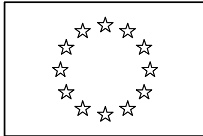

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REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on guarantees covered by the general budget
Situation at 30 June 2010

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1. INTRODUCTION

The objectives of this report are to monitor the credit risks exposure borne by the budget of the European Union resulting from the guarantees given and the lending operations implemented directly by the European Union or indirectly through the EIB external mandates.

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. TYPES OF OPERATIONS COVERED BY THE EU BUDGET

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[2] ("MFA") loans to third countries and in conjunction with the Bretton Woods institutions, balance-of-payments[3] ("BoP") loans granting support to non-euro Member States experiencing balance-of-payments difficulties, loans granting support to euro Member States under the European financial stabilisation mechanism (EFSM)[4]; and

– loans with microeconomic objectives, i.e. Euratom loans and most importantly European Investment Bank ("EIB") financing of operations that are covered by EU guarantees[5] in non-Member States ("EIB external financing")[6] .

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"),[7] while BoP and EFSM 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. It 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

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1 COM(2010)580 and SEC(2010)1218 make up the previous report on the guarantees covered by the Budget at 31 December 2009.

2 MFA may also take the form of grants to third countries. For more information on MFA, see Commission report COM(2010)513 and SEC(2010)1117.

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

4 A similar mechanism to BoP that covers all euro area Member States has been set up on 11 May 2010 on the basis of Council Regulation (EU) No 407/2010 of 11 May 2010 (OJ L 118, 12.5.2010, p.1). The EFSM had not yet been activated at 30 June 2010.

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

7 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).

– 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[8].

Following an amendment[9] 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 borne 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 had to the Budget.

In 2007, an amendment[10] 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).

3. EVENTS SINCE THE LAST REPORT AT 31 DECEMBER 2009

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

During the first semester 2010, two operations took place for a total amount of EUR 1.5 billion. The third tranche of EUR 0.5 billion of the loan granted to Latvia and the second tranche of EUR 1 billion of the loan granted to Romania were both disbursed on 11 March 2010. Both loans have been financed “back-to-back” via the issue of EU benchmark bonds and contributed to improve the confidence in the financial situation of these two non-euro Member States. On average 73% of the loan operations decided[11] have already been implemented.

3.2. Macro-financial assistance

During the first semester 2010, no loan disbursement took place and no new disbursements are expected to be implemented during the second semester.
Regarding the Council Decisions of 30 November 2009 granting new MFA operations for Armenia[12], Bosnia & Herzegovina[13] and Serbia[14] in the form of loans combined with a grant financial assistance to Armenia, the first disbursements are foreseen in 2011.

3.3. Euratom

No loan disbursement took place during the reported period.

3.4. EU budget guarantee for EIB external financing

Under the 2007-2013 external mandate, the loan signature and disbursement rhythm slowed down in comparison with 2009 and amounted to respectively EUR 1,197 million signed and

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[8] Although external risks are covered in fine by the guarantee of the EU budget, the Guarantee Fund acts as an instrument to protect the EU budget against the risk of payment defaults. For a comprehensive report on the functioning of the Fund, see COM(2006)695 and the accompanying Staff Working Document (SEC(2006)1460).

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

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

[11] See table A3a in the SWD.

[12] Council Decision 2009/890/EC of 30.11.2009 (OJ L320, 5.12.2009,p. 3-5)

[13] Council Decision 2009/891/EC of 30.11.2009 (OJ L320, 5.12.2009,p. 6-8)

[14] Council Decision 2009/892/EC of 30.11.2009 (OJ L320, 5.12.2009,p. 9-11)

EUR 1,443 million disbursed. The cumulative amount of loans disbursed under the 2007-2013 external mandate equalled to EUR 4,366 million at 30 June 2010.

3.5. European Financial Stabilisation Mechanism

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

On 5 May 2010, 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 and can support euro-area and non euro-area EU Member States. This mechanism does not imply any risk to the EU budget.

On 11 May 2010, the European Financial Stabilisation Mechanism (EFSM)[15] was set up. This mechanism is based on Treaty Art. 122 (2)[16]. Its activation is subject to strong conditionality, in the context of a joint EU/IMF support, and will be on terms and conditions similar to the IMF (the risk of operations under the EFSM will be covered by the EU budget).

For Greece, the financial support is provided directly by participating Member States and does not imply any risk to the EU budget.

The mechanism consists 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.

4. DATA ON RISKS COVERED BY THE BUDGET

4.1. 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 (55% of the total outstanding amount guaranteed as of 30 June 2010) 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 45% of the total outstanding amount guaranteed by the Budget). The large proportion of guaranteed loans linked to Member States is the result of the enlargement rounds[17] and the activation of the EU medium-term financial assistance facility for non-euro Member States (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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[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] Art. 122(2) of the Treaty foresees financial support for Member States in difficulties caused by exceptional circumstances beyond Member States' control.

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

– Calculating the total amount of capital outstanding for the operations concerned on a given date including accrued interest. This methodology makes it possible to determine the total amount of risk supported by the Budget on a given date for all future payment obligations independently of when in the future these payments are due and whether they are covered by the Fund or not (see table 1 below).

– The budgetary approach defined as "the annual risk borne by the Budget" is based on the calculation of the maximum amount of annual due payments which the EU would have to pay out in a financial year assuming that all payments of the guaranteed loans are in default[18]. The annual risk borne by the budget is given in table A2 of the Staff Working Document.

Table 1: Total outstanding amounts covered as of 30 June 2010 in EUR million

	Outstanding Capital	**Accrued Interest**	**Total**	**%**
Member States*				
MFA	65	0	65	<1%
Euratom	422	2	424	1%
BoP	10,700	142	10,842	33%
EIB	3,363	31	3,394	10%
Sub-total Member States	14,550	175	14,725	45%
Third Countries**				
MFA	492	2	494	2%
Euratom	55	0	55	<1%
EIB	17,468	140	17,608	54%
Sub-total third countries	18,014	142	18,157	55%
Total	**32,563**	**317**	**32,882**	**100%**

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

** 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.

18 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).

The total outstanding amount of capital and interest covered by the budget increased by EUR 3,126 million to EUR 32,882 million compared with the situation at 31 December 2009. This increase is mainly explained by the amount of EUR 1.5 billion disbursed under the BoP facility and also by the increase of EIB disbursements in third countries (EUR 1.9 billion during the first semester 2010).

4.2. Risk linked to Member States

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

During the second semester 2010, the Budget will bear a maximum direct risk linked to Member States of EUR 450.5 million (representing the amounts due during the second semester 2010 and assuming that defaulting loans are not accelerated). Table 2 shows that Hungary and Romania 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 at 30 June 2010 (EUR million)

Ranking	Country	Maximum risk (M EUR, rounded)	% of the total maximum risk
1	Hungary	146.7	32.6%
2	Romania	121.1	26.9%
3	Bulgaria	51.6	11.5%
4	Poland	42.1	9.3%
5	Czech Republic	40.8	9.1%
6	Slovak Republic	27.3	6.1%
7	Slovenia	8.5	1.9%
8	Cyprus	5.1	1.1%
9	Latvia	3.7	0.8%
10	Lithuania	2.8	0.6%
11	Estonia	0.5	0.1%
12	Malta	0.3	0.1%
	Total	450.5	100.0%

The risk on Member States concerns EIB, MFA and Euratom loans granted before the accession to the EU and the loans granted under the BoP facility.

4.3. Risk linked to third countries

At the beginning of the second semester 2010, the Fund will bear a maximum annual risk related to third countries of EUR 918 million (representing the amounts due in the second semester 2010 and assuming that defaulting loans are not accelerated). The top ten countries according to their total outstanding are listed below. They account for 77% of the risk borne by the Fund. 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 second semester 2010 (EUR million)

Ranking	**Country**	**Maximum risk (M EUR, rounded)**	**% of the total maximum risk**
1	Turkey	199.0	21.7%
2	Egypt	98.3	10.7%
3	Tunisia	81.1	8.8%
4	Morocco	81.1	8.8%
5	South Africa	70.6	7.7%
6	Lebanon	55.5	6.0%
7	Serbia	35.4	3.9%
8	Syria	30.1	3.3%
9	Brazil	26.6	2.9%
10	Mexico	25.3	2.8%
Total of the 10		703.2	76.6%

The Fund covers the guaranteed loans of 44 countries with maturities extending up to 2040. Details by country are provided in Table A2 of the SWD.

4.4. Global risk covered by the Budget

For the second semester 2010 the Budget will cover (directly and via the Fund) an amount of EUR 1,368 million representing the amounts due during this period, of which 33% are due from Member States (see Table A2 in the SWD).

4.5. Evolution of risk

- Balance of payments facility

During the first semester 2010, the global economy began to stabilise slowly following a period of significant declines. However the sovereign debt crisis continued to impact all the

Member States. The activation of the EU medium-term financial assistance facility (BoP) facility) in December 2008 helped some non-euro area countries to restore investor confidence. The BoP facility with its overall ceiling of EUR 50 billion has a remaining capacity of EUR 35.4 billion EUR to provide further BoP assistance if required.

- European Financial Stabilisation Mechanism (EFSM)

Financial assistance under the EFSM may take the form of a loan or of a credit line guaranteed by the EU budget. The Ecofin Council conclusions restrict the overall ceiling of the mechanism to EUR 60 billion[19], but the legal limit is provided in Article 2.2 of the Council Regulation, which limits the outstanding amount to the margin available under the own resources ceiling[20]. At 30 June 2010, the EFSM was not activated.

During the second semester 2010 the sovereign debt crisis continued to threaten the Euro area countries. In response to the Irish authorities' request on 21 November 2010, a three year joint EU / IMF financial support will be provided. The total programme for Ireland will amount to EUR 85 billion. EUR 17.5 billion will be financed by an Irish contribution through the Treasury cash buffer and investments of the National Pension Reserve Fund. The remainder of the overall package will be shared equally amongst:

– The European Financial Stabilisation Mechanism (EFSM) up to EUR 22.5 billion which is covered by the EU Budget;

– The European Financial Stability Facility (EFSF) for an mount of EUR 17.7 billion (not covered by the budget guarantee);

– Bilateral loans from United Kingdom (EUR 3.8 billion), Sweden (EUR 0.6 billion) and Denmark (EUR 0.4 billion). and

– The International Monetary Fund (IMF) for an amount of EUR 22.5 billion.

- Macro-financial assistance loans

MFA loans to third countries have been subject to individual decisions by the Council[21] and since the entry into force of the Lisbon Treaty by the European Parliament and the Council.

- 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% has already been used. The remaining margin is about EUR 600 million and could be disbursed to new projects in the Member States and Ukraine.

- EIB loans

[19] 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)

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

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

The previous EIB general mandate covering the period 2000-2007 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 2010, a total amount of EUR 3 517 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.

Following the Commission proposal to amend the legal basis of the EIB external mandate for the remainder of the current Financial Perspective 2007-2013[22], the Parliament and the Council are expected to adopt the relevant decision 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[23]. A total amount of EUR 13,124 million had been signed at 30 June 2010 under this mandate, of which EUR 8,930 million remained undisbursed at that date (see Table A6 of the SWD).

5. DEFAULTS, ACTIVATION OF BUDGET GUARANTEES AND ARREARS

5.1. 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[24].

5.2. Payments from the Budget

As no default was recorded in the first half of 2010, no appropriation was requested under Budget Article 01 04 01 (p.m. line) "***European Union guarantees for Union and Euratom borrowing operations and for EIB lending operations"***..

5.3. 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[25].

The Fund was not called on during the first half of 2010.

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22 COM(2010)174 of 21 April 2010.

23 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 European Parliament and the Council in the context of the mid-term review.

24 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, 1-12).

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

6. GUARANTEE FUND FOR EXTERNAL ACTIONS

6.1. Recoveries

As of 30 June 2010, the Fund had no arrears to recover.

6.2. Assets

At 30 June 2010, the net assets[26] of the Fund amounted to EUR 1 490 459 064 .

6.3. 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 1 490 459 064 and outstanding capital liabilities[27] EUR 18 156 522 331 within the meaning of the Fund Regulation has slightly increased from 8.15% at 31 December 2009 to 8.21% at 30 June 2010.

At year-end 2009, the Fund resources were lower than the target amount. According to the provisioning rules of the Guarantee Fund Regulation, a provisioning of EUR 138 880 000 was inserted in the adopted Budget of 2011. This amount will be paid from the Budget to the Fund in February 2011.

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

7.1. 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 4.3 above) should also be assessed.

7.2. Risk assessment methods

The risk assessment presented in the SWD 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 (MFA and Euratom loans included) for the second semester 2010..

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

27 Including accrued interests.