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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on guarantees covered by the general budget
Situation at 31 December 2013

{SWD(2014) 269 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 in conjunction with the Bretton Woods institutions, 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

[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(2013)871 final and SWD(2013)504 final make up the previous report on the guarantees covered by the Budget at 31 December 2012.

[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, the Euratom loans and MFA loans to third countries have since 1994 been covered by the Fund, while BOP and EFSM loans 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.

<u>Other crisis management mechanisms which are not covered by the EU budget</u>

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 following the decisions taken on 9 May 2010 within the framework of the Ecofin Council. The EFSF’s mandate is to safeguard financial stability in Europe by providing financial assistance to euro area Member States within the framework of a macroeconomic adjustment programme. The EFSF was created as a temporary rescue mechanism and is a lender 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 Table A4 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(2013)661 final and the accompanying Staff Working Document (SWD(2012)217 final).

[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]. In October 2010, it was decided to create a permanent rescue mechanism, the European Stability Mechanism,

- *European Stability Mechanism (ESM)*[13]: The ESM Treaty entered into force on 27 September 2012. From this date onwards, the ESM became a permanent crisis mechanism and the main instrument to finance new programmes. In parallel to the ESM, the EFSF continues with its ongoing programmes for Greece, Portugal and Ireland but is no longer engaged in new financing programmes or loan facility agreements since 1 July 2013. The ESM is an intergovernmental organization under public international law, based in Luxembourg. Its shareholders are the 18 euro area Member States. The total subscribed capital is €702 billion of which paid-in capital is EUR 80 billion (the last of 5 tranches is due to be paid by first half of 2014) and committed callable capital is EUR 622 billion. Its effective lending capacity is EUR 500 billion.

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.

3.1. Operations managed directly by the Commission

3.1.1. European Financial Stabilisation Mechanism

The Ecofin Council conclusions set the maximum volume of the mechanism to EUR 60 billion[14], with the legal limit being provided in Article 2(2) of Council Regulation No 407/2010, which limits the outstanding amount to the margin available under the own resources ceiling.

Following the Council decisions to grant Union financial assistance to Ireland[15] (up to EUR 22.5 billion) and Portugal[16] (up to EUR 26 billion), disbursements reached EUR 21.7 billion to Ireland and EUR 22.1 billion to Portugal.

<u>Developments during 2013</u>

No new operations took place in 2013.

At 31 December 2013, the EFSM had a remaining capacity of EUR 11.5 billion, out of its maximum volume of EUR 60 billion, to provide further assistance, if required[17].

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12 The loans granted under the EU/EFSM are guaranteed by the EU budget.

13 About the ESM : http://esm.europa.eu.

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

16 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).

17 For further information on EFSM, see also the report from the Commission on borrowing and lending activities of the European Union in 2012 (COM(2013)752 final).

Developments subsequent to 31 December 2013

In March 2014, the final tranche of EUR 800 million was disbursed to Ireland, closing the maximum loan capacity for the country. An additional tranche of EUR 1.8 billion was disbursed at the same time to Portugal.

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

Developments during 2013

As regards Romania, in addition to the EUR 5 billion assistance already provided, the Council decided on 12 May 2011 to provide precautionary financial assistance for this country up to EUR 1.4 billion[18]. However, no disbursements were required and the Facility expired on 31 March 2013.

On 22 October 2013, the Council decided to make available to Romania a second precautionary medium-term financial assistance[19] amounting to a maximum of EUR 2 billion in the form of a loan with a maximum average maturity of 8 years. Funds can be requested until 30 September 2015.

At 31 December 2013, the BOP facility had a remaining capacity of EUR 36.6 billion, out of an overall ceiling of EUR 50 billion, to provide further assistance if required.

Developments subsequent to 31 December 2013

No further operations were put in place.

3.1.3. Macro-financial assistance loans

Following the entry into force of the Lisbon Treaty, MFA decisions are no longer taken by the Council alone, but in accordance with the ordinary legislative procedure.

Developments during 2013

There was only one disbursement of EUR 100 million to Bosnia and Herzegovina (BiH) during this period. EUR 80.9 million was repaid by the beneficiary countries (Romania EUR 12.5 million, BiH EUR 4 million, fYRoM EUR 7.4 million, Serbia EUR 44.76 million, Montenegro EUR 0.24 million and Tajikistan EUR 12 million).

[18] 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).

[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).

The outstanding amount of MFA loans has increased from EUR 545.5 million to EUR 564.6 million in 2013.

Developments subsequent to 31 December 2013

The MFA assistance to Ukraine approved in 2010[20] together with the funds available from assistance approved in 2002[21] amounts to EUR 610 million in loans. Of this amount, the first tranche of EUR 100 million was disbursed mid-May 2014.

On 14 April 2014, the Council decided further MFA loans to Ukraine[22] for a maximum amount of EUR 1 billion. The first tranche (EUR 500 million) was disbursed in June 2014.

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 billion of which around 85% has already been used. The remaining roughly EUR 600 million could be used for financing new projects. A loan of EUR 300 million to Ukraine dedicated to the upgrade of existing nuclear facilities was signed on 7 August 2013.

Developments during 2013

No loan disbursements took place in 2013. Repaid amounts consisted of EUR 19.81 million from Bulgaria, EUR 10 million from Romania and EUR 6.61 million from Ukraine.

Developments subsequent to 31 December 2013

No further developments.

3.2. Evolution of the EIB external financing operations

Developments during 2013

The EU guarantee to the EIB for EIB external financing covering the period 2007-2013 ("the 2007-2013 external mandate") was extended by six months 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.

Defaults on interests payments and loan repayments from the Syrian Government continued in 2013. The EIB has called on the Guarantee Fund to cover these defaults (see paragraph 5.3 below).

[20] 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).

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

[22] 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).

Under the 2007-2013 external mandate, the loan signatures increased by 17% in 2013 and amounted to EUR 3,901 million. The amount of loans disbursed was EUR 2,288 million (+ 20% compared to 31 December 2012). Thus, the cumulative amount of loans signed and loans disbursed under the mandate reached - respectively - EUR 27,062 million and EUR 13,590 million at 31 December 2013. For previous EIB external mandates, see Annex to Table A1 of the SWD.

Developments subsequent to 31 December 2013

The new Decision granting an EU guarantee for EIB operations outside the Union for the period 2014-2020[23] 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 billion and an optional additional amount of EUR 3 billion. Activation, in whole or in part, of the optional additional amount will be decided in accordance with the ordinary legislative procedure on the basis of the mid-term review reporting of the implementation by the EIB of the Decision and the evolution of EIB operations. In parallel, a new Guarantee Agreement is in the process of being agreed as required by Article 14 of the Decision.

Outstanding amounts at 31 December 2013 for the various facilities referred 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[24].

– 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[25].

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

23 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).
24 See Table 1 of the Report.
25 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 3a/3b of the report and Table A2 of the SWD).

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 2013:

- 71% of the total outstanding amount concerns borrowing operations linked to loans to Member States which are directly covered by the EU budget (compared to 45% at 31.12.2010).

Detailed breakdown of the risk covered by the EU budget at 31 December 2013 is presented in Table 1.

Table 1: Total outstanding amounts covered by the EU budget at 31 December 2013 in EUR million

	Outstanding Capital	**Accrued Interest**	**Total**	**%**
Member States*				
Euratom	357	2	359	<1%
BOP	11,400	223	11,623	14%
EIB	2,657	22	2,676	3%
EFSM	43,800	669	44,469	54%
Sub-total Member States	58,214	916	59,130	71%
Third Countries**				
MFA	565	5	569	1%
Euratom	29	0	29	<1%
EIB***	22,917	155	23,072	28%
Sub-total third countries	23,510	160	23,670	29%
Total	**81,724**	**1,076**	**82,799**	**100%**

* This risk is directly covered by the EU 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.

***Loans subrogated to the EU following Syria defaults on EIB loans are included (amount: EUR 60 million).

Tables A1, A2, A3a and A3b of the SWD provide more detailed information on these outstanding amounts, in particular in terms of ceiling, disbursed amounts or guarantee rates.

4.3. Annual risk covered by the EU budget

For 2014, 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 7,395 million. This represents the capital and interest payments from guaranteed loans falling due during 2014, assuming that defaulting loans are not accelerated (for details see Table A2 in SWD).

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.

Table 2: Ranking of the Member States according to the annual risk borne by the EU budget in 2014 (EUR million)

Ranking	Country	Loans	Max annual risk	Weight of the country vis-à-vis annual risk of Member States (MS)	Weight of the country vis-à-vis total annual risk (MS and non-MS)
1	Hungary	a)+b)	2,128.42	41.0%	28.8%
2	Latvia	a)+b)	1,096.43	21.1%	14.8%
3	Ireland	c)	661.00	12.7%	8.9%
4	Portugal	c)	644.88	12.4%	8.7%
5	Romania	a)+b)	377.02	7.3%	5.1%
6	Bulgaria	a)	87.52	1.7%	1.2%
7	Czech Republic	a)	56.44	1.1%	0.8%
8	Poland	a)	52.49	1.0%	0.7%
9	Croatia	a)	42.62	0.8%	0.6%
10	Slovak Republic	a)	25.78	0.5%	0.3%
11	Slovenia	a)	7.44	0.1%	0.1%
12	Lithuania	a)	4.95	0.1%	0.1%
13	Cyprus	a)	3.29	0.1%	<0.1%
Total			5,188.29	100%	70.2%

4.3.2. Risk linked to third countries

The Fund covers guaranteed loans to third countries with maturities extending up to 2042. In 2014, the Fund will bear a maximum annual risk related to third countries of EUR 2,206.6 million (30% of the total annual risk).

The top ten countries (out of forty-two) are ranked below according to their total outstanding. They account for EUR 1,684 million or 76.3% 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 annual risk borne by the EU budget in 2014 (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	542.67	24.6%	7.3%
2	Tunisia	221.59	10.0%	3.0%
3	Morocco	217.77	9.9%	2.9%
4	Serbia	195.00	8.8%	2.6%
5	Egypt	184.11	8.3%	2.5%
6	Brazil	102.45	4.6%	1.4%
7	South Africa	74.51	4.6%	1.4%
8	Syria	72.52	3.3%	1.0%
9	Bosnia and Herzegovina	63.24	2.9%	0.9%
10	Ukraine	10.61	0.5%	0.1%
	Total of the 10	1,684.47	76.3%	22.8%

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[26]. This did not happen in 2013.

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 were recorded during the year 2013, 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[27].

The EIB experienced defaults on certain interest payments and loan repayments from the Syrian Government from December 2011. 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 right and remedies of the EIB. Recovery proceedings are undertaken by the EIB on behalf of the EU in respect of the subrogated sums.

[26] 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).

[27] Since its inception in 1994 and as at the reporting date, the Fund has been called for a cumulative amount of EUR 502 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[28]	Total
2012	2	24.02	n.a.	2.15	21.87
2013	8	59.27	1.36	0	60.63
Total	10	83.29	1.36	2.15	82.50

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

At 31 December 2013, the total capital outstanding of guaranteed loans related to Syria amounts to EUR 554 million, with the last loan maturity in 2030.

5.2. Evolution of the Fund

In accordance with the rules of 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 155.66 million to the Fund in February 2013, while in February 2014, the respective payment amounted to EUR 58.43 million.

At 31 December 2013, the net assets[29] of the Fund amounted to EUR 1,981.29 million. The ratio between the net assets and the outstanding capital liabilities[30] (EUR 23,609.19 million), within the meaning of the Guarantee Fund Regulation, was lower than the target amount. Consequently, a provisioning of EUR 144.40 million was inserted in the preliminary EU budget of 2015.

At 31 December 2013, the Fund had EUR 82.5 million arrears to recover.

[28] Since its inception in 1994, the total recoveries by the Fund at the reporting date have amounted to EUR 579 million (this includes the amount of capital and interest repaid, plus penalties interests for late payments, plus exchange rate gains and losses realized).

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

[30] Including accrued interests.