EUROPEAN
COMMISSION

Brussels, 31.7.2015
COM(2015) 373 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on guarantees covered by the general budget
Situation at 31 December 2014

{SWD(2015) 148 final}

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1. INTRODUCTION

The objective of this report is to monitor the credit risks borne by the EU budget resulting from the guarantees given and the lending operations implemented directly by the European Union or indirectly through the guarantee granted for EIB financing projects outside the Union.

This report is submitted pursuant to Article 149 of the Financial Regulation[1] which requires the Commission to report annually to the European Parliament and to the Council on EU budget guarantees and the corresponding risks[2].

The report is structured as follows: section 2 recalls the key features of the operations guaranteed by the EU budget; several other additional crisis management mechanisms, which do not imply any risk for the EU budget, are also presented. Section 3 lays out the evolution of the guaranteed operations. Then, section 4 highlights the main risks covered by the EU budget while section 5 outlines the activation of the guarantees and the evolution of the Guarantee Fund for external actions ("the Fund")[3].

A Commission Staff Working Document (SWD) complements this report with a set of detailed tables and explanatory notes. It also provides a macroeconomic analysis of the countries benefitting from EU loans and/or guarantees, representing the bulk of the exposure of the Fund.

2. OPERATIONS GUARANTEED BY THE EU BUDGET

The risks covered by the EU budget derive from a variety of lending and guarantee operations which can be divided into two categories:

– loans granted by the European Union with macroeconomic objectives, i.e. macro-financial assistance[4] ("MFA") loans to third countries, balance-of-payments[5] ("BOP") loans granting support to non-euro Member States experiencing balance-of-payments difficulties, loans under the European financial stabilisation mechanism ("EFSM")[6] granting support to all Member States experiencing or seriously threatened with a severe economic financial disturbance caused by exceptional occurrences beyond their control and are usually activated in conjunction with a financial support by the International Monetary Fund (IMF);

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1 Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

2 COM(2014)540 final and SWD(2014)269 final make up the previous report on the guarantees covered by the Budget at 31 December 2013.

3 Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 establishing a Guarantee Fund for external actions (codified version), the "Guarantee Fund Regulation" (OJ L 145, 10.6.2009, p.10).

4 MFA may also take the form of grants to third countries.

5 Council Regulation (EC) N° 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments (OJ L 53, 23.2.2002, p.1).

6 Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118, 12.5.2010, p.1).

– loans with microeconomic objectives, i.e. Euratom loans and, most significantly, European Investment Bank ("EIB") financing of operations in non-Member States ("EIB external financing") that are covered by EU guarantees[7].

The guaranteed EIB external financing, MFA and Euratom loans to third countries have since 1994 been covered by the Fund, while BOP, EFSM and Euratom loans to Member States are directly covered by the EU budget.

The Fund covers defaults on loans and loan guarantees granted to non-Member States or for projects in non-Member States. It was established:

– to provide a 'liquidity cushion' in order to avoid calling on the EU budget every time a default or late payment on a guaranteed loan arises; and

– to create an instrument of budgetary discipline by laying down a financial framework for the development of the EU policy on guarantees for Commission and EIB loans to third countries[8].

If third countries become Member States, loans relating to such countries are no longer covered by the Fund and the risk has to be directly borne by the EU budget. The Fund is provisioned from the EU budget and has to be maintained at a certain percentage of the outstanding amount of the loans and loan guarantees covered by the Fund. This percentage, known as the target rate, is currently 9%[9]. If resources of the Fund are not sufficient, the EU budget will provide the necessary funds.

Other crisis management mechanisms which are not covered by the EU budget

As part of the response to the crisis, several other mechanisms have been established which, however, do *not* imply any risk to the EU budget:

- *the Greek Loan Facility (GLF)*[10] which is financed via bilateral loans from other euro area Member States to Greece, centrally administered by the Commission.

- *European Financial Stability Facility (EFSF)*[11]: The EFSF was created by the euro area Member States as a temporary rescue mechanism in June 2010 to provide financial assistance to euro area Member States within the framework of a macroeconomic adjustment programme. The Treaty for a permanent rescue mechanism, the European Stability Mechanism (ESM) entered into force on 27 September 2012. Since 1 July 2013, the EFSF continues with its ongoing programmes to Greece (together with the IMF and some Member States) as well as to Ireland and Portugal (together with the IMF, some Member States and

7 References to legal bases are listed in the Annex of Table A3 of the SWD.

8 Although external risks are covered *in fine* by the EU budget, the Guarantee Fund acts as an instrument to protect the EU budget against the risk of payment defaults. For the latest annual report on the Fund and its management, see COM(2014)463 final and the accompanying Staff Working Document (SWD(2014)241 final). The report for 2014 is expected to be available by July 2015 on http://eur-lex.europa.eu/homepage.html .

9 For a comprehensive report on the functioning of the Fund and the provisioning target rate, see COM(2014)214 final and the accompanying Staff Working Document (SWD(2014)129 final).

10 About the GLF: http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm.

11 About the EFSF: http://www.efsf.europa.eu.

EU/EFSM)[12] but is no longer engaged in new financing programmes or loan facility agreements

- *European Stability Mechanism (ESM)*[13]: The ESM is an important component of the comprehensive EU strategy designed to safeguard financial stability within the euro area by providing financial assistance to euro area Member States experiencing or threatened by financing difficulties. It is an intergovernmental organization under public international law, based in Luxembourg, with an effective lending capacity of EUR 500,000 million.

3. EVOLUTIONS OF GUARANTEED OPERATIONS

This section sets out the evolution of the guaranteed operations; firstly of those managed directly by the Commission and then of those managed by the EIB.

Table 1: Total outstanding amounts covered by the EU budget at 31 December 2014 (in EUR million)

	Outstanding Capital	**Accrued Interest**	**Total**	**%**
Member States*				
Euratom	324	1	326	< 1
BOP	8,400	190	8,590	10
EIB	2,315	19	2,334	3
EFSM	46,800	707	47,507	56
Sub-total Member States	57,840	917	58,757	69
Third Countries**				
MFA	1,829	13	1,842	2
Euratom	24	< 1	24	< 1
EIB***	24,431	164	24,595	29
Sub-total third countries	26,283	178	26,461	31
Total	**84,123**	**1,095**	**85,218**	**100**

* This risk is directly covered by the EU budget. This also includes, Euratom and EIB loans granted to countries prior to their accession to the EU.

** This risk is covered by the Fund.

*** Loans subrogated to the EU following Syria defaults on EIB loans are included (amount: EUR 107 million).

[12] The loans granted under the EU/EFSM are guaranteed by the EU budget.
[13] About the ESM : http://esm.europa.eu.

Tables A1, A2a, A2b and A3 of the SWD provide more detailed information on these outstanding amounts, in particular in terms of ceiling, disbursed amounts or guarantee rates.

3.1. Operations managed directly by the Commission

3.1.1. European Financial Stabilisation Mechanism (EFSM)

In its conclusions of 9/10 May 2010, the Ecofin Council foresaw a maximum volume of the mechanism of EUR 60,000 million[14]. Moreover, Article 2(2) of Council Regulation No 407/2010[15] limits the outstanding amount of loans or credit lines to be granted to Member States to the margin available under the own resources ceiling for payment appropriations.

Following the Council decisions to grant Union financial assistance to Ireland[16] (up to EUR 22,500 million) and Portugal[17] (up to EUR 26,000 million), disbursements reached EUR 22,500 million to Ireland and EUR 24,300 million to Portugal.

<u>Developments during 2014</u>

In March 2014, the final tranche of EUR 800 million was disbursed to Ireland, using the maximum loan capacity for the country.

Regarding Portugal, EUR 2,200 million were disbursed in two tranches. The remaining EUR 1,700 million will not be used as the Portuguese government had decided not to request the disbursement. Moreover, the deadline for disbursement has expired.

At 31 December 2014, the EFSM had a remaining capacity of EUR 13,200 million, out of its maximum volume of EUR 60,000 million, to provide further assistance to any euro area Member State, if required[18].

3.1.2. Balance of payments facility

The EU medium-term financial assistance under the BOP facility was re-activated in November 2008 to help Hungary and subsequently Latvia and Romania, in January and May 2009, to restore market confidence for a total commitment of EUR 14,600 million. Of this amount, EUR 1,200 million was not disbursed due to no further requests and expiration of the deadline for disbursement.

<u>Developments during 2014</u>

Hungary repaid EUR 2,000 million and Latvia EUR 1,000 million.

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14 Cf. Press release on extraordinary Ecofin Council meeting 9/10 May 2010 (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf).

15 Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118, 12.5.2010, p.1).

16 Council Implementing Decision 2011/77/EU of 7 December 2011 on granting Union financial assistance to Ireland (OJ L 30, 4.2.2011, p. 348).

17 Council Implementing Decision 2011/344/EU of 17 May 2011 on granting Union financial assistance to Portugal (OJ L 159, 17.6.2011, p. 88); see also corrigendum (OJ L 178, 10.7.2012, p.15).

18 For further information on EFSM, see also the report from the Commission on borrowing and lending activities of the European Union in 2013 (COM(2014)529 final). The report for 2014 is expected to be available by July 2015 on http://eur-lex.europa.eu/homepage.html.

As regards Romania, the Council had decided on 22 October 2013 to make available to Romania a second precautionary medium-term financial assistance[19] amounting to a maximum of EUR 2,000 million in the form of a loan with a maximum average maturity of 8 years. No disbursements have been made yet but the facility may be activated and funds can be requested until 30 September 2015.

At 31 December 2014, the BOP facility had a remaining capacity of EUR 39,600 million out of an overall ceiling of EUR 50,000 million to provide further assistance if required.

The outstanding amount of BOP loans has decreased from EUR 11,400 million to EUR 8,400 million in 2014.

Developments subsequent to 31 December 2014

Two additionnal re-imbursements were made in January 2015 amounting to EUR 1,200 million for Latvia and to EUR 1,500 million for Romania. Hence, outstanding BOP loans as of 31 March 2015 amount to EUR 5,700 million.

3.1.3. Macro-financial assistance loans

As a general rule, MFA decisions are taken by the European Parliament and the Council (Article 212 of the TFEU). However, the Council may adopt the decision on a proposal from the Commission when the situation in a third country requires urgent financial assistance (Article 213 of the TFEU) and this procedure was used in the second MFA package for Ukraine in 2014.

Developments during 2014

On 14 April 2014, the Council decided to provide MFA loans to Ukraine[20] for a maximum amount of EUR 1,000 million, which was fully disbursed in 2014.

The MFA assistance to Ukraine approved in 2010[21] together with funds still available from assistance approved in 2002[22] amount to EUR 610 million in loans. EUR 360 million were disbursed in 2014.

On 15 May 2014, the European Parliament and the Council decided to provide macro-financial assistance to the Republic of Tunisia[23] of a maximum amount of EUR 300 milion in the form of loans.

Regarding repayments, EUR 96 million were repaid by the beneficiary countries (Bosnia Herzegovina EUR 4 million, former Yugolav Republic of Macedonia EUR 10 million,

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19 Council Decision 2013/531/EU of 22 October 2013 providing precautionary EU medium-term financial assistance for Romania (OJ L 286, 29.10.2013, p.1).

20 Council Decision No 2014/215/EU of the Council of 14 April 2014 providing macro-financial assistance to Ukraine (OJ L 111, 15.4.2014, p. 85).

21 Decision No 388/2010/EU of the European Parliament and of the Council of 7 July 2010 providing macro-financial assistance to Ukraine (OJ L 179, 14.7.2010, p. 1).

22 Council Decision 2002/639/EC of 12 July 2002 providing supplementary macro-financial assistance to Ukraine (OJ L 209, 6.8.2002, p. 22).

23 Decision 534/2014/EU of the European Parliament and of the Council of 15 May 2014 providing macro-financial assistance to the Republic of Tunisia (OJ L 151, 21.05.2014, p. 9).

Lebanon EUR 25 million, Montenegro EUR 1 million Serbia EUR 52 million, and Tajikistan EUR 4 million).

The outstanding amount of MFA loans has increased from EUR 564.6 million to EUR 1,828.6 million at 31 December 2014.

Developments subsequent to 31 December 2014

The first tranche of EUR 100 milllion to Jordan (out of the EUR 180 million decision) was disbursed in February 2015.

In April 2015, the remaining amount of EUR 250 million decided previously was disbursed to Ukraine together with the first EUR 10 million tranche to Georgia (out of the EUR 23 million decision).

The first tranche of EUR 100 million to Tunisia (out of the EUR 300 million decision) was disbursed in May 2015.

3.1.4. Euratom loans

The Euratom lending to Member States or in certain eligible non-member countries (Russian Federation, Armenia, Ukraine) has a ceiling of EUR 4,000 million of which around 85% has already been disbursed. A loan of EUR 300 million to Ukraine dedicated to the safety upgrade of existing nuclear facilities was signed on 7 August 2013. The disbursement can occur once all conditions for effectiveness have been satisfactorily completed.

EUR 326 million remaining out of the EUR 4,000 million decision could be devoted to new projects.

Developments during 2014

No disbursements took place in 2014. Repaid amounts consisted of EUR 22.6 million from Bulgaria, EUR 10 million from Romania and EUR equivalent of 6.6 million from Ukraine.

3.2. Evolution of the EIB external financing operations

Developments during 2014

The existing EU guarantee for the EIB external financing covering the period 2007-2013 ("the 2007-2013 external mandate") was extended until 30 June 2014 as no decision on a new EU guarantee to the EIB had been adopted by the Council and the European Parliament at 31 December 2013.

The new Decision granting an EU guarantee for EIB operations outside the Union for the period 2014-2020[24] was adopted in April 2014. It establishes that the maximum ceiling of the EU guarantee should be broken down into a fixed ceiling of a maximum amount of EUR 27,000 million and an optional additional amount of EUR 3,000 million. Activation, in whole or in part, of the optional additional amount will be decided in accordance with the ordinary

[24] Decision No 466/2014/EU of the European Parliament and of the Council of 16 April 2014 granting an EU guarantee to the European Investment Bank against losses under financing operation supporting investments projects outside the Union (OJ L 135, 8.5.2014, p. 1).

legislative procedure on the basis of the mid-term review of the implementation by the EIB of the Decision and the evolution of EIB operations. In parallel, a new Guarantee Agreement has been signed on 22 July 2014 as required by Article 14 of the Decision.

In 2014, with the use of the 2007-2013 and 2014-2020 external mandate, the loan signatures increased by 15% in comparison with the previous year and amounted to EUR 4,059 million. The amount of loans disbursed was EUR 2,260 million (+ 17% compared to 31 December 2013). The 2007-2013 Mandate has been almost fully used, taking into account that net signatures reach EUR 29,026 milllion, when the authorized ceiling was EUR 29,484 milllion. For previous EIB external mandates, see Table A3 of the SWD.

Defaults on interests payments and loan repayments from the Syrian Government continued in 2014. The EIB has called on the Guarantee Fund to cover these defaults (see paragraph 5.1.3 below).

Outstanding amounts at 31 December 2014 for the various facilities referred to in this section are presented in Table 1.

4. RISKS COVERED BY THE EU BUDGET

4.1. Definition of risk

The risk borne by the EU budget derives from the outstanding amount of capital and interest in respect of guaranteed operations.

For the purpose of this report, two methods are used for evaluating the risks borne by the EU budget (either directly or indirectly via the Fund):

– "The total risk covered" is based on the sum of the total amount of capital outstanding for the operations concerned on a given date including accrued interest[25].

– The budgetary approach defined as "the annual risk borne by the EU budget" is based on the calculation of the maximum amount of annual payments due which the EU would have to pay out in a financial year assuming that all payments of the guaranteed loans are in default[26].

4.2. Total risk composition

Until 2010 the maximum risk in terms of total outstanding amounts covered was mainly linked to loans granted to third countries. Since 2011, the financial crisis has impacted heavily on the public finances of the Member States leading to an increase in the lending activity of the EU to support higher sovereign financing needs in Member States.

As a consequence the composition of risk has changed. At 31 December 2014, 69% of the total outstanding amount[27] concerns borrowing operations linked to loans to Member States which are directly covered by the EU budget (compared to 45% at 31.12.2010).

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[25] See Table 1 of the Report.

[26] For the purpose of this calculation, it is assumed that defaulting loans are not accelerated, i.e. only payments due are taken into account (see Tables 2 and 3 of the report and Table A4 of the SWD).

[27] See Table 1.

4.3. Annual risk covered by the EU budget

For 2015, the maximum amount which the EU would have to pay out (directly and via the Fund) - *assuming* that *all* guaranteed loans would be in default - is EUR 12,379.8 million. This represents the capital and interest payments from guaranteed loans falling due during 2015, assuming that defaulting loans are not accelerated (for details see Table A4 in SWD).

4.3.1. Risk linked to Member States

In 2015, the Fund will bear a maximum annual risk related to Member States (MS) of EUR 9,811 million (ca. 79% of the total annual risk). The risk linked to MS concerns:

(a) EIB lending and/or MFA and/or Euratom loans granted before MS accession to the EU;

(b) the loans granted under the BOP facility, and

(c) the loans granted under the EFSM scheme.

Table 2: Ranking of the Member States according to the annual risk borne by the EU budget in 2015 (EUR million)

Ranking	Country	Loans	Max annual risk	Weight of the country vis-à-vis annual risk of MS	Weight of the country vis-à-vis total annual risk (MS and non-MS)
1	Ireland	c)	5,676.4	57.9%	45.9%
2	Romania	a)+b)	1,882.5	19.2%	15.2%
3	Latvia	a)+b)	1,265.3	12.9%	10.2%
4	Portugal	c)	684.5	7.0%	5.5%
5	Bulgaria	a)	86.1	0.9%	0.7%
6	Hungary	a)+b)	63.0	0.6%	0.5%
7	Czech Republic	a)	45.7	0.5%	0.4%
8	Poland	a)	42.8	0.4%	0.3%
9	Croatia	a)	40.6	0.4%	0.3%
10	Slovak Republic	a)	15.1	0.2%	0.1%
11	Lithuania	a)	4.8	< 0.1%	< 0.1%
12	Slovenia	a)	4.4	< 0.1%	< 0.1%
Total			9,811.1	100%	79.3%

4.3.2. Risk linked to third countries

In 2015, the Fund will bear a maximum annual risk related to third countries of EUR 2,568.7 million (21% of the total annual risk). The risk linked to third countries concerns EIB lending and/or MFA and/or Euratom loans (details are included in table A2b of the SWD). The Fund covers guaranteed loans to third countries with maturities extending up to 2042.

The top ten countries (out of forty-one) are ranked below according to the repayments due in 2015. They account for EUR 2,106 million or 82% of the annual risk related to third countries borne by the Fund. The economic situation of these countries is analysed and commented in point 3 of the SWD. Creditworthiness, as assessed by the rating agencies, is also indicated in each country table.

Table 3: Ranking of the **10 most important third countries** according to the annual risk borne by the EU budget in 2015 (EUR million)

Ranking	**Country**	**Max annual risk**	**Weight of the country vis-à-vis annual risk of third countries**	**Weight of the country vis-à-vis total annual risk (MS and non-MS)**
1	Turkey	535.9	20.9%	4.3%
2	Morocco	309.8	12.1%	2.5%
3	Brazil	254.0	10.0%	2.1%
4	Serbia	242.0	9.4%	2.0%
5	Tunisia	227.3	8.8%	1.8%
6	Egypt	204.2	7.9%	1.6%
7	Bosnia and Herzegovina	99.9	3.9%	0.8%
8	Lebanon	86.9	3.4%	0.7%
9	South Africa	86.3	3.4%	0.7%
10	Syria	57.0	2.2%	0.5%
Total of the 10		2,106.3	82.0%	17.0%

5. ACTIVATION OF THE GUARANTEES AND EVOLUTION OF THE FUND

5.1. Activation of guarantees

5.1.1. Payments from cash resources

When a debtor is late in paying the EU, the Commission draws on its cash resources in order to avoid delays and resulting costs in servicing its borrowing operations[28]. This did not happen in 2014.

5.1.2. Payments from the EU budget

If there would be an eventual default, the EU budget would be called to cover the shortfall. As no defaults from Member States occurred during the year 2014, no appropriation was requested.

5.1.3. Calls on the Fund and recoveries

In the event of late payment by the beneficiary of a loan to third countries granted or guaranteed by the EU, the Fund is called on to cover the default within three months of the request[29].

Starting from December 2011, the EIB has experienced defaults on certain interest payments and loan repayments from the Syrian Government. Since official payment requests have remained unsuccessful, the EIB started to call the Fund in May 2012. The evolution of the calls on the Fund corresponding to defaulting loans in Syria is presented in Table 4.

The amounts called by the EIB are withdrawn from the Guarantee Fund account after authorization by the Commission services. When the EU makes a payment under the EU Guarantee, it is subrogated into the rights and remedies of the EIB.

Recovery proceedings are undertaken by the EIB on behalf of the EU in respect of the subrogated sums.

[28] See Article 12 of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom, on the system of the European Communities own resources (OJ L 130, 31.5.2000, p. 1).

[29] Since its inception in 1994 and as at the reporting date, the Fund has been called for a cumulative amount of EUR 645 million. EUR 579 million were recovered (this includes the amount of capital and interest repaid, plus penalties interests for late payments, plus exchange rate gains and losses realized). For more details, see Section 2.5.4 of the SWD.

Table 4: Calls on the Guarantee Fund on defaulting loans in Syria (in EUR million)

Year	Number of calls paid	Amount of due instalments	Penalties and accrued interests (1)	Amount recovered	Total
2012	2	24.02	n.a.	2.15	21.87
2013	8	59.27	1.36	0	60.63
2014	8	58.68	1.54	2.15	60.22
Total	18	141.97	2.90	2.15	142.72

(1) Penalties and accrued interests are claimed by the EIB only with the second payment request of each individual loan and run from the default date until the payment date by the Guarantee Fund.

At 31 December 2014, the total capital outstanding of guaranteed loans related to Syria amounts to EUR 554 million[30], with the last loan maturity in 2030.

Developments subsequent to 31 December 2014

Two additionnal calls have been received during the four first months of 2015 for a total amount of EUR 12.15 million.

5.2. Evolution of the Fund

In accordance with the Guarantee Fund Regulation, the Fund has to reach an appropriate level (target amount) set at 9% of the total outstanding capital liabilities arising from each operation, plus accrued interest. A provisioning mechanism is in place to ensure the target amount is met.

On the basis of the provisioning mechanism, the EU budget paid EUR 58.43 million to the Fund in February 2014, while in February 2015, the respective payment amounted to EUR 144.40 million.

At 31 December 2014, the net assets[31] of the Fund amounted to EUR 2,114.67 million. The ratio between the net assets and the outstanding capital liabilities[32] (EUR 26,353.17 million), within the meaning of the Guarantee Fund Regulation, was lower than the target amount. Consequently, a provisioning of EUR 257.12 million was inserted in the preliminary EU budget of 2016.

At 31 December 2014, the Fund had EUR 142.72 million arrears to recover.

30 This includes the amount of EUR 142.72 million already called by the EIB and paid by the Commission.

31 Total assets of the Fund minus accrued payables (EIB fees and audit fees).

32 Including accrued interests.