COUNCIL OF THE EUROPEAN UNION

Brussels, 22 April 2013

8733/13

FIN 210

COVER NOTE

from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	19 April 2013
to:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No Cion doc.:	COM(2013)°211 final
Subject:	Report from the Commission to the European Parliament and the Council on guarantees covered by the general budget: Situation at 30 June 2013

Delegations will find attached Commission document COM(2013) 211 final.

Encl.: COM(2013) 211 final

EUROPEAN
COMMISSION

Brussels, 18.4.2013
COM(2013) 211 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on guarantees covered by the general budget
Situation at 30 June 2012

{SWD(2013) 130 final}

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1. INTRODUCTION

The objective of this report is to monitor the credit risks 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 the Financial Regulation which requires the Commission *to report to the European Parliament and to the Council 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 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 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 under the European financial stabilisation mechanism ("EFSM")[4] granting support to all Member States experiencing or seriously threatened with a severe economic financial disturbance caused by exceptional occurrences beyond their control; 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") that are covered by EU guarantees[5].

The guaranteed 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 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

1 COM(2012)609 final and SEC(2012)347 final make up the previous report on the guarantees covered by the Budget at 31 December 2011.
2 MFA may also take the form of grants to third countries.
3 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).
4 Council Regulation (EU) No 407/2010 of 11 May 2010 (OJ L 118, 12.5.2010, p.1).
5 References to legal bases are listed in Table A4 of the SWD.
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).

– 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 EU non-member countries[7].

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 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 resources of the Fund are not sufficient, the Budget will provide the necessary funds.

3. EVENTS SINCE THE LAST REPORT AT 31 DECEMBER 2011

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

No operations took place during the first semester 2012. The precautionary EU medium-term financial assistance for Romania has not been activated at 30 June 2012.

3.2. Macro-financial assistance

The second and final tranche of EUR 39 million to Armenia was disbursed in February and EUR 19 million were repaid (BiH: EUR 2 million, fYRoM EUR 5million and Tajikistan EUR 12 million). .

3.3. Euratom

No loan disbursements took place during the reported period. Repaid amounts consisted of EUR 10.5 million from Bulgaria and EUR 2.8 million from Ukraine.

3.4. European Financial Stabilisation Mechanism

Disbursements to Ireland and Portugal amounted respectively to EUR 4.5 billion and EUR 6 billion during the first six months 2012.

Outstanding amounts at 30 June 2012 for the four facilities are presented in table 1.

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

– *European Financial Stability Facility (EFSF[8])/ European Stability Mechanism (ESM[9])* guaranteed by participating Member States, on a pro-rata basis, and

– *the Greek Loan Facility[10]* which is financed via bilateral loans from the other euro area Member States, centrally administered by the Commission.

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7 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 a comprehensive report on the functioning of the Fund, see COM(2012)399 final and the accompanying Staff Working Document (SWD(2012)217 final).

8 About EFSF: http://www.efsf.europa.eu

9 About ESM: http://www.esm.europa.eu

3.5. Budget guarantee for EIB external financing

Under the 2007-2013 external mandate, the loan signatures increased by 3% during the first semester 2012 and amounted to EUR 605 million. The amount of loans disbursed was EUR 1,065 million. Thus, the cumulative amount of loans disbursed under the mandate reached EUR 9,626 million at 30 June 2012, up by 12.5% compared to 31 December 2011.

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.

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):

– "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[11].

– The budgetary approach defined as "the annual risk borne by the 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[12].

4.2. 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 government financing needs.

As a consequence the composition of risk has changed. At 30 June 2012:

- 73% of the total outstanding amount guaranteed concerns borrowing operations linked to loans to Member States which are directly covered by the Budget (compared to 45% at 31.12.2010).

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10 The Greek Loan Facility - ECFIN - European Commission: http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm

11 See Table 1 of the Report.

12 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 also Tables 2 and 3 of the Report and Table A2 of the SWD).

The total risk covered by the Budget at 30 June 2012 is presented in the following table 1.

Table 1: Total outstanding amounts covered by the Budget at 30 June 2012 in EUR million

	Outstanding Capital	**Accrued Interest**	**Total**	**%**
Member States*				
MFA	25	0	25	<1%
Euratom	393	2	395	1%
BOP	11,400	145	11,545	15%
EIB* **	2,838	24	2,862	4%
EFSM	38,500	444	38,944	52%
Sub-total Member States	53,156	615	53,771	73%
Third Countries**				
MFA	585	21	606	1%
Euratom	41	0	41	<1%
EIB* **	21,205	171	21,376	26%
Sub-total third countries	21,831	192	22,024	27%
Total	**74,987**	**808**	**75,795**	**100%**

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

** This risk is covered by the Fund.

***About 82% of EIB lending operations (sovereign and sub-sovereign lending operations) are covered by a comprehensive guarantee while on the remaining operations the EIB benefits from a political risk coverage only.

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 continued to increase mainly because of the amounts granted under the EFSM.

4.3. Annual risk covered by the Budget

For the second semester 2012, the Budget may cover (directly and via the Fund) EUR 1,871 million[13] representing the amounts (capital and interests) which fall due during this period. Table A2 of the SWD provides details on the weight of each country in the total risk covered.

4.3.1. Risk linked to Member States

The risk linked to Member States concerns:

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

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

(c) the loans granted under the EFSM scheme.

[13] Representing the amounts due for the last semester 2012 (out of the total outstanding at 30 June 2012) and assuming that defaulting loans are not accelerated (for details see Table A2 in SWD).

Table 2: Ranking of the Member States according to the maximum risk borne by the Budget for the 2nd semester 2012 (EUR million)

Ranking	Country	Loans	Maximum risk	Weight of the country vis-à-vis total risk of Member States (MS)	Weight of the country vis a vis total risk (MS and non-MS)
1	Portugal	c)	207.6	25.9%	11.1%
2	Ireland	c)	192.7	24.0%	10.3%
3	Romania	a)+b)	160.4	20.0%	8.6%
4	Hungary	a)+b)	79.0	9.9%	4.2%
5	Bulgaria	a)	43.4	5.4%	2.3%
6	Poland	a)	40.2	5.0%	2.2%
7	Czech Republic	a)	35.1	4.6%	1.9%
8	Slovak Republic	a)	22.1	2.8%	1.2%
9	Latvia	a)+b)	8.5	1.1%	0.5%
10	Slovenia	a)	5.7	0.7%	0.3%
11	Cyprus	a)	3.9	0.5%	0.2%
12	Lithuania	a)	2.6	0.3%	0.1%
13	Malta	a)	0.4	0.0%	0.0%
Total			801.5	100%	42.8%

4.3.2. Risk linked to third countries

The Fund covers guaranteed loans to third countries with maturities extending up to 2042. The Fund will bear a maximum annual risk related to third countries of EUR 1,070 million (57% of the total annual risk).

The top ten countries (out of forty-six) are ranked below according to their total outstanding. They account for EUR 841 million or 78.6% of the annual risk 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.

The risk linked to third countries concerns EIB lending and/or MFA and/or Euratom loans (details are included in table A3b and A4 of the SWD).

Table 3: Ranking of the **10 most important third countries** according to the maximum risk borne by the Fund for the 2nd semester 2012 (EUR million).

Ranking	Country	Maximum risk	Weight of the country vis-à-vis total risk of third countries	Weight of the country vis-à-vis total risk (MS and non-MS)
1	Turkey	249.4	23.3%	13.3%
2	Serbia	103.1	9.6%	5.5%
3	Tunisia	96.8	9.1%	5.2%
4	Egypt	95.8	9.0%	5.1%
5	Morocco	93.4	8.7%	5.0%
6	South Africa	57.5	5.4%	3.1%
7	Lebanon	48.8	4.6%	2.6%
8	Syria	41.5	3.9%	2.2%
9	Bosnia and Herzegovina	28.0	2.6%	1.5%
10	Jordan	26.8	2.5%	1.4%
Total of the 10		841.1	78.6%	45.0%

4.4. Evolution of risk

The level of uncertainty remains high as the global economic and financial crisis continues to affect the economic recovery in the EU and the global growth. Geopolitical tensions affecting some Southern Mediterranean countries added also uncertainty on the economic recovery in certain third countries.

- *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 in January and May 2009 to help Latvia and Romania to restore market confidence for a total commitment of EUR 14.6 billion. EUR 1.2 billion will not be disbursed as the deadline for disbursement has expired.

In addition to the EUR 5 billion of BOP assistance for Romania already provided, the Council decided on 12 May 2011 to provide precautionary financial assistance for this country of up to EUR 1.4 billion[14] of which no disbursements has been made yet.

The BOP facility with its overall ceiling of EUR 50 billion has a remaining capacity of EUR 37.2 billion EUR to provide further BOP assistance if required.

- *European Financial Stabilisation Mechanism (EFSM)*

Tensions in the sovereign bond markets remained high during the first semester 2012. Issuing conditions for peripheral euro-area sovereigns remain stressed despite the activation of the EFSM - supplemented by bilateral loans - and the EFSF. The successful fulfiment of the increased refinancing needs of Member States' governments in the coming months and years will remain challenging.

The Ecofin Council conclusions set the maximum volume of the mechanism to EUR 60 billion[15], 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[16].

Following the Council decisions to grant Union financial assistance to Ireland[17] and Portugal[18], disbursements reach EUR 18.4 billion to Ireland and EUR 20.1 billion to Portugal.

Out of its maximum volume of EUR 60 billion, the EFSM has - at 30 June 2012 - a remaining capacity of EUR 21.5 billion to provide further assistance if required[19] .

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[14] Council Decision 2011/288/EU of 12 May 2011 providing precautionary EU medium-term financial assistance for Romania (OJ L 132, 19.5.2011, p.15).

[15] 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)

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

[17] Council Implementing Decision 2011/77/EU of 7 December 2011 on granting Union financial assistance to Ireland (OJ L 30, 4.2.2011, p348).

[18] Council Implementing Decision 2011/344/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 159, 17.6.2011, p.88) and Corrigendum Council Implementing Decision of 17 May 2011 on granting Union financial assistance to Portugal (OJ L 178, 10.7.2012, p.15)..

[19] For further information on EFSM, see also the report from the Commission on borrowing and lending activities of the European Union in 2011, COM(2012)419.

- *Macro-financial assistance loans*

Following the entry into force of the Lisbon Treaty, MFA decisions are no longre taken by the Council alone, but in accordance with the ordinary legislative procedure (co-decision). A new legislative proposal for a MFA Framework Regulation has been adopted by the Commission on 4.7.2011 to improve the decision–making process under the Lisbon Treaty[20].

Under the proposed Framework Regulation, the procedure for MFA would become similar to that of other external financing instruments, whereby the Commission would have competence for adopting decisions granting MFA under the supervision of a committee of Member States representatives in accordance with the examination procedure introduced by the new comitology rules, which entered into force on 1 March 2011[21]. The Parliament and the Council continued discussions on the proposed Regulation in 2012, including on the procedure for the MFA decision-making.

- *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 rouhgly EUR 600 million could be used for financing new projects.

- *EIB loans*

Under the EIB general mandate covering the period 2007-2013 a total amount of EUR 19,998 million had been signed at 30 June 2012, of which EUR 9,626 million had been disbursed at that date (see Table A6 of the SWD). For more information on the countries covered by the EIB mandates, see Tables A1 and A2 of the SWD.

The EIB started experiencing defaults on certain interests payments and loan repayments from the Syrian Government as of end of 2011 (see paragraph 5.3 below).

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[22].

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20 COM(2011) 396 final – 2011/0176 (COD) of 4.7.2011.

21 Regulation (EU) 182/2011 of the European Parliament and of the Council laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13), which replaces Council Decision 1999/468/EC.

22 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).

5.2. Payments from the Budget

As no defaults from Member States were recorded during the first half of 2012 , no appropriation was requested under the p.m. lines of Article 01 04 01 of the Budget "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 request[23].

The EIB experienced defaults on certain interest payments and loan repayments from the Syrian Government. Since official payment requests have remained unsuccessful, the EIB has called the Guarantee Fund in May 2012 for the payment of EUR 15.5 million corresponding to non payments due in November and December 2011. This amount was withdrawn from the Guarantee Fund account in August 2012. Three other payment requests for unpaid loans by the Syrian Government have been sent for EUR 8,6 million, EUR 2,6 million and EUR 15,4 million to be paid by the Fund to the Bank respectively in November 2012, January and February 2013. In the meantime, EUR 2,1 million have been recovered by the Bank. Unless the country situation improves, further calls are to be expected.

The total capital outstanding of guaranteed loans related to Syria amounts to EUR 551 million, with the last loan maturity in 2030. In conformity with the Guarantee Agreements, when the EU has made a payment under the EU Guarantee, it subrogates into the right and remedies of the EIB. Recovery proceedings are to be undertaken by the EIB in respect of the subrogated sums.

6. GUARANTEE FUND FOR EXTERNAL ACTIONS

6.1. Recoveries[24]

At 30 June 2012, the Fund had no arrears to recover, since no payments have been made.

6.2. Assets

At 30 June 2012, the net assets[25] of the Fund amounted to EUR 1,839,956,496.39.

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[23] Since its inception in 1994, the Fund has been called for a cumulative amount of EUR 493 million. For more details, see Section 2.5.3 of the SWD.

[24] Since its inception in 1994, the total recoveries by the Fund have amounted to EUR 576 million (it includes the amount of capital and interest repaid, plus penalties interests for late payments, plus exchange rate gains and losses realized).

[25] Total assets of the Fund minus accrued payables (EIB fees and audit fees).

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. At 31 December 2011, the ratio between the Fund's resources (EUR 1,755.43 million) and the outstanding capital liabilities[26] (EUR 21,234.34 million) within the meaning of the Fund Regulation were lower than the target amount. Consequently, a provisioning of EUR 155,66 million was inserted in the preliminary Budget of 2013.

In February 2012, the Budget paid EUR 260,17 million to the Fund as provisionned in the preliminary draft Budget of 2012 and in accordance with the rules of the Fund Regulation (the 9% target amount).

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

7.1. Objectives

The previous sections of this report provided information on quantitative aspects of the risk borne by the Budget, relating to third countries. Section 3 of the SWD, provides a macroeconomic analysis of the third countries to which the Budget has the largest exposure, or which benefit from the EU lending facilities (MFA and Euratom loans).

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 3 of the SWD for the countries having the highest credit risk and exposure to the Budget (MFA and Euratom loans included) at 30 June 2012.

[26] Including accrued interests.