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REPORT FROM THE COMMISSION

to the budgetary authority on guarantees covered by the general budget
Situation at 30 June 2009

SEC(2010)479

TABLE OF CONTENTS

1. INTRODUCTION AND TYPES OF COVERED OPERATIONS

This report is submitted pursuant to Article 130 of the Financial Regulation which requires the Commission *to report to the European Parliament and to the Council twice a year on budgetary guarantees and the corresponding risks*[1]. It is completed by a Commission Staff Working Document with a set of detailed tables and explanatory notes (the "SWD")[2].

The risks covered by the budget of the European Union (the "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[3] ("MFA") loans to third countries and in conjunction with the Bretton Woods institutions and balance-of-payments ("BoP") loans granting support to non-euro Member States experiencing balance-of-payments difficulties; and

– loans with microeconomic objectives, i.e. Euratom loans and most importantly European Investment Bank ("EIB") financing of operations in non-Member States ("EIB external financing")[4]. The latter are covered by EU guarantee[5].

The EIB external financing, the Euratom loans and the MFA loans have since 1994 been covered by the Guarantee Fund for external actions ("the Fund"),[6] while BoP loans are directly covered by the budget. The Fund covers defaults on loans and loan guarantees granted to non-Member States or for projects in non-Member States and was established:

to provide a 'liquidity cushion' in order to avoid calling on the 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 EU policy on guarantees for Commission and EIB loans to non-member countries[7].

– Following an amendment[8] of the Guarantee Fund Regulation in 2004, the Fund's coverage is withdrawn if third countries become Member States and the risk is transferred from the Fund to be directly born by the Budget. The Fund is provisioned from the 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%. If there are insufficient resources in the Fund, recourse will be made to the Budget.

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1 COM(2009)398 and SEC(2009)1063 make up the previous report on the guarantees covered by the Budget at 31 December 2008.

2 SEC(2010)479.

3 MFA may also take the form of grants to third countries. For more information on MFA, see Commission report COM(2009)514 and SEC(2009)1279.

4 The figures concerning the EIB mandates are displayed in Table A1 and references to legal bases are listed in Table A4 of the SWD.

5 Most recently established for the period 1 February 2007—31 October 2011 by Decision No 633/2009/EC of the European Parliament and of the Council of 13 July 2009 (OJ L 190, 22.7.2009, p. 1) (the "External Mandate Decision"), replacing Council Decision 2006/1016/EC of 19 December 2006.

6 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).

7 For a comprehensive report on the functioning of the Fund, see COM(2006)695 and the accompanying Staff Working Document (SEC(2006)1460).

8 Council Regulation (EC, Euratom) No 2273/2004 (OJ L 396, 31.12.2004, p. 28).

In 2007, an amendment[9] of the Council Regulation set up a new provisioning mechanism. It functions through annual transfers from the Budget and involves a smoothing mechanism to limit the impact of calls on the Fund (see also Section 5.3 below). An external evaluation is currently assessing the functioning of the Fund, including the target rate, as part of a mid-term review.

2. EVENTS SINCE THE LAST REPORT AT 31 DECEMBER 2008

2.1. Balance of payments support to non-euro Member States

From a quantitative point of view, the most important development during the first half of 2009 were two disbursements of loans in the context of the BoP support for non-euro Member States in the wake of the financial crisis. The first tranche of EUR 1 billion of the BoP loan granted to Latvia was disbursed in February 2009. The second tranche of EUR 2 billion of the BoP loan granted to Hungary was disbursed in March 2009 (see section 3.5). These loans have been refinanced "back-to-back" via the issuance of EC benchmark bonds and are not covered by the Fund.

2.2. Macro-financial assistance

A first disbursement of EUR 25 million out of the EUR 50 million MFA loan to Lebanon took place during the first half of 2009. The loan has been refinanced "back-to-back" via a private placement borrowing operation.

2.3. EU budget guarantee for EIB external financing

Regarding EIB financing operations, a total amount of EUR 8 611 million had been signed by the EIB under the External Mandate Decision by 30 June 2009. Concerning the disbursement volume, a total amount of EUR 2 576 million was signed during the first half of 2009 of which EUR 260 million were disbursed by 30 June 2009.

3. DATA ON RISKS COVERED BY THE BUDGET

3.1. Definition of risk

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

Defaulting operations will be covered by the Fund when they are linked to third countries (61% of the total outstanding amount guaranteed as of 30 June 2009) and directly by the Budget where Member States are involved (BoP loans and loans to or for the benefit of projects in Member States account for the remaining 39% of the total outstanding amount guaranteed). The large proportion of guaranteed loans linked to Member States is the result of the most recent enlargement rounds[10] and the activation of the EU medium-term financial assistance facility for Member States not having adopted the EUR (the BoP facility).

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

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9 Council Regulation (EC, Euratom) No 89/2007 of 30 January 2007 (OJ L 22, 31.1.2007, p.1).

10 According to Article 1, third paragraph, of the Fund Regulation, once a country becomes a Member State, the risk on the loans is transferred from the Fund to the Budget.

– The method of calculating the total amount of capital outstanding for the operations concerned on a given date including accrued interest. This methodology allows determining the total amount of risk supported by the Budget on a given date for all future payment obligations independent of when in the future these payments are due and whether they are covered by the Fund or not.

– The budgetary approach defined as "the annual risk borne by the Budget" is based on the calculation of the maximum amount which the EU would have to pay out in a financial year assuming that all guaranteed loans are in default[11].

[11] For the purpose of this calculation, it is assumed that defaulting loans are not accelerated, i.e. only due payments are taken into account (see also Section 1 of the SWD).

Table 1: Total outstanding amounts covered as of 30 June 2009 in EUR million				
	Outstanding Capital	**Accrued Interest**	**Total**	**%**
Member States*				
MFA	115	1	116	<1%
Euratom	431	3	434	2%
BoP	5 000	64	5 064	21%
EIB	3 659	33	3 692	16%
Sub-total Member States	9 205	101	9 306	39%
Third Countries**				
MFA	536	4	540	2%
Euratom	50	0	50	<1%
EIB	13 659	122	13 781	58%
Sub-total third countries	14 245	126	14 371	61%
Total	**23 450**	**227**	**23 677**	**100%**
* This risk is directly covered by the Budget. ** This risk is covered by the Fund.				

Tables A1, A2, A3 and A4 of the SWD provide more detailed information on these outstanding amounts, in particular in terms of ceiling, disbursed amounts or guarantee rates.

The total outstanding amount of capital and interest covered by the budget increased by EUR 2 950 million to EUR 23 677 million compared with the situation at 31 December 2008.

3.2. Risk linked to Member States

Current risks on Member States result from loans granted prior to accession and the activation of the BoP facility.

In the second semester of 2009, the Budget will bear a maximum risk linked to Member States of EUR 482.7 million (representing the amounts due during this period and assuming that defaulting loans are not accelerated). Table 2 shows that Romania and Hungary are ranked first and second among Member States in terms of their outstanding amount.

Table 2: Ranking of the Member States according to the exposure with regard to the maximum risk borne by the budget during the 2nd semester 2009 (EUR million)			
Ranking	**Country**	**Maximum risk (M EUR, rounded)**	**% of the total maximum risk**
1	Romania	152.4	31.6%
2	Hungary	122.5	25.4%
3	Bulgaria	68.3	14.1%
4	Czech Republic	42.3	8.8%
5	Poland	41.7	8.7%
6	Slovak Republic	30.5	6.3%
7	Slovenia	12.4	2.6%
8	Cyprus	4.8	1.0%
9	Latvia	3.6	0.7%
10	Lithuania	3.2	0.6%
11	Estonia	0.5	0.1%
12	Malta	0.3	0.0%
	Total	482.7	100.0%

The risk on Member States concerns EIB, MFA and Euratom loans granted before the last two enlargements and the loans granted under the BoP facility.

3.3. Risk linked to third countries

In the second semester of 2009, the Fund will bear a maximum risk related to third countries of EUR 594 million (representing the amounts due during this period and assuming that defaulting loans are not accelerated). The top ten countries according to their total outstanding are listed below. They account for 76.1% of the risk borne by the Fund during the second semester 2009. The economic situation of these countries is analysed and commented in the SWD.

Table 3: Ranking of the 10 most important third countries according to the exposure with regard to the maximum risk borne by the Fund during the 2nd semester 2009 (EUR million)			
Ranking	**Country**	**Maximum risk (M EUR, rounded)**	**% of the total maximum risk**
1	Turkey	156.5	20.0%
2	Egypt	92.7	11.9%
3	Morocco	70.5	9.0%
4	Tunisia	69.0	8.8%
5	Lebanon	58.1	7.4%
6	South Africa	43.9	5.6%
7	Serbia	34.2	4.4%
8	Georgia	24.2	3.1%
9	Jordan	22.9	2.9%
10	Mexico	22.0	2.8%
Total of the 10		594.0	76.1%

The Fund covers the guaranteed loans of 45 countries with maturities extending up to 2038. Details by country are provided in Table A2 of the SWD.

3.4. Global risk covered by the Budget

In total, the Budget will cover during the second semester 2009 an amount of EUR 1 263 million representing the amounts due during this period, of which 38% are due by Member States (see Table A2 in the SWD).

3.5. Evolution of risk

- Balance of payments facility

The intensity of the international crisis has impacted some Member States which have not yet adopted the euro. The activation of the EU medium-term financial assistance facility (balance of payments (BoP) facility) in December 2008 gave the opportunity for some of them to restore investor confidence by using the EU financial assistance. The increased number of eligible Member States following the recent enlargement necessitated an extension of the BoP facility in December 2008[12] from EUR 12 billion to EUR 25 billion in response to the

[12] Council Regulation (EC) No 1360/2008 of 2 December 2008 amending Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance to Member States' balances of payments.

potential needs. Another increase to EUR 50 billion of the overall ceiling of the BoP facility was decided in May 2009[13] in order for the EU to continue to be able to react quickly to potential further demand for BoP assistance.

Therefore, the total risk towards Member States has continued to increase during the first semester 2009 following the disbursements of tranches under the BoP facility for a total amount of EUR 3 billion. Further tranches are planned to be disbursed during the second semester for a total amount of EUR 4.2 billion.

A BoP loan to Latvia was granted in early 2009[14] for up to EUR 3.1 billion. A first tranche of EUR 1 billion was disbursed on 25 February 2009. One additional tranche of EUR 1.2 billion was disbursed on 27 July 2009.

On 26 March 2009, the second tranche of EUR 2 billion was disbursed for Hungary under the BoP loan granted in 2008. An additional tranche of EUR 1.5 billion was disbursed on 6 July 2009.

A loan to Romania was granted on 6 May 2009 for up to EUR 5 billion. The loan will be disbursed in several tranches in 2009 and 2010. A first tranche of EUR 1.5 billion was disbursed on 27 July 2009.

- Macro-financial assistance loans

MFA loans to third countries have been subject to individual decisions by the Council[15] and since the entry into force of the Lisbon Treaty by the Council and the Parliament. The financial assistance granted under Council Decision 2007/860/EC of 10 December 2007 providing macro-financial assistance to Lebanon consists of EUR 50 million in loans and up to EUR 30 million in grants. The payment of the first tranche of the loan (EUR 25 million) was made in early June 2009, and the release of the second tranche is planned in early 2010.

- 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 billion of which around 85% have already been used. The remaining margin is about EUR 600 million. No disbursements were made under the Euratom Facility in the 1st half of 2009.

The disbursement of the third (and last) tranche under the Loan Agreement for the K2R4 project (USD 10.3 million) in Ukraine took place on 12 October 2009.

- EIB loans

The previous general mandate to the EIB expired on 31 July 2007. At this date, contracts corresponding to a total 98% of the overall ceiling under this mandate (EUR 20 060 million – see Table A5 of the SWD) had been signed. At 30 June 2009, a total amount of

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13 Council Regulation (EC) No 431/2009 of 18 May 2009 amending Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance to Member States' balances of payments.

14 Council Decision 2009/290/EC of 20 January 2009.

15 After entry into force of the Lisbon Treaty, the co-decision procedure will be the ordinary legislative procedure.

EUR 4 794 million remained to be disbursed under this mandate but may still be disbursed under EU guarantee within 10 years from the end of the mandate, at which time the EU guarantee lapses for any undisbursed amounts.

The most important item that will impact the risk for the Budget in future is the EU guarantee granted to the EIB under the External Mandate Decision. The external mandate is currently under mid-term review and a decision covering the remainder of the current Financial Perspective 2007-2013, replacing the current decision, must be adopted by Council and Parliament before 31 October 2011. The EU guarantee is restricted to 65% of the aggregate amount of credits disbursed and guarantees provided under EIB Financing Operations, less amounts reimbursed and plus all related sums, with a maximum ceiling of EUR 27 800 million[16]. A total amount of EUR 8 611 million had been signed at 30 June 2009 under this mandate, of which EUR 7 449 million remained undisbursed at that date (see Table A6 of the SWD).

4. DEFAULTS, ACTIVATION OF BUDGET GUARANTEES AND ARREARS

4.1. Payments from cash resources

The Commission draws on its cash resources in order to avoid delays and resulting costs in servicing its borrowing operations when a debtor is late in paying the EU[17].

4.2. Payments from the Budget

No appropriation was requested under Budget Article 01 04 01, "European Community guarantees for lending operations", as no default was recorded in the first half of 2009.

4.3. Activation of the Guarantee Fund for external actions

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 date on which payment is due[18].

During the first half of 2009, the Fund was not called.

5. GUARANTEE FUND FOR EXTERNAL ACTIONS

5.1. Recoveries

As of 30 June 2009, the Fund had no arrears to recover.

5.2. Assets

At 30 June 2009, the net assets[19] of the Fund amounted to EUR 1 205 807 618.

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16 Broken down into a basic ceiling of a fixed maximum amount of EUR 25 800 million and an optional mandate of EUR 2 000 million. The activation of the optional mandate may be decided by the Council and the European Parliament in the context of the mid-term review.

17 See Article 12 of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 94/728/EC, Euratom, on the system of the EU's own resources.

18 For more details, see Section 1.4.3 of the SWD.

5.3. Target amount

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. The ratio between the Fund's resources (EUR 1 205 807 618) and outstanding capital liabilities[20] (EUR 14 375 441 140) within the meaning of the Fund Regulation has slightly increased from 8.34% at 31 December 2008 to 8.39% at 30 June 2009.

At year-end 2008, the Fund resources were lower than the target amount. According to the provisioning rules adopted by the Council in 2007[21], a provisioning of EUR 93 810 000 million was inserted in the Preliminary Draft Budget of 2010. This amount was paid from the Budget to the Fund on 10 February 2010.

6. EVALUATION OF RISKS: ECONOMIC AND FINANCIAL SITUATION OF THIRD COUNTRIES WITH THE LARGEST EXPOSURE

6.1. Objectives

The previous sections of this report provide information on quantitative aspects of the risk borne by the Budget, relating to third countries. However, the quality of the risks which depend on the type of operation and the standing of the borrowers (see Section 3.3 above) should also be assessed.

6.2. Risk assessment methods

The risk assessment in this report is based on the information on the economic and financial situation, ratings and other known facts of the countries having received guaranteed loans. This assessment does not include estimations of expected losses and recoveries which are inevitably highly uncertain.

Country risk indicators included in the tables in the SWD indicate the evolution of risk of defaults. This analysis is provided in the section 2 of the SWD for the countries having the highest credit risk and exposure to the Budget in 2009 and the countries having a direct exposure with the Budget (MFA and Euratom loans).

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

20 Including accrued interests.

21 Council Regulation (EC, Euratom) No 89/2007 of 30 January 2007 (OJ L 22, 31.1.2007, p. 1).