*

In addition to the geopolitical events and the ongoing negotiations at EU level, the regulatory environment continued to evolve with changing capital and liquidity standards, data privacy legislation, a transition to risk-free rates and increased cyber security threats. In 2018, the EIB formally documented and defined in detail the holistic Best Banking Practice Framework. Further information on the Audit Committee's work in verifying the Bank's compliance with BBP is provided in Annex A.5.

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<sup>6</sup> As disclosed in the EIB Financial Statements, as at end of 2018, the UK subscribed capital represented 16.11% of the EIB's capital, accounting for EUR 3.5 bn of the paid-in and EUR 35.7 bn of the Bank's callable capital. In addition, as of the end of 2018, aggregate loan exposures to projects located in the UK amounted to EUR 40 bn.

<sup>7</sup> At the time of the preparation of this report, continuing uncertainty remained for the announced withdrawal of the UK's membership of the EIB due to the political process and the next steps to be undertaken.

### A.3. OUTCOME OF EXTERNAL AUDITING ACTIVITIES

In its work, the Audit Committee relies on the external and internal auditors and where appropriate, on 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, signed based upon 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.

#### *Oversight of the external audit process*

As set out in the Article 26.2 of EIB's Rules of Procedure, the Audit Committee assigns the audit of the EIB's Financial Statements to the external auditor. The external auditor of the EIB appointed by, and reporting directly to the Audit Committee, is KPMG Luxembourg, Société coopérative, a Luxembourg entity and a member firm of the network of independent firms affiliated with KPMG International Cooperative.

Based on the work undertaken and the information received, including external auditor's unqualified audit report from the external auditors on the Financial Statements of EIB, the Audit Committee concludes that the Financial Statements (as set out in Annex A.1.) and adopted by the Board of Directors, present a true and fair view of the financial position of the Bank as at 31 December 2018 and of the results of its operations and its cash-flows for 2018, in accordance with the applicable accounting framework.

The Audit Committee reviewed and challenged the application of the audit methodology and approach set out in KPMG's annual audit plan, where the following areas of audit focus, including key areas of judgement and estimation in the Financial Statements, include:

- 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,
- venture capital, including valuation of private equity investments,
- information technology, including data quality and governance,
- the use of experts in the audit,
- the financial reporting process, in particular, in relation to the IFRS consolidated Financial Statements, and
- application of accounting standards, including any additional changes to Financial Statements disclosures.

In relation to the first time application of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers, the Audit Committee:

- received regular briefings from the Financial Control Directorate ('FC') and KPMG during the reporting period on the status of implementation of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers, effective as of 1 January 2018,
- discussed the nature, extent, timing and the outcome of IFRS 9 related procedures performed by KPMG, in particular regarding:
  - the establishment of audited consolidated financial information as of 1 January 2018,
  - the classification and measurement of financial assets,
  - the expected credit loss model for calculating impairment,
  - new hedge accounting principles,
  - EIB Group considerations and revised disclosure requirements,
- was informed by KPMG of the impact of the new IFRS 9 and IFRS 15.

In discharging its responsibilities in respect of the oversight of the external audit of the Bank's Financial Statements, the Audit Committee:

- met with KPMG at 8 of the 10 Audit Committee meetings held in 2018, monitored the execution of KPMG's audit plan through regular meetings with senior members of the audit team, including the lead audit engagement partner.
- was briefed on the progress and outcome of the audit procedures, in particular in relation to the priority audit areas set out above, together with the identification and reporting of Key Audit Matters as set out in KPMG's independent auditor's reports on the Bank's Financial Statements,
- reviewed and discussed the summary of identified adjusted and unadjusted audit differences,
- made inquiries in relation to KPMG's understanding and extent of evaluation of the Bank's processes, systems and controls, in particular regarding the Bank's credit approval and related decision making process at the EIB further to an Internal Audit report discussed with the Audit Committee in early 2018,
- read and challenged the content of regular written reports submitted to it from the external auditor, addressing the various stages of the external audit process and including audit methodology and audit approach, the results of audit testing, levels of materiality, audit differences, significant matters arising from the audit process and auditor independence,
- discussed KPMG's recommendations which are reported in their Management Letter to the Bank, as well as the status of the implementation of prior year recommendations,
- received assurance from the external auditor that the audit process was achieved as planned, with support from the Bank's services.

The Audit Committee required that when obtaining an understanding of the EIB's internal control environment relevant to the external audit, KPMG carry out controls testing in order to:

- *acquire an adequate understanding of the organisation of key control functions within the Bank and its subsidiary. At a minimum, key control functions include the Internal Audit, Risk Management, Compliance, Financial Control and other monitoring functions,*
- *assess whether there are any material gaps in the Bank's internal control systems and understand the level of risk tolerance defined by those charged with governance, and*
- *report to the Audit Committee on the outcome.*

Finally, based on the results of the external audit work and on its own work, the Audit Committee formulated the conclusions, as enumerated in its Statements (as per Annex A.1. of this Report), issued to the Board of Governors, which accompany the EIB Group's Annual Report.

#### ***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 the prevailing EU Regulation. The Audit Committee received and discussed details of 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 not to 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 2018.

#### ***Facilitating the future rotation of the external auditor***

In view of restrictions on the provision of non-audit services by audit firms to audit clients that seek to maintain the independence of the external auditor, the Audit Committee requested in 2016 that the EIB propose ways in which to facilitate the process for the future and timely rotation of the EIB's external auditor.

The Audit Committee understands that:

- *the MC agreed that the next audit tender process will be initiated in 2019 and concluded in the course of 2020 to appoint an external auditor responsible for the audit of the Financial Statements for the year beginning 1 January 2022, and*
- *without prejudice of the economic operators' freedom to participate in EIB Group published procurement*

*procedures for the provision of non-audit services, various initiatives have been identified that aim to monitor and balance the EIB's use of professional service firms, typically eligible to bid for external audit services, for consultancy work.*

#### **A.4. OUTCOME OF THE REVIEW AND MONITORING OF THE INTERNAL CONTROL ENVIRONMENT, RISK MANAGEMENT, COMPLIANCE, INSPECTORATE GENERAL AND INTERNAL AUDIT**

The Risk Management, Compliance, Inspectorate General and Internal Audit functions retained unrestricted access to the Audit Committee during 2018.

##### ***Internal Audit***

Internal Audit is an independent function within the EIB with a direct reporting line to the Bank's President. The Audit Committee met with the Head of IA at each of the 10 meetings held in 2018, and at each of the three meetings held jointly with the EIF Audit Board to review joint audits of EIB/EIF, such as the joint audit on cyber security. The salient features of IA reports issued and received were examined and discussed, as well as the updates of the status of implementation of the related agreed action plans. The Audit Committee reviewed the draft IA work plan for 2019-2020, which included a new Internal Audit planning methodology where a new combined EIB Group audit universe was presented and an enhanced risk scoring assessment was implemented. These improvements in the IA methodology would allow the IA plan of 2020 to be almost entirely risk-based with the exception of some recurring audits, as required by EU regulations.

The Audit Committee was informed of the proposed follow-up action plans and areas for further development following the external independent quality review performed back in 2017. That external review of the IA function was in respect of its mission and role set out in the Internal Audit Charter as well as about the effectiveness of IA's processes, practices and standards. The Audit Committee took note of the proposed actions and areas for improvement of IA.

Finally, the status of implementation of IA AAPs was regularly monitored. The timely implementation of AAPs is a key indicator that the internal control environment is adequate and effective and is evidence of a sound risk culture in a bank. The Audit Committee highlights this to underline that the timely implementation of IA AAPs must remain a management priority.

##### ***Internal Control Framework and Financial Control***

The Internal Controls and Assertions Division within the Financial Control Directorate is responsible within the EIB for the implementation and maintenance of the Internal Control Framework and the setting of operating principles designed to help the Bank document and assess how effective and efficient the control environment is in order to manage and mitigate the identified risk exposures.

The Audit Committee strongly supported the further development of the internal control framework. The EIB's Board of Directors endorsed the first ICF Policy in June 2018. The Audit Committee met with the FC/ICA Division on two occasions during 2018. While the ICF is in the process of being enhanced, the Audit Committee underlines its recommendation that EIB strengthen the internal control environment further to ensure that it is sufficiently robust. This is essential for the Bank in view of its evolving business model, more diversified product mix with higher risk profile and new initiatives.

An internal control framework, which is well designed and effective at both the EIB and the EIB Group level, is of the highest priority for the Audit Committee, which receives assurance from the Bank and its Management on the effectiveness of the ICF. The Audit Committee relies on having a sound control and risk management environment in order to perform its duties. In addition, an effective and mature ICF is the responsibility of all Services, not just the Risk Management and control functions within the EIB, and is vital in order to foster a risk-awareness culture among employees.

In terms of the need for the Bank to calculate prudential ratios and stress testing results on an IFRS- basis, the Audit Committee expects that the Bank develop this capability in 2019.

##### ***Inspectorate General***

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



The Audit Committee met with the Inspector General at five of the 10 meetings held in 2018. The Audit Committee examined and discussed with the IG the on-going cases under their remit. The Audit Committee received regular presentations of the status of the complaints mechanism, related revisions to the complaints policy, reviewed the anti-fraud activity report and the lessons learned from External Offices investigations and recommended the Inspector General to reflect on the systemic conclusions from individual fraud investigations.

The Audit Committee was also provided with an overview of the evaluation report of the European Fund for Strategic Investments and discussed the conclusions of the report. The Audit Committee expressed concern about the insufficient cost coverage for EFSI and recommended that the Bank make a careful assessment of the impact of these operations in respect of financial sustainability.

### ***Risk Management***

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 nine of the 10 meetings held with the RM Directorate in 2018, and had met eight times with the Transaction Management and Restructuring ('TMR') Directorate. In addition, the Audit Committee and the EIF Audit Board discussed at two of the three annual meetings, topics related to the EIB Group risk management organisation and encouraged further strengthening of the group oversight of risk management. The Audit Committee expects further progress in view of building the group risk management function over 2019.

In obtaining assurance in relation to risk management activities, the Audit Committee discussed and made recommendations to the Bank's RM and TMR Directorates at these meetings. The Audit Committee focused on topics such as credit risk assessment and monitoring, liquidity risk management, capital adequacy requirements, capital planning, operational risk assessment and monitoring. The Audit Committee addressed different aspects of risk management and regularly reviewed the monthly risk report and dashboard, the quarterly risk outlook, watch list and the monthly operational risk report.

In addition, the Audit Committee discussed and provided comments on the EIB's Risk Appetite Framework, the EIB Group Risk Management Disclosure Report, the ICAAP, the ILAAP documents, the results of the stress testing exercises performed during 2018.

The Audit Committee expects that the RM function be enhanced and extended to ensure the group oversight of risks and that it becomes more proactive in anticipating and monitoring upcoming regulatory changes. In addition, RM has to play an effective role in the group alignment and the coordination of equity and quasi-equity activities, and to foster a sound risk culture.

### **Capital adequacy, capital planning and stress testing**

The Audit Committee met with RM staff at each RM session to monitor and discuss the evolution of the Bank's Capital Adequacy ratio ('CAD'), the statutory gearing ratio and externally calculated capital metric ('S&P RAC ratio'). The Audit Committee also received presentations of the potential impact on capital adequacy and gearing ratios of the developments around the announced withdrawal of the UK from the shareholding of the Bank, and the reconciliation between the regulatory CAD ratio and the S&P RAC ratio.

The Audit Committee subsequently requested that the approximate capital consumption of different BBP projects of the Prudential BBP Programme be estimated, disclosed in the risk report, and integrated in the capital planning process of the Bank. The Audit Committee has also specifically recommended that the Bank build a forward-looking approach to capital adequacy and capital planning.

With reference to the assessment of capital adequacy, the Audit Committee provided comments on the EIB's 2017 Internal Capital Adequacy Assessment Process document and requested improvements in a number of areas.

The Audit Committee also recommends that the EIB continues to work on the Risk Appetite Framework, which needs to be extended to a group dimension, and fully embedded in the management of risks and the steering of the risk profile of the Bank and the EIB Group. Further detail on the work performed by the Audit Committee in relation to the prudential BBP Programme and on the assessment of the status of implementation of the BBP Framework is provided in Annex A.5.

### Stress testing framework and IFRS

In view of the stress testing framework and recently performed stress testing exercises, the Bank needs to ensure that the stress-testing exercises are performed in line with the prudential requirements and expectations of the EBA/ECB. Consequently, the Bank should have the capacity to calculate the stress testing results and prudential ratios on an IFRS basis. This would allow for a comparison between the Bank's stress testing results, prudential ratios and risk profile and those of other financial institutions.

### Liquidity risk

The Audit Committee reviewed and discussed the results of the Bank's key liquidity risk metrics throughout the reporting period, which include the Liquidity Coverage Ratio ('LCR'). The Audit Committee received updates to the Bank's liquidity risk management, the currency specific LCR and the status of the Bank's implementation of the Net Stable Funding Ratio ('NSFR') in the liquidity risk framework.

Due to the Bank's participation in the ECB Euro monetary policy operations, a signed agreement is in place between the EIB and the BCL, establishing the framework for the assessment of the Bank's liquidity situation and liquidity risk management. The Audit Committee reviewed the BCL assessment of the Bank's liquidity received in early 2018 and discussed with Bank's Services the related recommendations and key observations. In addition, the Audit Committee requested the Management Committee to address, as a matter of priority, the recommendations of BCL on liquidity risk adequacy and liquidity risk management, as some are repeated recommendations and relate to improvements needed in risk data aggregation and systems integration, as well as to liquidity stress testing, the ILAAP document and the development of group approach to liquidity management. The latter is especially important in view of achieving consistency in view of liquidity management but also for the group oversight of risks. The Audit Committee also discussed and provided comments on the Bank's second iteration of the ILAAP report (i.e. the ILAAP document for 2017).

The Audit Committee received a separate report and presentation on the use of derivatives and implications for liquidity, the impact of the announced withdrawal of the UK from the EU on derivatives clearance and the replacement of Libor and impacts on the Bank's funding costs.

### Asset quality and governance of credit risk

The Audit Committee held discussions throughout the year with RM concerning the trends of key risk indicators such as the evolution of loan grading, large exposures and concentration risk, the quality of the loan portfolio, the non-compliance events, as well as 'watch listed' and loans in arrears.

The Audit Committee sought further explanations concerning the monitoring of operations reported on the 'watch list', loans where specific provisions were accounted for and loans where contractual clause related events had occurred. The Audit Committee reiterated the need for adequate provisioning under the IFRS 9 and the need for continued monitoring of the loan portfolio. The Audit Committee recommended that the analysis, monitoring and reporting of exposures be enhanced going forward and is expecting that progress is achieved with the comprehensive review of the credit appraisal and approval process, which is also part of the IA plan for 2019.

### ***Compliance Function***

The Office of the Chief Compliance Officer ('OCCO') comprises four organisational units (OCCO Divisions of Operations, Monitoring and Corporate, the Data Protection Office as well as the Procurement Compliance, and the Regulatory & Tax teams).

The Audit Committee met with the Group Chief Compliance Officer at six of its 10 meetings held in 2018. Topics discussed related to the status of the Anti-Money Laundering and Combating the Financing of Terrorism ('AML-CFT') Framework. In addition, OCCO provided the Audit Committee with updates on: i) sanctions, ii) the revisions in the Whistleblowing Policy and the Staff Code of Conduct, iii) the project to develop a methodology for risk assessment of reputational risk, iv) the implementation plan at group level of the new Data protection Regulation ('GDPR'), which entered into force on 25 May 2018, and iv) the completion of the 'legacy' project, which included a comprehensive revision of the Know Your Customer ('KYC') records of existing and new counterparties.

In addition, the Audit Committee acknowledges OCCO's initiative to launch a Compliance Culture Change Programme, to review the Dignity at Work Policy at the EIB and has received updates on the status of these documents in early 2019.

As per the last year's Report, the Audit Committee expects that the revision of the Bank's Whistleblowing policy be completed as soon as possible, as this was a previous Audit Committee recommendation. The existing whistleblowing policy dates back to 2009 and the Audit Committee received an update of the status of the project from OCCO in late 2018. The Audit Committee expects to be consulted by OCCO in view of the envisioned changes to the Staff Code of Conduct, also expected to be completed in early 2019.

The Audit Committee took note of the on-going implementation of the AML-CFT Monitoring Framework, consisting of the self-assessment reported by the Group Chief Compliance Officer whereas the AML-CFT requirement for the enhanced monitoring of Politically Exposed Persons ('PEPs') is assessed as "partially compliant".

## A.5. OUTCOME OF THE VERIFICATION OF EIB'S COMPLIANCE WITH BEST BANKING PRACTICE

The Audit Committee, by virtue of the EIB's Statute and Rules of Procedure, verifies the Bank's compliance with applicable Best Banking Practice.

### *Verification by the Audit Committee of EIB's compliance with the Best Banking Practice*

The Audit Committee task to verify EIB's compliance with applicable best banking practice also encompasses the review and monitoring of the capital and liquidity adequacy, the effectiveness of the internal control environment and monitoring and assessing risks to the EIB's risk profile.

### BBP Framework at the EIB

During 2018, the EIB has formally documented and defined in detail the holistic BBP Framework, which encompasses four building blocks. The BBP Framework of the Bank:

- is based on high-level best banking practice Guiding Principles ('BBP GP'), setting out the purpose and applicability of BBP at the EIB in view of its Statutory mission,
- comprises a BBP Book that will set out best banking practice determined as either not applicable or requiring adaptation in view of the EIB's mission, and including mitigating measures based on a "comply or explain" approach,
- includes an Applicability Assessment Procedure, ensuring consistent, timely identification and assessment of the relevant BBP rules, and
- covers a BBP rules repository including all relevant EU Directives and Regulations Legislative Acts and Guidelines with which the EIB has voluntarily decided to comply.

The Audit Committee supports the EIB's intention to establish the holistic BBP Framework and has been consulted during the approval process of the BBP GP. The Audit Committee is in the process of providing its review on the BBP Book, the Applicability Assessment Procedure and the BBP rules repository documents, as they become available.

The full implementation of the BBP Book and compliance with the Applicability Assessment Procedure will require significant commitment and resources on behalf of the Bank and the Audit Committee expects that these resources be provided. The Bank will need to follow the BBP Framework in place and to continuously monitor new and emerging guidelines and regulations for potential impact on the EIB and the EIB Group. Currently, the Bank's compliance with best banking practice is based on a hierarchical set of reference BBP documents, e.g. EU Treaties, the EIB's Statute and Rules of Procedure, EU Banking Directives and Regulations, guidance and principles issued, and best practice adopted by global and EU regulatory bodies.

In 2018, the Audit Committee carried out its annual verification exercise by reviewing various BBP documents, had deliberations with Services on the status of implementation of BBP within each Directorate and discussed the outcome of the annual self-assessment of EIB Services' compliance with the best banking practice. To complement the self-assessments reported by Directorates, the Audit Committee has requested that IA include within the Internal Audit Annual Plan the audit of at least one area of the BBP Framework each year. In addition, the Audit Committee will explore whether the external auditor can prepare a long-form report for the verification of the Bank's compliance with BBP. Looking forward, the Audit Committee is expecting full implementation of the formally documented and defined BBP Framework and the finalization of all remaining elements (BBP Book, Applicability Assessment Procedure and BBP rules repository).

### *Areas where further improvements need to be achieved*

The Audit Committee has met and discussed with the Bank's Services the status of implementation of the applicable best banking practice and the results of the annual verification process, and has identified areas where further improvements are necessary.

### Prudential Risk Management

Areas under responsibility of the RM Directorate include compliance with the Capital Requirements Directive and the Capital Requirements Regulation ('CRD/CRR'), current guidelines and practices adopted by the Basel Committee on Banking Supervision ('BCBS') and by EBA.

The Audit Committee acknowledges the work carried out by RM during the reporting period to ensure the closure of certain compliance gaps. This includes the second iteration of the ILAAP, the enhancements and revisions of the Liquidity Contingency Plans, the additional liquidity monitoring metrics, the improvements to the rating coverage, the Recovery and Capital Contingency Plans, the calculation of capital requirements for counterparty credit risk and as well as the preparation and completion of the periodic ICAAP document and the EIB Group Risk Disclosure Report ('Pillar 3 Report').

The Audit Committee took note of the annual update of the EIB's compliance with best banking practice in the field of risk management as of end of 2018, and the need to continue to implement and close remaining compliance gaps in the area of setting risk appetite, integration of capital and liquidity metrics in the risk management framework and the steering of the Bank's risk profile, as well as the enhancements necessary to the stress testing framework, operational risk, model risk, risk data aggregation and risk reporting and the management of Interest Rate Risk in the Banking Book ('IRRB').

The Audit Committee would like to underline the following improvements needed in the area of the prudential risk management, in particular to: i) develop further and enhance Bank's capability to capture and aggregate data (BCBS 239, Risk Data Aggregation and Risk Reporting); ii) perform the stress testing exercise fully in line with prudential requirements of the EBA/ECB and consult with the Audit Committee and the Board of Directors in advance of any departures from these methodologies, and iii) ensure that the risk management function becomes more pro-active and forward looking and is adequately prepared to implement new and emerging regulatory changes<sup>8</sup>.

The most recent version of prudential BBP Programme for which RM is responsible, was presented to the Audit Committee and identified 18 active projects, of which four projects were classified as high priority, and the rest of the BBP projects were either of low/medium priority, on hold or in the planning stage.

The following high priority BBP Programme projects – Interest Rate Risk in the Banking Book, intraday liquidity risk management, RAF 2.0 completion, and the implementation of BCBS 239, need to be complemented by projects requiring a long period to analyse and implement, such as the new internal models based approach for the calculation of capital requirements for market risk (i.e. the Fundamental Review of the Trading Book, 'FRTB'), as well as the full implementation of the Net Stable Funding Ratio. The Audit Committee expects that Risk Management take ownership of the Prudential BBP program and its full implementation, ensuring that the program has the right scope and appropriate deadlines, as well as the right prioritisation and staffing.

The Audit Committee notes that the Bank aims to implement during 2019 the governance changes presented together with the capital replacement package of July 2018, which include the full deployment of the three lines of defence model within the Bank, and the setting-up of a group oversight of risk management with the establishment of a Group CRO function. The governance changes are expected to strengthen the risk management function as well as the control environment within the EIB and the EIB Group.

Further improvements in the assessment, monitoring and raising awareness of the cyber security risk are also needed. The Audit Committee notes that a second line of defence of information security will be established within the RM Directorate and is looking forward to the full deployment and enhancement of operational resilience of the Bank.

In addition, the Audit Committee expects that the Bank addresses in 2019 the comments raised in relation to the ICAAP and ILAAP documents, and in particular expects the Bank to address the recommendations of BCL with respect to liquidity risk management, risk data aggregation, systems integration, liquidity stress testing, and the need for a consistent approach to liquidity management across the EIB Group, as well as the improvements expected in the ILAAP document as per the BCL's liquidity assessment.

In view of the requirements of EU banking reform<sup>9</sup>, as presented by the European Commission in November 2016, the finalized Basel III reforms as well as of any recently issued guidance from the ECB, EBA and the BCBS, the EIB should present an action plan detailing the status of impact assessment and the date of expected compliance with the

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<sup>8</sup> The EU banking reform package of November 2016: [http://eur-lex.europa.eu/resource.html?uri=cellar:9b17b18d-cdb3-11e6-ad7c-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:9b17b18d-cdb3-11e6-ad7c-01aa75ed71a1.0001.02/DOC_1&format=PDF).

<sup>9</sup> The EU banking reform package of November 2016: [http://eur-lex.europa.eu/resource.html?uri=cellar:9b17b18d-cdb3-11e6-ad7c-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:9b17b18d-cdb3-11e6-ad7c-01aa75ed71a1.0001.02/DOC_1&format=PDF).

upcoming regulatory changes. The Audit Committee urges the Bank's Management Committee to continue its efforts to implement key BBP projects.

### Corporate Governance

In relation to Group oversight of all key risks and key control functions including risk management, compliance, finance, IT and cyber security risks, the Audit Committee requests that further progress be made in that respect and that the Bank establish group oversight of risk management, as well as over other group level control functions. While the governance changes are expected to be implemented in 2019, the Audit Committee notes the importance of the Bank's ability to exercise an effective oversight over its majority-owned subsidiary. In view of IT security and operational resilience, the Audit Committee expects that the management of cyber security and operational risks be further enhanced.

The Audit Committee reiterates its prior year's recommendation that the Bank needs to deploy fully the three lines of defence model, thus allowing the members of the management body to be able to discharge their responsibilities in line with applicable best banking practice including the requirements the EU law in relation to the required individual and collective knowledge, skills and experience. The review of the responsibilities of the Management Committee should be performed in conjunction with the completion of the projects to review the credit appraisal and approval process and to review of the terms of reference for the control functions (referred in section 1.3 under AC's recommendations for Risk Management and Internal Control).

### Culture and conduct, resources and remuneration,

The EIB needs to foster a sound risk culture across the three lines of defence, which includes elements such as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak up<sup>10</sup>.

The Audit Committee notes the progress achieved in relation to updates of the Staff Code of Conduct and the Whistleblowing Policy initiated by the Compliance function, including the Compliance Culture Change Programme.

The Audit Committee has monitored the effectiveness and resourcing of control functions within the Bank and underlines its recommendation that second and third lines of defence within the Bank should be able to effectively perform their duties and to deliver high quality work. This is especially important in view of the evolving business model of the Bank, the higher risk profile of Bank's operations, and the need to maintain a strong control environment. The Audit Committee underlines that the control functions need to be appropriately and sufficiently staffed, and that any recruitment gaps in control functions need to be filled as a matter of priority.

In terms of remuneration practices, the Audit Committee reiterates its recommendation from the prior year for the Bank to strive to address the gaps identified in this area in order to foster a sound risk culture within the EIB Group. Relevant best banking practice in the area of remuneration practices include the Capital Requirements Directive IV and EBA Guidelines and addresses remuneration related topics, including remuneration governance, remuneration structure, performance assessment, the identification of material risk takers - identified staff and disclosure requirements.

In 2018, the Audit Committee reviewed the assessment of the current EIB remuneration practices against prevailing BBP requirements performed by Personnel and reiterated that the Bank needs to address the gaps identified in this area, for example, to balance better remuneration policies in order to reflect not only volume-based KPIs as a driver of objectives setting. Last but not least, the AC does not agree with the way the gender pay gap has been interpreted.

In addition, the Audit Committee has reviewed and discussed with EIB Services the IA and Task Force reports on the administration of benefits. The Audit Committee expects that the Bank develop an action plan and implements it in an expedient manner in order to address the findings in the IA and Task Force reports with the aim to strengthen the control environment for the administration of staff benefits and to simplify the system as much as possible. The Audit Committee requires that the gaps are closed as a matter of priority. The Audit Committee concludes that the findings could expose the Bank to potential reputational risks and has taken note of the fact that some of the IA AAPs on this topic are overdue, therefore requesting Management Committee's urgent attention to close the gaps.

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<sup>10</sup> Relevant EBA Guidelines include the EBA Guideline on internal governance, the FSB's Guidance on Supervisory Interaction with Financial Institutions on Risk Culture - A Framework for Assessing Risk Culture published in April 2014.

Last but not least, the Audit Committee encourages the Bank to improve diversity and gender balance at the senior management level and within the EIB Group's governing bodies.

## **A.6. COOPERATION WITH THE AUDIT BOARD OF THE EIF, COLLABORATION WITH THE ECB BANKING SUPERVISION, OTHER AUDIT BODIES AND THE GOVERNING BODIES OF THE EIB**

### *Meetings with the Audit Board of EIF*

The Audit Committee and the Audit Board of EIF continued their cooperation<sup>11</sup> and met on three occasions over 2018. The two audit bodies discussed common issues and coordinated actions that have an impact on the consolidated Financial Statements of the EIB Group and group policies, namely in the field of risk management, equity and quasi-equity activities and internal audit. The Audit Committee is strongly committed to continue its cooperation with the Audit Board of EIF in order to strengthen further the group oversight of the EIB and the EIF activities in terms of risk management and equity and quasi-equity but also in view of operational resilience, IT and cyber security, data warehouse, single data policy and financial control.

### *Meeting with ECB Banking Supervision*

The Audit Committee has engaged more proactively with the European Central Bank Banking Supervision. The Audit Committee and the ECB discussed topics of high supervisory priority, related to best banking practice at the EIB, such as credit risk, compliance, risk management, governance including group alignment, IT and cyber risk, as well as climate risk. The Audit Committee's 2017 Annual Report and related key observations were presented. The Audit Committee intends to continue its proactive strategy and to meet regularly with the ECB Banking Supervision, with non-Euro zone National Competent Authorities and international standard setting bodies including the Basel Committee on Banking Supervision.

In relation to assessing liquidity adequacy and liquidity management, the Audit Committee reviewed the report of BCL on the Bank's liquidity and recommends that the Bank fully addresses the BCL recommendations.

### *Meetings with the governing bodies of the EIB*

In addition, the Audit Committee has regularly met with Members of the Management Committee, and with representatives of other governing bodies of the EIB; the Audit Committee has also participated in the Board of Directors Induction day in July 2018 in order to promote a better understanding and awareness of the Audit Committee's work, role and responsibilities.

In December 2018, the Audit Committee met with the WGG and the RPC of the Board of Directors to discuss topics of common interest. The Audit Committee met with the Board of Directors during 2018, which allowed all parties to deliberate on strategic issues, such as the need to promote group oversight and group control functions, as well as to express support of the full deployment of a more conventional three lines of defence model within the EIB Group. The Audit Committee will continue to meet more frequently with the Board of Directors' WGG and the RPC in 2019.

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<sup>11</sup> The 'Cooperation Paper' signed in 2017 between the Audit Committee and the Audit Board of EIF provides the basis for the cooperation between the two audit bodies.



## A.7. SUMMARY TABLE OF AUDIT COMMITTEE'S RECOMMENDATIONS 2018

|    | <b>Key Observations:</b>                            | <b>Audit Committee Recommendations:</b>  |
|----|---|--|
| 1. | <b>Sustainability and Business Model</b>            | <p>1. monitor closely the viability of the evolving and more diversified business model of the Bank, as well as the trends in margin, net surplus and asset quality as contributing factors to the Bank's sustainability,</p> <p>2. prepare a strategic review of profitability per product and per mandate, and</p> <p>3. develop further the capacity to analyse revenue and expense drivers as well as cost coverage with the aim to ensure adequate profitability per product and per mandate and ensure the Bank's financial sustainability.</p>  |
| 2. | <b>Group Alignment</b>                              | <p>4. prioritise group alignment within the EIB Group by creating a genuine group structure with the parent company exercising effective oversight of the EIF, and of any future subsidiaries, and including group control (second and third lines of defence) and support functions. As a matter of priority, the EIB needs to ensure that the three lines of defence model functions in the existing structure, and to ensure the group oversight of risk management and the establishment of group control functions. The AC recommends that the focus of the group alignment in 2019 be on Risk Management,</p> <p>5. ensure a coordinated approach within the EIB Group of the equity and quasi-equity operations as these activities have grown in importance over the past few years. This approach should aim to avoid an overlap of product offerings between EIB and EIF and to ensure a clear delineation of roles and responsibilities within the EIB Group,</p> <p>6. develop the capability within the EIB Group to capture and aggregate all material risks, enhance group reporting and build a common data warehouse, as well as establish group IT policies; invest in appropriate IT infrastructure as the current state of such group infrastructure also poses increased operational risks, and</p> <p>7. extend the EIB Risk Appetite Framework to a group dimension in order to steer the risk profile of the EIB and the EIF within the group, as well as develop the ICAAP, ILAAP, stress testing framework, liquidity, capital contingency plans and recovery plan at a group-level.</p> |
| 3. | <b>Risk Management and Internal Control</b>         | <p>8. address the findings in the IA report on the credit appraisal and approval process,</p> <p>9. complete the review of the terms of reference of the control functions, of the roles and responsibilities within each control functions, and across the EIB Group,</p> <p>10. ensure that the ICF is further developed and is sufficiently robust, by integrating and enhancing the ICFs in each Directorate,</p> <p>11. ensure the timely closure of outstanding IA AAPs, and</p> <p>12. enhance the oversight and control of IT, cyber security preparedness and operational risks in view of increased operational threats and elevate cyber security within the Bank and the EIB Group by adopting a group approach and policies.</p>  |
| 4. | <b>Best Banking Practice</b>                        | <p>13. complete the development and fully operationalize the holistic BBP Framework by implementing the necessary processes and procedures within the EIB and the EIB Group,</p> <p>14. close the remaining BBP compliance gaps, including the closure of the BCL's recommendations in relation to systems integration and risk data aggregation, liquidity stress testing and the ILAAP document, as well as the development of a group approach to liquidity management,</p> <p>15. enhance the management of the prudential BBP Programme and its implementation within the right scope, timeline and resourcing, including in IT, as well as the right prioritisation of BBP projects with a view to anticipate and proactively manage upcoming regulatory changes impacting the EIB and the EIB Group,</p> <p>16. develop a common data warehouse,</p> <p>17. develop the capability to calculate prudential ratios and stress testing results on an IFRS basis,</p> <p>18. in terms of best governance practices and the full deployment of the three lines of defence at the Bank, complete the review of the responsibilities of the Members of the Management Committee be completed, and ensure that the requirements of EU law are applied to their collective and individual skills, knowledge and experience; the review should be completed in conjunction with the review of the terms of reference of the control functions (referred to under AC's recommendations for Risk Management and Internal Control).</p>   |
| 5. | <b>Culture, Conduct, Resources and Remuneration</b> | <p>19. encourage a sound risk culture within the EIB Group in order to ensure that it includes such features as sufficient challenge from the second line of defence, accountability, a tone from the top, and incentives to speak-up,</p> <p>20. review the Code of Conduct of the Management Committee and the Board of Directors,</p>   |

|  |  |
|--|--|
|  | <p>21. <i>ensure the appropriate, efficient and effective pace of hiring of the second and third lines of defence within the Bank to enable them to perform effectively their duties and to deliver high quality work; close any recruitment gaps in the control functions as a matter of priority,</i></p> <p>22. <i>address the gaps identified in remuneration policies in order to foster sound risk culture within the EIB Group, and ensure that remuneration practices are better balanced to reflect not only volume-based KPIs as a driver of objectives setting; enhance the remuneration governance, remuneration structure, performance assessment, and remuneration disclosure requirements in line with best banking practice, and</i></p> <p>23. <i>ensure that the findings of the IA and the Task Force reports on the gaps related to the inefficient and complex administration of staff benefits be addressed by the development of an action plan, which must be implemented quickly.</i></p> |
|--|--|

**AUDIT COMMITTEE**

**OF THE EUROPEAN INVESTMENT BANK**

**ANNUAL REPORT TO THE BOARD OF GOVERNORS ON THE INVESTMENT FACILITY**

**FOR THE 2018 FINANCIAL YEAR**

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## 1. INTRODUCTION - the role of the Audit Committee

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

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

## 2. AUDIT COMMITTEE REVIEW

The assurance expressed by the Audit Committee is mainly based on the work of the external auditor, KPMG Luxembourg, Société coopérative, a Luxembourg entity and a member firm of the network of independent firms affiliated with KPMG International Cooperative. Based on the results of the external audit work and its own work, the Audit Committee formulated the conclusions detailed in its Statements, issued to the Board of Governors, as of the date of signature of the audit report by the external auditors.

The Investment Facility relies on a number of systems provided by the Bank, notably the ones of: risk management, human resources management, treasury management and financial reporting. The Audit Committee obtains an understanding of the activities and risks associated with the various developments by reviewing management reports and by interacting with the relevant Bank services involved in the Investment Facility activities.

### **Meetings with Management**

The Audit Committee has met during the past year with the Management of the Investment Facility within the EIB, who provided details about the recent developments and future orientations for the Investment Facility and the Bank's activities in Africa, the Caribbean, and the Pacific ('ACP') region in general. The Investment Facility portfolio, including the watch list, together with current project trends were 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 verbal and written reports, by reviewing and challenging the audit work and deliverables of the external auditor, and by making further inquiries including through a formal interview before the sign-off of the accounts. The Audit Committee assesses the external auditor's independence, including the absence of conflicts of interests.

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

**Internal Audit**

The Internal Audit ('IA') Department is an independent function within the EIB with a direct reporting line to the Bank's President. The Head of IA retains unrestricted access to the Audit Committee and may request private sessions. The EIB's Internal Audit has performed no specific internal audits in relation to the IF during the reporting period.

**Inspectorate General**

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

The Audit Committee met with the Inspector General at five of the 10 meetings held in 2018. The Audit Committee examined and discussed with the IG the on-going cases under their remit and was informed about any alleged cases of wrongdoing and ongoing investigations relating to Bank projects, including Investment Facility operations, if applicable.

The Audit Committee met with other control functions of the Bank, notably with Risk Management and Compliance, and discussed relevant topics related to the Investment Facility operations.

**European Court of Auditors**

The Audit Committee notes that the European Court of Auditors did not perform any audits related to the IF during the year ended 31 December 2018.

**3. THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2018 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE**

The Audit Committee examined the Investment Facility's 2018 Financial Statements, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union 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 Investment Facility's Financial Statements is the International Financial Reporting Standards, as adopted by the European Union.

The Financial Statements of the Investment Facility comprise the statement of financial position as at 31 December 2018, the statement of profit or loss and other comprehensive income, the statement of changes in contributors' resources, the statement of cash flows for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies and other explanatory information, in accordance with the accounting framework applied by the Bank.

#### 4. CONCLUSION

In 2018, the Audit Committee achieved a balanced approach in terms of focus, issues handled and means utilised and obtained the necessary assurance. The Audit Committee is of the opinion that it has been able to carry out its work to fulfil its statutory mission under normal, unrestrictive conditions. The Audit Committee has received full cooperation from the Management Committee and the Management of the Investment Facility within the EIB during the reporting period.

Based on the work undertaken and the information received (including the opinion from the external 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 2018, 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 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, as adopted by the European Union.

On this basis, the Audit Committee signed its annual Statement on the Investment Facility's 2018 Financial Statements, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, as of 14 March 2019, the date on which the EIB Board of Directors has approved the submission of the Investment Facility 2018 Financial Statements to the EIB Board of Governors.

**Luxembourg, 14 June 2019**

**Signed by:**

**D. PITTA FERRAZ**

**J. SUTHERLAND**

**L. BALOGH**

**CHAIRMAN**

**M. MACIJAUSKAS**

**V. IUGA**

**P. KRIER**

**U. CERPS**

**J.H. LAURSEN**

**RESPONSE OF THE MANAGEMENT COMMITTEE**  
**TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE**  
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## 1 INTRODUCTION

- 1.1 Within the Bank's statutory framework, 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. 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 own funds and assets.
- 1.2 The Audit Committee of the EIB is responsible for the auditing of the accounts (financial statements), verifying that the activities of the Bank conform to Best Banking Practice (BBP) applicable to the Bank. The Annual Reports of the Audit Committee to the Bank's Board of Governors, in line with the Statute of the Bank and the Rules of Procedure, cover the results of its work since the date of the previous annual reports.
- 1.3 This report presents the response of the Bank's Management Committee to the points raised by the Audit Committee in its annual reports for the 2018 financial year.

## 2 OPERATING CONTEXT

- 2.1 In recent years, the business of the Bank and the European Investment Fund (EIF), which together form the EIB Group, has evolved and grown significantly – notably due to the strategic role in the delivery of third party mandates, and particularly the European Fund for Strategic Investments (EFSI), and in responding to G20 and G7 initiatives on further global matters, such as migration and forced displacement and investment towards meeting the United Nations Sustainable Development Goals (SDGs). The implementation of such mandates and other initiatives has facilitated additional flexibility and focus in the delivery of EU policy.
- 2.2 Whilst the core elements of the EIB's existing strategic framework based around provision of financing and related support to EU policy priorities, delivering on its mandates and consistency with other statutory requirements remain valid, the scope and complexity of the individual strategic initiatives, which are not necessarily all mutually compatible, has required increasingly innovative responses to address persistent investment gaps in infrastructure, innovation and climate action.
- 2.3 All of these factors need to be considered in the decisions on the strategic initiatives and their implementation in the context of the replacement of the UK's capital in the Bank. In July 2018, when discussing the replacement of the UK's capital with the Board, further amendments to further strengthen the EIB governance in context of a changing policy and operating environment were agreed as part of the capital replacement package. Stabilisation of the EIB's capital base and strengthened governance will provide the foundation for the Bank's long-term strategy to provide financing supporting EU policy priorities and strengthening the EU economy.
- 2.4 At the same time, the EIB is faced with increasing prudential and non-prudential requirements impacting Group activities. The EIB has made significant progress on these matters, and on other aspects which are of noted interest to the Audit Committee, as set out in this report.

### 3 RESPONSE TO KEY AUDIT COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

- 3.1 In its annual reports, the Audit Committee highlighted observations related to five key areas, which are also closely linked to the above mentioned governance reforms proposed as part of the capital replacement package, and on which the Management Committee elaborates as follows:

#### Sustainability and business model

- 3.2 The Management Committee agrees with the Audit Committee's assertion that maintaining the EIB's high credit rating and investor confidence is at the core of its business model and is indeed a natural precondition to the Bank being able to deliver its mission whilst ensuring its future sustainability. It therefore reiterates its uncompromising commitment to maintaining the highest credit standing which continues to be critical in the face of current political events.
- 3.3 The EIB Group Operational Plan 2019 identifies the potential impacts of political, regulatory and macroeconomic developments on the Bank's future activities and articulates key aspects that will be pursued based on current knowledge and expected evolution. In absolute terms, the 2019 lending orientations are reduced in comparison to recent years based on our assessments of current market needs and of the heterogeneous economic situation in the EU. The Plan came with assurance that the EIB Group maintains its commitment to productive investment, to target activities to address market gaps, to ensure the highest levels of impact and additionality possible whilst ensuring longer-term financial sustainability. Whilst the EIB is not a profit maximising institution, close attention continues to be paid by the Management Committee to revenues and costs and their impact on capital.
- 3.4 The contribution to net surplus and cost coverage via each product type varies significantly. Factors such as product complexity, client relationship maturity, sector, geography, size and tenor all impact the actual costs and revenues incurred. However, to consider the overall 'profitability' of each product, the Bank has introduced the absolute return on capital (defined as net surplus/adjusted economic capital). On this basis standard loans are likely to have the highest absolute return on capital due to strong revenue generation, low risk and relatively low economic capital consumption. As such, the EIB is paying attention to ensure that the balance between standard loans and the higher risk activities such as Special Activities, Equity and Guarantees is appropriate. At the same time the EIB aims for a business mix optimisation that maximises impact and additionality in support of EU policy objectives.
- 3.5 In respect of the Audit Committee's observations regarding the pressure on net surplus and cost coverage due to EIB's mandate activity, the Management Committee highlights that while this is indeed true when considering those costs and revenues incurred/received within a given calendar year, the relative proportions of costs incurred and revenues received each year can look notably different, due to different phases of ramp-up, investment, monitoring and wind-down of the various mandates. Indeed, the annual cost coverage statistics do not represent the lifetime cost coverage results of mandates.
- 3.6 Mandators are usually public institutions (the main being the European Commission), who typically pay for EIB's support with corresponding EU budget funds. The expected lifetime cost coverage of mandates is transparent during the approval process. However, profitability is not the key driver for the EIB in accepting such mandates which bring other benefits. For example, the guarantees from EFSI and the External Lending Mandate (ELM) offer capital relief for the EIB and allows the EIB to extend its role to fulfil key EU policy objectives via new markets, clients and products. The Bank has also consciously chosen to financially contribute to a number of mandates via defined contribution agreements, such as the Joint Assistance to Support Projects in European Regions (JASPERS) or European Investment Advisory Hub (EIAH).
- 3.7 In late 2018, the Bank conducted a review focused on the strategic backstop of maintaining the EIB's high credit rating and longer-term financial sustainability, also considering the anticipated adverse effect of the UK's departure as an EIB shareholder. A series of short term and medium term measures were implemented to manage available resources and risk bearing capacity, including enhanced projections of

all capital risk metrics and the development of an integrated capital planning and management framework paving the way for a Group Capital Sustainability Policy.

- 3.8 The new Group Capital Sustainability Policy was approved by the Board of Directors in March 2019. It takes into account the EIB's statutory framework and mission and its existing Capital Planning and Management Framework, including the Risk Appetite Framework (RAF), Capital Contingency Plan (CCP), Recovery Plan (RP) and Internal Capital Adequacy Assessment Process (ICAAP) documents.
- 3.9 The Operational Plan for 2020-2022 will be supported by the new Group Capital Plan. Together with related monitoring and reporting on key ratios, the Group Capital Plan will give the Board additional means to better anticipate and correct any deviations from a sustainable path. It further strengthens the interconnection of the business planning, implementation and management and capital planning and management. The operational planning process brings together all aspects, which are relevant for the business planning decision (i.e. policy objectives including additionality and impact vs. capital planning, available resources, and funding) and elaborates on potential business scenarios. The Group Capital Sustainability Policy underpinned by the Group Capital Plan will formalise a key component of this balancing process.
- 3.10 To complement the matters discussed above, in terms of the recommendations made by the Audit Committee, the Bank acknowledges and agrees with the Audit Committee's views and has already taken, or will take, the actions described below:
- a. The Risk Report is the main tool used by the Bank's Governing Bodies to monitor and control the risks the Bank is exposed to and how they impact the Bank's sustainability. The Risk Reporting framework of the Bank has been reviewed in 2018 and 2019 to ensure alignment with Best Banking Practice and will be updated in 2020 to reflect the Bank's changing business model, risk profile and risk management practices.
    - i. the Risk Appetite Framework (RAF 2.0) is scheduled to be completed by 2020;
    - ii. as noted in §3.9, the Group Capital Sustainability Policy approved by the Board in March 2019, and introduction of a Group Capital Plan will strengthen the link between business planning and RAF.
  - b. Whilst the EIB is not a profit maximising institution, close attention continues to be paid by the Management Committee to revenues and costs and their impact on capital. Strategic discussions on such topics, including also the product and mandate dimensions, will be enhanced in 2019 and reflected in the Group Capital Sustainability Policy and the Group Capital Plan.
  - c. A methodology for analysing the profitability per product line has been developed and will be fine-tuned based on experience and lessons learnt and regular updates to the Audit Committee on the trends identified and related actions being taken are foreseen.

#### Group Alignment

- 3.11 Following the financial crisis, measures to avoid excessive and short-term oriented risk taking and the effective integration of control mechanisms and risk management into the decision-making processes of banking institutions have been discussed by relevant authorities. This has resulted in a number of different recommendations affecting as well the internal organisation of services preparing and implementing decisions by the relevant management body.
- 3.12 The rapid change in the nature and complexity of the EIB's activities in recent years necessitates relevant adaptations in the Group functions. The maintenance and strengthening of the Group's structure and processes with a clear focus on effective internal control mechanisms remain of the highest priority. The enhancement of risk management processes and internal controls from a Group perspective is very much in the interest of the EIB, being the majority shareholder of the EIF. For more details, please refer also to

§3.14c).

3.13 The equity activity of the EIB Group has been scaled-up by more than 250% over the past five years, from EUR 1.6bn in 2013 to EUR 5.7bn in 2018. The main trigger for this expansion was the launch of EFSI, which allowed the EIB Group to better address identified financing gaps in the European equity markets. EIB Group's equity business today represents 18% of its total Risk Weighted Assets. In the context of this significant expansion in activity, the EIB Group is confronted with a number of questions, specifically related to the business development in European equity markets, optimal use of scarce resources (notably, EIB capital and other sources of financing, e.g. EC mandates) and an adequate organizational set-up ensuring complementarity between the EIB and the EIF activities. To ensure a more comprehensive view of capital needs and optimal use of capital at the Group level, the Group approach to risk management will be further integrated. For further details, refer to §3.14 a) & b).

3.14 In terms of the recommendations made by the Audit Committee, the Bank acknowledges and agrees with the Audit Committee's views and has already taken, or will take, the actions described below:

a) As part of the implementation roadmap of the governance changes agreed with the Board in July 2018, the Group Risk Management Charter has been revised, in order to ensure adherence to sound risk management principles at the Group level. The revised Charter, approved by the EIB Board in April 2019, (i) strengthens the Group Risk Management Function through the establishment of a Group Chief Risk Officer (GCRO) responsible for all group risks in the EIB Group, (ii) defines the Group Risk Management Framework comprised of policies, procedures, risk limits and controls, (iii) governs management of all Group risks, (iv) further strengthens existing Group Risk Management Principles and introduces new Principles (for Capital and Liquidity Adequacy and Information Exchange, Risk Reporting and Data Aggregation). The establishment of a new Group Risk Steering Panel is also being considered to support the GCRO and facilitate a holistic Group risk approach.

In 2018, Internal Audit's risk assessment supporting the definition of the yearly Audit Plan has been enhanced and is performed at a Group-wide level; this is now used to deliver an Audit Plan at the level of the Group in addition to specific assignments at the EIB and the EIF. An update of the Internal Audit Charter will be completed in 2019 and include a reference to Group wide audits – see also Section 4.

Further synergies are being developed in order to strengthen a consistent group approach on Compliance, in line with the guidelines of the European Banking Authority and Basel Committee. On the basis of a Framework of Cooperation signed in 2018, the respective Compliance teams continue strengthening their engagement on policies, processes and procedures. This concerns in particular Compliance topics such as Ethics, Tax/ Non-Compliant Jurisdictions (NCJ), Anti-Money Laundering/ Countering Financing of Terrorism (AML-CFT), Sanctions, Reputational Risk Assessment initiative, etc. See also §3.38 *et seq.*

b) The Management Committee has entered into discussions with the Board of Directors on the various options for structuring the EIB Groups equity activities, taking into account statutory constraints and scarce capital resources. The EIB Group Equity Strategy presented to the Board of Directors in March 2019 revisits the remit of the Group entities with the goal to identify potential efficiency gains and areas where activities could be streamlined, and to ensure the best set up in terms of leveraging existing expertise, aligning processes and organisation, and having a coherent positioning in the market.

c) The Management Committee acknowledges that in terms of data and reporting capabilities at a Group level, further progress needs to be made in the context of implementing the revised Group Risk Management Charter and compliance with prudential Best Banking Practice.

Work is underway to strengthen the application of the BCBS 239 principles through a common Group risk reporting infrastructure (covering Risk, Compliance and Operational reporting) and processes and development of Group data governance and reporting policies, processes and definitions. BCBS 239

compliance is a multiannual, resource-intensive endeavour with dependencies on many systems and services across the Group.

- d) More enhancements are foreseen to extend the EIB Risk Management Framework to a Group dimension and strengthen Group processes and procedures:
- The ILAAP report (end 2018) has been further expanded to better reflect the Group dimension. The Bank will continue to improve its intra-group liquidity risk management practices, notably with regards to Liquidity Contingency Planning.
  - The ICAAP document (end 2018) will build upon and reflect the feedback received from the Audit Committee. Most notably, the scope of the document will be expanded with a more comprehensive inclusion of the EIF in order to assess capital adequacy from a Group perspective.
  - The Bank is currently working on the implementation of RAF 2.0 - see §3.10a). The EIF has been actively involved throughout the implementation project to share the overall approach in view of the future development of a Group Risk Appetite Framework.
  - The stress testing framework will be reviewed in 2019 and further aligned to the latest regulatory guidelines. Enhancements should include the expansion of the framework to the Group and the establishment of an annual stress testing timeline fully aligned with the Capital Planning and Management Framework. The EIB's Management Committee and Board of Directors will, on an annual basis, approve the stress testing programme.
  - The Capital Contingency and Recovery Plan will be updated in 2019 and expanded to better reflect the Group dimension.

#### Risk Management and Internal Control

- 3.15 In order to maintain the Bank's financial stability, as reflected by its high credit rating, risk taking at the EIB is exercised in a stringent manner. As such, robust risk management processes are maintained and risks are accepted up to a level where these risks are aligned with the Bank's risk appetite, i.e. the amount of risk that it is willing and able to take in the pursuit of its public mission and objectives.
- 3.16 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 regular risk reports. Within the Board of Directors, the Risk Policy Committee meets no less than four times per year (in 2018, 10 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.
- 3.17 The Management Committee concurs with the Audit Committee's view that the promotion of a risk awareness culture throughout the organisation is paramount, and is clear in its message that risk management is the responsibility of all services, not just the named risk and control functions. To further support this message, the responsibilities of all services in relation to each risk category are being reviewed and mapped in the context of the "Three Lines of Defence for Effective Risk Management and Control" (Three Lines of Defence) model. The Internal Control Framework documentation is being enhanced to clearly articulate how significant risks for each key process are being mitigated through the lines of defence; this continuous exercise serves 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.
- 3.18 In 2015, the Board approved the first version of 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. Following the approval by the Management Committee of the design of an enhanced Risk

Appetite Framework (RAF 2.0) in July 2018, the RAF 2.0 project advanced into the implementation phase – see also §3.10a) & §3.14d).

- 3.19 Credit risk monitoring remains vital due to the uncertain external environment and the challenges this poses for future planning. As such, the Bank will continue to take a prudent approach and only make commitments within acceptable risk boundaries. The high levels of higher risk activities benefitting from the EFSI / EU budget first loss portfolio guarantee have been sustained under the extension of EFSI. The Bank will seek new initiatives with similar risk mitigation techniques in order to remain aligned to its risk appetite. The Bank's strong control and monitoring functions will continue to ensure that activity levels are financially sustainable.
- 3.20 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 (both internal and regulatory) 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 (BCL) to enable them to fulfil their formal role as the independent oversight body in relation to the Bank's liquidity situation.
- 3.21 The EIB considers ICF practices as one of the key pillars of the internal governance. In March 2015, the revisions of the Bank's Compliance and Controls Framework led to the creation of a further second line of defence function (Internal Controls and Assertion Division, operational since 2016). That function aims notably at (i) strengthening EIB's second line of defence in line with the BCBS and EBA, standards (ii) ensuring control risk oversight, (iii) providing a common platform for the implementation and maintenance of Bank-wide ICF and, lastly, (iv) assessing and reporting to Senior Management and Audit Committee on EIB's control deficiencies covering key activities of the Bank. EIB's Internal Control Framework is continuously evolving and periodical reviews aim at strengthening the control structure and aligning the control framework with Best Banking Practices requirements.
- 3.22 So too, information and information systems are critical and vitally important assets to the EIB Group. The EIB Group is committed to maintaining and protecting all the information it creates, uses and/or stores in accordance with its value, sensitivity and the risks to which the information may be exposed, and in a manner consistent with applicable legal, prudential and contractual requirements and Best Banking Practices.
- 3.23 Information Security controls need to be embodied in the EIB Group's processes and procedures. The EIB's Information Security Policy specifies the principles that all EIB Group employees, contractors and consultants as well as members of its Governing Bodies must comply with in order to keep the organisation's information secure.
- 3.24 In recent years, the Bank has sought to strengthen its physical and IT security measures because of an increasing level of threat to its operations and/or reputation. The need for a reinforced governance and the development of synergies across the Group has also been highlighted by Internal Audit and the Audit Committee. This has led to a revision of the Information Security Policy in early 2019 reflecting a governance model for all Information Security related matters at EIB Group level.
- 3.25 In terms of the recommendations made by the Audit Committee, the Bank acknowledges and agrees with the Audit Committee's views and has already taken, or will take, the actions described below:
- a) The review of the Bank's lending appraisal and approval process and governance in the light of Best Banking Practice, is ongoing. The Audit Committee is, and will continue to be, regularly informed of major developments introduced as part of governance changes and also the specific changes introduced in relation to the Internal Audit Agreed Action Plans.
  - b) The terms of reference on the review of the internal control functions have been prepared. This would

entail an analysis of the different components of the controls functions and reporting lines, benchmarked against other banks/institutions best banking practice, as applicable. The analysis, in cooperation with all the relevant control services, will be carried out with the help of consultants. It is envisaged that the preliminary findings will be presented to the Audit Committee during the course of the Q2 2019.

- c) In 2018, willing to address increased expectations in relation to internal control activities stemming from internal and external stakeholders, the EIB Board has approved the EIB Internal Control Framework Policy. This Policy sets the tone from the top and intends amongst other objectives to define the control assurance standards and clarify roles and responsibilities across the three lines of defence.
- d) The Information Security Steering Committee (ISec) membership and its decision making process have been revisited to integrate active members from both the EIB and the EIF at senior management level and to achieve a better alignment of Information Security policies and practices within the Group. Adhering to best banking practices and implementing another Internal Audit action point, the EIB Information Security function has been transferred to Risk Management in order to ensure full separation between first and second lines of defence and improve the ability to coordinate and standardize key information security processes and principles.
- e) Compliance will continue to monitor Money Laundering/Financing of Terrorism (ML- FT) risks, including related reputational risk. In 2018, measures have been taken to strengthen monitoring of business relationships, which will continue throughout 2019, with the aim to (i) further strengthen active monitoring in collaboration with the first line of defence, (ii) improve availability and quality of compliance data in systems and (iii) implement a new screening tool, In 2019, compliance testing will continue, and test outcomes will be followed-up, as appropriate.

#### Best Banking Practice

- 3.26 According to Article 12 of the EIB Statute, the activities of the Bank have to conform to Best Banking Practice (BBP). The Rules of Procedure refer to adherence to BBP “applicable to it” implying that the specificities of the EIB’s business model may warrant modified application of the regulatory requirements. The Audit Committee responsibilities include the requirement to verify that the activities of the Bank conform to Best Banking Practice, the outcome of which it reports to the EIB’s governing bodies on an annual basis.
- 3.27 The EIB adopts a transparent and proactive approach to conforming to applicable BBP, and is convinced of the associated strategic and business benefits. The Bank’s management shares the Audit Committee’s view that the maintenance of the highest credit standing is also inextricably linked to the implementation of BBP and aforementioned sound risk management practices. As such, critical importance is placed on the adherence to BBP applicable to the Bank.
- 3.28 The BBP Framework is based on the hierarchy of relevant legal and regulatory rules consisting of the EU Treaties, EIB Statute and Rules of Procedure, EU banking directives and regulations and further standards and guidelines issued by EU regulatory and supervisory bodies (such as EBA, European Securities and Markets Authority (ESMA) and for interpretation purposes, standards published by international standard setting bodies such as BCBS, International Organization of Securities Commissions (IOSCO) and Financial Stability Board (FSB)). The BBP Framework comprises of four elements: BBP Guiding Principles, a BBP Book, an Applicability Assessment Procedure and a BBP Rule Repository.
- 3.29 In 2018, the BBP Guiding Principles were approved by the Board of Governors, following detailed consultation with the Audit Committee and the Board of Directors. The related BBP Book is following an equally rigorous consultation and is being finalised – see §3.32a). As BBP is a dynamic term – both as

a concept and in substance - both documents are subject to regular updates and amendments as the regulatory landscape is evolving. The BBP Guiding Principles adopt a “comply or explain” approach. This means that in case a regulatory requirement is not applied by the EIB (as BBP), the rationale for any such non-application or, as the case may be, adaptation to the requirement is set out in the BBP Guiding Principles or the BBP Book. The EIB’s Management Committee approved the relevant Applicability Assessment Procedure in Q1 2019.

3.30 Much of the overall BBP Framework is already operational and subject to Internal Audit reviews on an on-going basis; the ongoing enhancements to the BBP Framework will form part of the Internal Audit risk assessment and planning process.

3.31 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 is also subject to best practice as a consolidated entity of the EIB to support regulatory compliance at the EIB Group level. To this end, an EIB Group Regulatory Forum was launched in 2018 to facilitate related compliance activities between the EIB and the EIF. In 2019, Risk Management will prepare a prudential BBP surveillance update on regulatory changes which will be implemented into the EU legislative framework and affect the Bank and/or the Group.

3.32 In terms of the recommendations made by the Audit Committee, the Bank acknowledges and agrees with the Audit Committee’s views and has already taken, or will take, the actions described below:

- a) The first BBP Book - adopted by the Board of Directors in Q2 2019. Pending or ongoing assessments will be part of future revisions of BBP Guiding Principles or of the BBP Book.
- b) The implementation of regulations and regulatory guidelines through the Prudential BBP Programme, as reported on a half yearly basis to the Audit Committee, will continue. Additional measures are envisaged to strengthen the delivery capabilities in terms of resources and technical architecture. In 2018, the Programme focused on the launch of four key initiatives: BCBS 239, Interest Rate Risk in the Banking Book (IRRBB), Intraday Liquidity and RAF 2.0. These initiatives will remain priority projects throughout 2019.
- c) The Bank’s risk systems are interfaced with the accounting system under EU Generally Accepted Accounting Principles (EU GAAP). The development of a general ledger under International Financial Reporting Standards (IFRS) and regular production of prudential ratios on an IFRS and Group basis would require substantial investment in processes, IT infrastructure and integration as well as careful management of resulting communication challenges and potentially higher volatility of results. The Bank would need to further analyse the impacts of a potential switch to IFRS taking into account (i) its business model and (ii) management practices, which are currently aligned to its primary accounting framework based on EU GAAP. For more details on IFRS implementation, please refer to §6.6.

The Bank’s interpretation and implementation of the ‘Three Lines of Defence’ facilitates the Management Committee members to be able to act objectively, critically and independently in relation to oversight of first and second line of defence activities – whilst approving policies and financing proposals as a collective body. Furthermore, the Management Committee members overseeing second line of defence activities do so in the context that they are overseeing policy matters to be approved by the Management Committee. One Management Committee member, currently the President, oversees risk management, compliance and other control functions and does not have any first line of defence activities. As such, the existing combination of Management Committee members’ oversights remains in line with the responsibilities set out in the Statute and Rules of Procedure and have a high level of transparency. Nevertheless, the Management Committee is committed to further deploying the Three Lines of Defence model across the Bank.



## Culture and Conduct, Resources and Remuneration

- 3.33 The maintenance and strengthening of the Bank's internal control and risk management environment and the promotion of a risk awareness culture amongst its employees remains of the highest priority.
- 3.34 In order to avoid compliance and reputational risks and to promote a strong compliance culture across the EIB Group the Compliance Culture Change Programme has been launched in 2018 – for more detail, please refer to §3.40a). Compliance is and continues to be a shared responsibility of all services, staff and members of the governing bodies. Its effectiveness depends not only on written policies and rules, as well as proper implementation and continuous monitoring, but also and foremost on the “culture of the organisation”. Proper Culture is seen as crucial for a functioning and thriving institution and has developed to become an important part, even as the foundation of Best Banking Practices.
- 3.35 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, further improvements to the Risk Appetite Framework have been initiated – see also §3.10a), §3.14d) & §3.18.
- 3.36 The members of the Management Committee and the Board are entrusted with responsibilities and duties prescribed in the EIB Statute and EIB Rules of Procedure. The Codes of Conduct (Codes) for the members of the Management Committee and of the Board apply, upon acceptance of their mandate. These Codes regulate and provide guidance on matters of professional ethics and behaviour that are applicable.
- 3.37 In light of the Bank's on-going culture change programme, the main purpose of the proposed review of the Codes of Conduct for the Management Committee and the Board is to identify possible improvements of the standards of behaviours required by the Codes in the light of the practical experience gleaned up from (i) the Ethics and Compliance Committee since 2011; (ii) improvement recommendations from the European Ombudsman and the European Parliament; (iii) new regulations (e.g. Market Abuse); and, (iv) keeping up with a benchmarking exercise to be conducted in respect of the latest comparable Codes of Conducts of peer institutions.
- 3.38 A review of the Bank's Anti-Fraud Policy (AFP), also with the aim to transform this into a Group policy, started in 2018 and is subject to a focused external stakeholders' consultation. Under the AFP, the EIB Group's Fraud Investigation under the Inspector General is mandated to investigate prohibited conduct, including the conduct of Pro- Active Integrity Reviews. The Bank also aims to fully implement the Exclusion Policy (approved by the Board in December 2017). Together, these changes are expected to help staff better understand their obligations to the Bank and ensure that staff have adequate and swift mechanisms to raise concerns.
- 3.39 Taking account of most recent EU and international developments in the areas of anti- money laundering and tax good governance, the Bank's 2010 Non-Compliant Jurisdictions (NCJ) Policy (with 2014 Addendum) has been revised and, to ensure alignment between the EIB and the EIF, transformed in an EIB Group NCJ Policy. In February 2019, the EIB Board of Directors and in March 2019, the EIF Board of Directors approved the EIB Group Policy towards Weakly Regulated, Non-transparent and Non- cooperative Jurisdictions and Tax Good Governance. The Board approved a revised EIB Group Complaints Mechanism Policy in November 2018.
- 3.40 In terms of the recommendations made by the Audit Committee, the Bank acknowledges and agrees with the Audit Committee's views and has already taken, or will take, the actions described below:
- a) In order to minimise compliance and reputational risks and to promote a strong compliance culture across the EIB Group, a Compliance Culture Change Programme was launched in 2018. In line with recommendations of the European Banking Authority and Basel Committee, the Board of Directors will be more closely involved in the setting of Compliance policies and promotion of a compliance culture and ethical behaviour, reinforcing the protection of the EIB's reputation through a collective commitment on EIB values and integrity principles.

The amended Staff Code of Conduct and Whistleblowing Policies will be presented to the Board for information by mid-2019. The Whistleblowing Policy has been fully aligned with the package of measures to strengthen Whistleblower protection, adopted by the Commission on the 23 April 2018. The reform of the Code of Conducts and the EIB Whistleblower Protection Policy are milestones in the revision of policies and procedures within the Compliance Culture Change Programme. Other important elements include the encouragement of a strong speak-up culture across the Bank. In line with best banking practices, the Audit Committee together with the Management Committee and Board of Directors will also be involved in the building up of a strong speak-up and ethics culture.

- b) As an immediate first step and to deploy further the Three Lines of Defence model across the Bank, the Board of Directors has approved in March 2019 the Bank's proposal to incorporate additional provisions in the Management Committee Code of Conduct in line with the principles agreed in July 2018 regarding the segregation of first and second lines of defence activities at Management Committee level.

In a second step, a proposal will be made in 2019 to review in greater depth both the Management Committee Code of Conduct and the Board Code of Conduct.

- c) The EIB has made it a priority to close recruitment gaps in control functions and dedicates significant efforts and resources to achieve this goal. From 2014 to 2018, the Bank's main control functions, including Risk Management, Financial Control, the Inspectorate General and Compliance, have all grown faster than the EIB average. Significant emphasis has been given to provide resources directed to the implementation of Best Banking Practices. To fill these posts in a timely manner, recruitment plans have been developed that enable clear prioritization.
- d) Conclusions on the final assessment on the current remuneration practices against relevant regulatory BBP requirements are subject to ongoing discussion with the Audit Committee.
- e) The Bank is elaborating a comprehensive plan that will illustrate how it intends to address the administration of staff benefits. This plan will include concrete measures, a timetable and ownership for all action identified.
- f) Since the implementation of the new 2018-2021 Diversity and Inclusion strategy, actions to support the promotion of women to senior positions within the EIB Group resulted in 29% of senior management positions being held by women in 2018, up from 25% in 2017 and from 18% in 2012. Women at middle management level increased to 29% up from 28% in 2017 and from 21% in 2012.

The members, i.e. the Vice Presidents of the EIB's Management Committee are nominated by Member States and as such the gender balance of the Management Committee is not decided by the Bank. In 2018, the appointment of Vice President Navarro, was a welcome step in the right direction and an improvement for the diversity of the Management Committee.

The Board of Directors is made up of Member State representatives/nominees. Since July 2018, there are 11 female Board of Directors members, out of 29 members (28 Member States + EC), 38%. Even if the Bank does not have control over the final appointments to the Board of Directors, the EIB President regularly makes a call to keep in mind diversity when appointing new members.

## 4 AUDITING & RELATED ACTIVITIES

- 4.1 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 an EU 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.

- 4.2 The Audit Committee is responsible under Article 12 of the EIB Statute for the auditing of its accounts. As set out in Article 26.2 of the EIB's Rules of Procedure, the Audit Committee is empowered to delegate day-to-day work concerning the audit of the Bank's financial statements to an external auditor. The firm KPMG has been the EIB's external auditor since 2009.
- 4.3 The 2016 EU Audit reform imposed further restrictions on the provision of non-audit services by audit firms to audit clients. The Management Committee is acutely aware of the implications for the appointment of the external auditor at the EIB as well as the challenges linked to external auditor tendering including for the future rotation of the external auditor due to extensive use of professional service firms at EIB. As such, the Management Committee shares the Audit Committee's concerns on this matter and is paying attention on how to facilitate timely rotation of the EIB's external auditor. The launch of the audit tender will be in 2019, to be concluded in 2020, for a contract commencing 1 January 2022. A related action plan is being supervised by the Compliance and Control Committee and without prejudice of the economic operators' freedom to participate in EIB Group published procedures for the provision of non-audit services, various initiatives exist for the EIB Group to monitor and balance the consultancy services procured from those Professional Service Firms who would typically be eligible to bid for external audit services.
- 4.4 The Management Committee supports the Audit Committees request to the current external auditors, KPMG, to provide enhanced assessment reports on the Bank's internal control systems – see also §3.21 and §3.25c).
- 4.5 Under the 2017 Internal Audit Charter, which is a formal document defining the purpose, authority and responsibility of the Internal Audit function, the direct reporting of the Head of Internal Audit to the President and the authority of the Audit Committee to request ad-hoc assignments were confirmed. In 2017, the EIB Audit Committee and the EIF Audit Board also signed a Cooperation paper', introducing the concept of joint audits in areas of mutual relevance to both institutions. In view of this, a further update of the Internal Audit Charter will be completed in 2019 in order to include a reference to Group wide audits; these are now formally part of the revised biannual Internal Audit risk assessment and planning process following the finalisation of the audit plans for both the EIB and the EIF in December 2018 that include a common section for Group audits.
- 4.6 The Management Committee share the Audit Committee's view that timely and complete implementation of Internal Audit agreed action plans is a necessity, particularly for those points relating to high priority matters. The need for an organisational commitment to respect agreed resolution dates is (and will continue to be) regularly reiterated to all services. The Management Committee pays particular attention to expedite the closure of existing agreed action plans.
- 4.7 The 2017 external quality assurance review of the Internal Audit function was performed by Deloitte and concluded that Internal Audit generally conforms with the Institute of Internal Auditors Standards and Codes of Ethics. The report highlighted that many of the best practices consistent with internal audit functions across the financial services industry have been adopted. The review yielded some recommendations to enhance the function, many of which have already been implemented; such as the creation of a Group Audit Universe combining EIB and EIF processes / activities. The remaining actions to be implemented in 2019 principally relate to the update of the Internal Audit Charter as mentioned above. In line with the Institute of Internal Auditors Standards, the next quality assurance of the Internal Audit function will be by 2022.
- 4.8 The 2019-2020 Internal Audit Plan was approved by the Management Committee following consultation with the Audit Committee. Recognising the Group dimension, the scope of the Internal Audit Plan is derived from a Group-wide risk assessment, which aims to ensure periodic audit coverage of all major risk areas, whilst also providing broad coverage of the main areas of activity.

## 5 THE INVESTMENT FACILITY

- 5.1 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.

- 5.2 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.

## 6 LOOKING AHEAD

- 6.1 As its 60th anniversary celebrations drew to a close, the EIB Group underlined its commitment to continue changing and adapting in line with all stakeholders' expectations in these uncertain times. Once again, the uncertainty still surrounding the UK's departure as an EIB shareholder and the future shape of the EU institutional family and the EIB's position within it, particularly the EIB's role in the EU's Multi-Annual Financial Framework 2021-2027 mean that another 'exceptional one-year' Operational Plan for 2019 with preliminary indications given for the subsequent two years is appropriate and may be subject to additional review during 2019.
- 6.2 In terms of the further amendments to EIB, which were proposed as part of the capital replacement package as set out in section 2, good progress has been made and most of the points should be addressed in 2019.
- 6.3 Whilst such internal measures are hugely important, in uncertain times, it is necessary to recall the purpose and success of the EU Bank in fulfilling its Treaty obligations and providing finance where market gaps persist and crowding-in of additional financing to support those projects. In keeping with the EIB's statutory role and mission, continued action is necessary to ensure compliance with all the requisite regulatory standards and other Best Banking Practice requirements. Understanding the relevant market implications is critical for regulatory compliance, and to demonstrate accountability, credibility, and financial sustainability in the eyes of the public, investors and other stakeholders.
- 6.4 The Bank's high credit rating is the basis of its business model. Investor confidence, similar to credit evaluation, is built both on the financial strength of the EIB and on the strength and availability of support from its Member States. Whilst being confident that the Member States will continue to demonstrate a high level of support to the Bank, prudent risk management remains paramount in the evolving political and economic environment in order to ensure that the Bank's activity remains compatible with its risk appetite. This is especially so as further regulatory and market developments may influence the Bank's capital adequacy. The Bank will continue to monitor the evolving landscape and report on its findings, possible mitigation, and expected impact on EIB's activities and key risk indicators.
- 6.5 Upcoming regulatory changes of note are the expected approval by the European Parliament and the Council of the CRD IV/CRR package proposed by the European Commission in November 2016 with a view to implementing the reforms agreed at international level by the BCBS and the FSB in the aftermath of the 2007/2008 crisis.
- 6.6 The Bank follows on an ongoing basis the evolution of applicable accounting standards (i.e. IFRS and EU Accounting Directives) in order to ensure timely implementation and full compliance. In particular, in 2018, the Bank has implemented the IFRS 9 and IFRS 15 standards. Going forward, the Bank will continue to consider any emerging guidance and best practices issued by accounting standards setters in order to adjust as necessary internal models, management assumptions and accounting estimates.
- 6.7 Although the EIB operates as a non-profit-making organisation in line with Article 309 of the Treaty on the Functioning of the EU (TFEU), and notwithstanding that the demands from stakeholders, and the diversity and complexity of the Bank's activities over recent years, have changed, the EIB also has a strategic aim to

be financially sustainable. The recently approved Group Capital Sustainability Policy underpinned by a Group Capital Plan will complement future Operational Plans by providing a more fine-tuned, EIB Group response and business mix optimisation that maximises impact and additionality together with a more optimal, capital consumption planning and execution.

- 6.8 Other measures for ensuring financial sustainability will target a more granular consideration of the bottom-line effect of different types of financing activities. Focus will be on revenue opportunities given the ongoing low interest rate environment and on cost management. In addition, consideration will be given to the future size and shape of the Bank, redefining its culture and values and the way we work.

## 7 CONCLUSION

- 7.1 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 Board of Directors, Management Committee, Audit Committee, the internal auditors and external auditors. The Management Committee is pleased to note that for the first time, in 2018, the Audit Committee met with the European Central Bank – Single Supervisory Mechanism to exchange views on topics of supervisory priority and also met with the European Stability Mechanism as part of an EU strategy to safeguard financial stability and are supportive of such initiatives to further improve the effectiveness of the Audit Committee.
- 7.2 The Management Committee is highly appreciative of the level of engagement and the valuable feedback provided by the Audit Committee during 2018. It is also pleased to note the increased co-operation between the Audit Committee and the Audit Board of the EIF, including the way in which the two bodies cooperate and transparently communicate.
- 7.3 In view of restrictions on the provision of non-audit services by audit firms to audit clients that seek to maintain the independence of the external auditor, the Management Committee has welcomed the Audit Committee's support to the Compliance and Controls Committee to monitor and balance the EIB Group's use of professional service firms typically eligible to bid for external audit services, for consultancy work. The Management Committee and EIB services will work closely with the Audit Committee in the next audit tender to be initiated in 2019.
- 7.4 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.



CORPORATE

# Audit Committee Annual Reports

for the year 2018



**European  
Investment  
Bank**

*The EIB bank*

**European Investment Bank**  
98-100, boulevard Konrad Adenauer  
L-2950 Luxembourg  
☎ +352 4379-22000  
[www.eib.org](http://www.eib.org) – ✉ [info@eib.org](mailto:info@eib.org)