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REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON BORROWING AND LENDING ACTIVITIES
OF THE EUROPEAN UNION IN 2009

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1. INTRODUCTION

The Council decisions establishing the various lending instruments of the European Union require the Commission to inform the European Parliament and the Council, each year, of the use of these instruments. In order to meet these information requirements, this report describes the lending operations for each of the areas concerned.

In particular, this report gives a brief presentation of lending and borrowing activities under the balance-of-payment support to non-euro area Member States (BOP)[1] and the macro-financial assistance provided by the European Union to third countries (MFA). In addition, it provides information on Euratom lending and borrowing activities.

To complete the picture of EU activities, the final section provides a summary overview of European Investment Bank (EIB) lending and borrowing activities in 2009.

2. LENDING ACTIVITIES OF THE EUROPEAN UNION

2.1. Overview

Financial support for non-member States and for non-euro area Member States is provided by the Commission under different legal bases, depending on the geographical areas concerned and the objectives pursued.

Financial operations administered by the Commission under various Council decisions generally take the form of bilateral loans (macro-financial support to non-member States (MFA) or balance-of-payments support to non-euro area Member States (BOP)), where the European Union helps to re-establish a country's macro-economic balance. The Euratom lending instrument is available for financing operations in Member States and certain non-member States (Armenia, Russia and Ukraine).

Each MFA, BOP or Euratom loan disbursement is based on a back-to-back operation. In other words, the amounts due (interest and/or principal), currency and payment dates of the loans match the amounts due, the currency and payment dates of the underlying borrowing transaction.

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[1] Council Regulation (EC) No 407/2010 of 11 May 2010 established a similar mechanism with the full support of the EU budget, the European financial stabilisation mechanism (EFSM), to support euro area Member States. As of 1st October 2010 the mechanism has not been activated.

Table 1: Loan disbursements for macro-financial assistance*, Euratom to non-member States, and Balance of Payments loans to non-euro area Member States

EUR million

	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**Total**
Romania (MS as of 01.01.2007)		**50**							50
Albania					**9**				9
Bosnia and Herzegovina			**10**		**10**				20
fYRoM	**12**	**28**							40
Serbia and Montenegro		**40**		**15**					55
Lebanon								25	25
Sub total MFA	**12**	**118**	**10**	**15**	**19**			**25**	**199**
Euratom(1)	**40**	**25**	**65**	**215**	**51**	**39**	**16**	**7**	**458**
Hungary							2 000	3 500	5 500
Latvia								2 200	2 200
Romania								1 500	1 500
Sub-total BOP(2)							**2000**	**7 200**	**9 200**
Grand Total	**52**	**143**	**75**	**230**	**70**	**39**	**2 016**	**7 232**	**9 857**

(1) Including Bulgaria and Romania (Member States as of 01.01.2007)

(2) On 2 December 2008 the ceiling for the maximum amount of loans granted to non-euro area Member States under the BOP facility was increased from EUR 12 billion to EUR 25 billion. On 18 May 2009 the limit was increased to EUR 50 billion.

* Regarding the grants, a total amount of EUR 417 million was disbursed during the period (2002-2009) of which EUR 15.3 million in 2009 (further information on Macro-financial assistance can be found in the report from the Commission to the Council and the European Parliament on the implementation of macro-financial assistance to third countries in 2009).

2.2. BOP facility

The financial and economic crisis took a heavy toll on economic activity in Europe and the world at large. Despite unprecedented fiscal and monetary measures taken by governments and central banks to support financial markets, short-term and long-term financing conditions remained difficult during the year 2009. In 2008, the Balance-of-Payments (BOP) facility was reactivated to help non-euro Member States overcome balance of payments difficulties resulting from the financial crisis. In 2009, the lending acitvity under the BoP facility increased as the financial crisis continued to affect non-euro area Member States in their financing activities.

2.2.1. *Main characteristics of the BOP facility*

BOP assistance takes the form of medium-term loans provided by the Commission and is generally provided in conjunction with financing provided by the IMF and other multilateral lenders, such the EIB, the EBRD or the World Bank, or bilateral assistance from Member States. The facility is exceptional in nature and is mobilised on a case-by-case basis. Potential beneficiaries are the Member States outside the euro area[2] being faced with serious balance-of-payments difficulties. The assistance is of a macro-economic nature (i.e. not linked to a specific use of the funds as in the case of project assistance). It is released subject to the fulfilment of economic policy conditions and is aimed at easing the recipient Member States' global external financing constraints and restoring the viability of the balance of payments. Such policy conditions are agreed by the Commission following consultation with the Economic and Financial Committee (EFC) and the Member State in a memorandum of understanding signed prior to the implementation of the loan agreements. The assistance underpins the implementation of adjustment measures designed to remedy these difficulties. The verification of such measures is a condition for the disbursement of further instalments under these loans.

Created in 1975[3], several operations aimed at supporting the balance of payments of Member States under particular financial threats or difficulties were carried out by the Community under the Balance of Payments facility over the following twenty years. These operations consisted of loans funded by Community borrowings.

The increased number of eligible Member States following enlargement[4] and the intensity of the international financial crisis called for the BOP facility to be activated again and increased in December 2008[5] from EUR 12 billion to EUR 25 billion in order to respond to the potential needs. Another increase to EUR 50 billion of the borrowing ceiling was decided in May 2009[6] in order to continue being able to react quickly to any further demand for BOP assistance.

2.2.2. *BoP operations decided and disbursed in 2009*

In 2009, the Council decided to support two additional countries under the BOP facility:

– Latvia with a loan of up to EUR 3.1 billion (Council Decision 2009/290/EC of 20 January 2009), and

– Romania with a loan of up to EUR 5 billion (Council Decision 2009/459/EC of 6 May 2009).

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[2] On 1 October 2009, the following Member States had not adopted the euro: Bulgaria, the Czech Republic, Denmark, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Sweden and the United Kingdom.

[3] Council Regulation (EEC) No 397/75 of 17 February 1975 establishing a new mechanism known as the Community Loan Mechanism (CLM) to help some EC countries overcome unsustainable current account imbalances caused by the first oil shock.

[4] After introduction of the Euro, only non-Euro Member States continued to stay eligible for Balance of Payments assistance.

[5] 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.

[6] 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.

BOP was a substantial part of EU lending activity in terms of volume of disbursements in 2009. A total amount of EUR 7.2 billion was disbursed over several tranches.

Table 2: list of loan operations disbursed under BoP facility in 2009

Country	Decision	Tranche	Date	Amount in EUR million
Hungary[7]	2009/102/EC	2nd	26/03/2009	2 000
		3rd	6/07/2009	1 500
Latvia	2009/290/EC	1st	25/02/2009	1 000
		2nd	27/07/2009	1 200
Romania	2009/459/EC	1st	27/07/2009	1 500

2.2.3. EU response to the euro area sovereign debt crisis

In the wake of the crisis in Greece, the Council and the Member States have decided in May 2010 a package of measures to preserve financial stability in Europe.

One of these measures is the creation of a European Financial Stabilisation Mechanism (EFSM). The mechanism is based on Art. 122.2[8] of the Treaty with the full backing of the EU budget. Its activation is subject to strong conditionality, in the context of a joint EU/IMF support; terms and conditions will be similar to those of the IMF. As of 1st October 2010 the mechanism has not been activated

Two other measures have been decided in parallel with the EFSM

- the financial support to Greece consisting of pooled bilateral loans provided by euro area Member States for a total amount of EUR 80 billion. EUR 30 billion are provided by the IMF in the context of a joint EU/IMF support amounting to EUR 110 billion in total.

- the European Financial Stability Facility (EFSF) was set up with a capacity of EUR 440 billion. It is guaranteed on a pro rata basis by participating Member States.

2.3. MFA facility

Detailed information on MFA operations can be found in the annual Commission Report to the Council and the European Parliament on the implementation of MFA to third countries[9].

2.3.1. Main charateristics of MFA

Macro-financial assistance (MFA) in the form of loans and/or grants supports the political and economic reform efforts of the beneficiary countries and is implemented in association with

[7] On 9/12/2008 there was a first instalment of EUR 2 000 million in favour to Hungary.

[8] Art. 122.2 of the Treaty foresees financial support for Member States in difficulties caused by exceptional circumstances beyond Member States' control.

[9] Not yet published for 2009. For 2008, see COM/2009/514, SEC/2009/1279.

the Bretton Woods institutions (IMF and World Bank). Key features of the MFA are: the exceptional character of this assistance, the fact that it complements financing from the International Financial Institutions (IFIs), and macroeconomic conditionality. In close coordination with the International Monetary Fund (IMF) and the World Bank, the EU, tailored to the needs of a specific country, has supported several third countries with the overall objective of stabilising the financial situation and establishing market-oriented economies.

The MFA loans are generally disbursed in several instalments, as and when macroeconomic conditionality milestones are met. Each disbursement is subject to a borrowing transaction by the Commission. Should a situation of default arise as a result of failure by the beneficiary country to honour its repayment obligations, the Commission may activate the Guarantee Fund for External Actions[10] so that the repayment of the corresponding borrowing by the Commission is secured.

Loans disbursed under this instrument since 2002 are listed in Table 1 above.

2.3.2. MFA operations decided and disbursed in 2009

The key MFA activities in 2009 relate to negotiations with the relevant authorities and focused on the following:

- The terms of the assistance to Lebanon (Memorandum of Understanding and Loan Agreement signed on 18 and 19 December 2008 respectively).

The MFA programme with Lebanon consists of a grant of EUR 30 million and a loan of EUR 50 million, both to be disbursed in two instalments. The disbursement of the first tranche of the loan (EUR 25 million) was made in early June 2009. In December 2009, the Commission extended the availability period of the second tranche of the assistance programme, which will now expire on 21 December 2010. Disbursement of the second tranche is subject to the fulfilment of the conditionalities included on the Memorandum of Understanding agreed with national authorities.

- The implementation of the split between Serbia and Montenegro of the MFA loans granted in favour of the former Federal Republic of Yugoslavia.

The separation of EU claims relating to Montenegro from those on Serbia was the outcome of the independence of Montenegro in June 2006 and of an agreement between Serbia and Montenegro in July 2006 to allocate external liabilities among the two separate states. It did not create any new obligations for the EU and has no budgetary implications. A separate loan agreement was signed with Montenegro in 2009 and entered into force on 4 February 2010. It implements Council Decision 2008/784/EC[11], under which part of the liabilities granted by the EU to the State Union of Serbia and Montenegro - formerly the Federal Republic of Yugoslavia – were allocated to Montenegro reducing as a consequence the liability of Serbia .

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10 See Council Regulation (EC, Euratom) No 480/2009.

11 OJ L 269, 10.10.2008, p. 8.

On 30 November 2009[12], the Council of the European Union decided the following three new MFA operations:

- Armenia (Council Decision 2009/890/EC) consisting of a grant of EUR 35 million and a loan facility of up to EUR 65 million. The EU MFA will complement support from other donors and is intended to help cover Armenia's financing needs in 2010 – 2011as well as to alleviate the financial crisis effect. The conditions for the delivery of the MFA will complement the conditionality of the IMF programme and will include the satisfactory implementation of that programme, along with suggested reforms in the area of public finance management, debt management, procurement policy and custom policy.

- Bosnia and Herzegovina (Decision 2009/891/EC) in the form of a loan facility of up to EUR 100 million. The objective of this assistance is to help the authorities to address residual external financing and budgetary needs that emerge as a consequence of the strong economic slowdown affecting the country. It is complementary to IMF and World Bank programmes. The disbursement is planned in two tranches, which are tentatively planned for the third and fourth quarter 2010, subject to satisfactory compliance with conditionality requirements.

- Serbia (Council Decision 2009/892/EC) macro-financial assistance in the form of a loan facility of up to EUR 200 million. The objective of this assistance is to help the authorities to address residual external financing and budgetary needs that emerged in the context of the global crisis in the country. It is complementary to IMF and World Bank programmes. This assistance is expected to be released in 2011 subject to a satisfactory track record of conditionality requirements. In addition, and as noted above, Serbia's liabilities stemming from previous MFA to the former Federal Republic of Yugoslavia were reduced through the allocation of part of them to Montenegro pursuant to Council Decision 2008/784/EC.

There was one operation disbursed under MFA loan facility in 2009[13]:

– the first instalement of EUR 25 million of loan to Lebanon.

2.3.3. Impact of the financial crisis on MFA

In the wake of the financial crisis, several neighbourhood countries (Ukraine, Georgia, Armenia and Belarus) as well as other third countries (Iceland, Kyrgyz Republic and Tajikistan) requested MFA support in order to alleviate pressure on foreign exchange reserves and to contribute to economic stability and reform.

The Commission adopted in October 2009 a proposal for a MFA loan of EUR 500 million for Ukraine (to be added to the EUR 110 million decision adopted in 2002 and which has not yet been disbursed due to the absence of a working arrangement with the IMF). The proposal for Ukraine was adopted by the Council on 29 June 2010 and voted by the Parliament on 7 July 2010 in the ordinary legislative procedure on the basis of Article 212 of the Treaty on the functioning of the European Union (TFEU).

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[12] In addition the Council Decision 2009/890/EC decided to provide a MFA to Georgia for an amount of EUR 46 million in Grants.

[13] The first instalement of EUR 15.3 million of grant to Georgia was disbursed in 2009.

2.4. Euratom facility

2.4.1. Main characteristic

The Euratom loan facility may be used to finance projects within Member States (Council Decision 77/270/Euratom) or in certain third countries (Ukraine, Russia or Armenia) (Council Decision 94/179/Euratom). These loans are off-budget operations that the Commission finances back to back by borrowing from the financial market. In 1990 the Council fixed a borrowing limit of EUR 4 billion, of which some EUR 3.4 billion have been decided and disbursed. In 2002 the Commission proposed an increase in the borrowing limit from EUR 4 billion to EUR 6 billion, for which agreement has not yet been reached at the Council.

2.4.2. Operation disbursed

Euratom activities in 2009 focused on the lending and borrowing operation of the third (and last) tranche of USD 10.3 million[14] under the loan agreement for the K2R4[15] project in Ukraine.

3. BORROWING ACTIVITIES OF THE EUROPEAN UNION

3.1. Description

In order to finance the lending activities decided by the Council, the Commission is empowered to borrow funds on the capital market on behalf both the European Union Euratom. For each instrument (BOP, MFA and Euratom loans) the borrowing and lending mechanism operation is determined in its respective legal base. There is a ‘back-to-back’ link between a borrowing operation and the related lending operation, which ensures that the EU budget does not take of any interest rate or foreign exchange risk. Outstanding borrowings are matched by outstanding loans.

3.2. BOP

Bond issuances succeeded in confirming the EU as a major issuer to the euro benchmark bond market. The bonds were very well received in the market. As investor interest remained very strong, the bonds were always quickly oversubscribed. All important investor classes were represented in the final distributions, including central banks, investment funds, bank treasuries and insurance companies. The bond prices were close to the best in their reference group, the Sovereign Supranational Agency Sector (SSA), in line with issuers such as European Investment Bank (EIB), "Kreditanstalt für Wiederaufbau" (KFW) and "société de financement de l'économie française" (SFEF).

The secondary market performance was also very satisfactory and confirmed the EU’s strong standing as a first class benchmark bond issuer. This good standing was reinforced with subsequent benchmark bonds issued in July 2010.

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14 The last tranche was disbursed in October 2009.

15 On 29 September 2004 the Commission approved a loan for a total amount in EUR equivalent to USD 83 million for the safety upgrade of the nuclear power units known as Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) in Ukraine.

Table 3: EU bond issued during 2009[16]

Country	Description	Issue date	Maturity Date	Size (EUR)	Coupon
Latvia	EEC 3.25 2014	25/02/2009	3/04/2014	1.0 bn	3.125%
Hungary	EEC 3.25 2014	26/03/2009	7/11/2014	2.0 bn	3.25%
Hungary	EEC 3.625 2016	06/07/2009	6/04/2016	1.5 bn	3.625%
Latvia + Romania	EEC 3.125 2015	27/07/2009	27/01/2015	2.7 bn	3.125%

3.3. MFA

In 2009 there was only one borrowing for an amount of EUR 25 million in connection with the lending operation to Lebanon under macro-financial assistance.

3.4. Euratom

In 2009, an amount of USD 10.335 million (EUR 7.104 million equivalent) was raised for Euratom on a back-to-back basis for the funding of the K2R4 project in Ukraine.

Table 4: Volume of borrowing operations by financial instrument from 2002 to 2009[17] (EUR million)

	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
MFA	12	118	10	15	19			25
Euratom	40	25	65	215	51	39	16	7
BOP							2 000	7 200
Total	52	143	75	230	70	39	2 016	7 232

[16] http://ec.europa.eu/economy_finance/financial_operations/market/borrowing/benchmark_issues_2011-14_en.htm
http://ec.europa.eu/economy_finance/financial_operations/market/borrowing/benchmark_issues_2015-16_en.htm

[17] More information on the EC bonds can be found at http://ec.europa.eu/economy_finance/financial_operation_instruments/market_operations59_en.htm.

Table 5: Total borrowing of the European Union — outstanding amounts of capital at the end of each year over the period 2002-2009[1] (EUR million)

	ECSC i.l.[1] [2]	Euratom [1]	BOP	MFA	Total European Union
2002	713	80		1 379	**2 172**
2003	431	105		1 372	**1 908**
2004	423	170		1 214	**1 807**
2005	440	385		1 080	**1 905**
2006	436	436		969	**1 841**
2007	400	474		786	**1 260**
2008	266	484	2 000	654	**3 404**
2009	214	481	9 200	584	**10 479**

(1)The conversion rates used are those of 31 December of each year.

(2)The European Coal & Steel Community is in liquidation since 2002. The last bond issued by ECSC matures in 2019.

4. EUROPEAN INVESTMENT BANK

4.1. EIB lending activities

Loans granted by the EIB from its own resources are either in the form of direct financing for individual projects or global loans to financial intermediaries, which then allocate funds to smaller-scale local projects. In 2009, the total volume of EIB signed operations increased by 37 % to EUR 79.3 billion, of which an amount of EUR 70.5 billion was signed with Member States and EUR 8.8 billion with partner countries.

EIB lending activities have an impact on the EU budget when they are accompanied by EU guarantees, interest rate subsidies or other EU/EIB risk-sharing provisions. In particular, some EIB loans outside the EU benefit from an EU budget guarantee. A detailed report on the 2009 EIB external lending activity was issued by the Commission on 21 April 2010 in the framework of the mid-term review of the EIB external mandate[18]. At the same time, the EIB manages risk sharing facilities involving the use of the EU budget to support intra-EU policies (e.g. Risk Sharing Finance Facility for research and development projects and Loan Guarantee for TEN-Transport projects)[19].

4.2. EIB borrowing activities

The global financial crisis changed the market conditions. Although markets regained a moderate amount of confidence during the second semester 2009, market uncertainty remained elevated throughout the year, making issuance challenging, particularly for issuance of large size transactions and in longer maturities. Government rescue plans led to massive

18 COM (2010) 173

19 The Commission reported to the Council and Parliament on the implementation in 2009 of new financial instruments financed by the EU budget in the framework of the annual budgetary exercise, in accordance with point 49 of the Inter-institutional Agreement between the EC, the EP and the Council.

supply of both sovereign and government-guaranteed bonds. Investors were in a position to be increasingly selective.

Despite the difficult funding environment in 2009, the EIB raised an amount of EUR 79.4 billion at favourable terms in line with its strong market standing under the 2009 funding programme.