COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.7.2009
COM(2009) 398 final

REPORT FROM THE COMMISSION

to the budgetary authority on guarantees covered by the general budget Situation at 31 December 2008

{SEC(2009) 1063}

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1. INTRODUCTION AND TYPES OF COVERED OPERATIONS

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

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 Communities with macroeconomic objectives, i.e. macro-financial assistance[3] ("MFA") loans to third countries and in conjunction with the Bretton Woods institutions, balance-of-payments ("BOP") loans granting support to non-EMU Member States grappling with transitional difficulties; and

– loans with microeconomic objectives (Euratom loans and most importantly European Investment Bank ("EIB") external financing[4]). These operations have been covered since 1994 by the Guarantee Fund for external actions ("the Fund")[5] which was set up, among other things, to limit the budgetary impact stemming from calls on guarantees given by the Budget for lending operations in third countries (if a third country has become a Member State the risk is directly born by the Budget). If there are insufficient resources in the Fund, recourse will be made to the Budget.

The Council Regulation establishing the Fund (the "Fund Regulation"[6]), which was adopted in 1994, was first amended in 1999. Following a second amendment of the Council Regulation in 2004, the Fund's coverage is withdrawn if third countries become Member States. In 2007, an amendment[7] of the Council Regulation set up a new provisioning mechanism. The Budget directly covers loans to Member States granted or guaranteed by the Community.

2. EVENTS SINCE THE LAST REPORT AT 30 JUNE 2008

There were no disbursements under macro financial assistance during the second half of 2008.
A new disbursement of USD 22 million for a Euratom loan took place in October 2008.
A first tranche of EUR 2 000 million of the Balance of Payments loan granted to Hungary was disbursed in December 2008 (see section 3.5).

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[1] COM(2009)68 and SEC(2009)159 make up the previous report on the guarantees covered by the Budget at 30 June 2008.

[2] SEC(2009)1063.

[3] MFA may also take the form of grants to third countries. For more information on MFA, see the Commission report COM(2008)590 and SEC(2008)2504.

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

[5] For the most recent report on the functioning of the Fund, see COM(2006)695 "Comprehensive Report on the functioning of the Guarantee Fund" and the accompanying staff working document (SEC(2006)1460).

[6] Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions, (OJ L 293, 12.11.1994, p.1).

[7] Council Regulation (EC, Euratom) No 89/2007 of 30 January 2007, (OJ L 22, 31.01.2007, p.1).

Regarding EIB financing operations, a total amount of EUR 5 943 million had been signed by the EIB under the general mandate 2007-2013 (Council Decision 2006/1016/EC). Concerning the disbursement volume, an amount of EUR 2 052 million was disbursed during the second half of 2008 of which EUR 643 million was disbursed under the new general mandate 2007-2013.

It should be noted that, following an action undertaken by the Parliament, on 6 November 2008 the Court of Justice annulled Council Decision 2006/1016/EC on the grounds that it should have been adopted under a dual legal basis. The Court, while annulling the Decision, ordered "*that its effects be maintained for EIB financing arrangements entered into before the entry into force, within a period of 12 months from the date of delivery of this judgment, of a new decision adopted on the appropriate legal basis, namely Articles 179 EC and 181a EC together*". The Commission adopted a proposal to the European Parliament and the Council to replace the annulled decision on 14 January 2009 COM (910) 2008.

3. DATA ON RISKS COVERED BY THE BUDGET

3.1. Definition of risk

The risk borne by the Budget is based on the exposure assessment and 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 (68% of the total outstanding amount guaranteed as of 31 December 2008) and directly by the Budget where Member States are involved (loans to or for the benefit of projects in Member States account for the remaining 32% of the total outstanding amount guaranteed). The large proportion of guaranteed loans linked to Member States is the result of the recent enlargement rounds[8] and the activation of the Community medium-term financial assistance facility for Member States not having adopted the EUR.

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 method of calculating the total amount of capital outstanding for the operations concerned on a given date including accrued interest. This methodology gives the level of risk supported by the Budget on a given date.

– The budgetary approach defined as "the annual risk borne by the Budget" is based on the calculation of the maximum amount which the Community would have to pay out in a financial year assuming that all guaranteed loans are in default[9].

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

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

Table 1: Total outstanding amounts covered as of 31 December 2008 in EUR million

	Outstanding Capital	Accrued Interest	Total	%
Member States*				
MFA	140	2	142	1%
Euratom	433	8	440	2%
BoP	2 000	4	2 004	10%
EIB	3 921	36	3 957	19%
Sub-total Member States	6 494	50	6 544	32%
Third Countries				
MFA	514	1	515	2%
Euratom	53	7	60	<1%
EIB	13 480	129	13 609	66%
Sub-total third countries	14 047	137	14 184	68%
Total	**20 541**	**187**	**20 728**	**100%**

* This risk is directly covered by the Budget and includes Bulgaria and Romania as they have joined the EU on 01.01.2007.

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

The total outstanding amount of capital and interest covered by the budget increased by EUR 3 627 million to EUR 20 728 million compared with the situation at 30 June 2008 (see Section 3.5. below).

3.2. Risk linked to Member States

Current risks on Member States result from loans granted prior to accession and the activation of the balance of payment instrument at the end of 2008.

In 2009, the Budget will bear a maximum risk linked to Member States of EUR 802 million. Table 2 shows that Romania and Czech Republic 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 in 2009 (EUR million)			
Ranking	**Country**	**2009**	**%**
1	Romania	264.5	33.0%
2	Czech Republic	144.3	18.0%
3	Bulgaria	96.1	12.0%
4	Hungary	93.7	11.7%
5	Poland	85.8	10.7%
6	Slovak Republic	66.2	8.3%
7	Slovenia	26.2	3.3%
8	Cyprus	9.5	1.2%
9	Latvia	7.3	0.9%
10	Lithuania	6.4	0.8%
11	Estonia	1.0	0.1%
12	Malta	0.7	0.1%
	Total	801.8	100.0%

The risk on Member States concerns all loans granted before last two enlargements with the last loan maturing in 2038.

3.3. Risk linked to third countries

In 2009, the Fund will bear a maximum risk related to third countries of EUR 1 494 million. The top ten countries according to their total outstanding are listed below. They account for 79% of the risk borne by the Fund in 2009. The economic situation of these countries -as well as Montenegro, Georgia and Ukraine- 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 in 2009 (EUR million)			
Ranking	**Country**	**2009**	**% of the total maximum risk**
1	Turkey	293.4	19.6%
2	Egypt	208.7	14.0%
3	Morocco	137.1	9.2%
4	Tunisia	131.2	8.8%
5	South Africa	115.2	7.7%
6	Brazil	80.8	5.4%
7	Lebanon	70.6	4.7%
8	Serbia	57.0	3.8%
9	Jordan	45.8	3.1%
10	Syria	35.6	2.4%
Total of the 10		1 175.3	78.7%

The Fund covers the guaranteed loans of 57 countries with maturities extending up to 2038. Details by country are provided in Table A2 of the SWD.

3.4. Global risk covered by the Budget

In total, the Budget will cover in 2009 an amount of EUR 2 296 million representing the amounts due during this period, of which 35% are due by Member States (see Table A2 in the SWD).

3.5. Evolution of risk

- Balance of payments facility

The total risk towards Member States increased in 2008 with the activation of the Community medium-term financial assistance facility (balance of payments facility, BOP). This financial facility enables loans to be granted to one or more Member States which have not yet adopted the euro and which are experiencing, or are seriously threatened with, difficulties in their balance of payments.

On 2 December 2008[10], the ceiling for the maximum amount of loans being granted to non Euro-area Member States under the BOP facility was increased from EUR 12 billion to EUR 25 billion.

A first loan for Hungary of EUR 6 500 million was granted and signed in the second semester 2008[11]. One tranche of EUR 2 000 million was disbursed in December 2008. Another tranche of EUR 2 000 million was disbursed in March 2009. Two additional tranches are planned to be disbursed during the year 2009 for a total amount of EUR 2 500 million.

A second loan to Latvia was granted in early 2009[12] for up to EUR 3 100 million. The loan will be disbursed in several tranches in 2009.

On 18 May 2009[13], the limit on the outstanding amount to be granted to the Member States outside the euro area was increased from EUR 25 billion to EUR 50 billion.

- Macro-financial assistance loans

MFA loans to third countries are subject to individual decisions by the Council. The financial assistance granted under Council Decision 2007/860/EC of 10 December 2007 providing macro-financial assistance to Lebanon consists of EUR 50 million in loans and up to EUR 30 million in grants. The loan part will be disbursed in two equal tranches in 2009.

- Euratom loans

The Euratom lending to Member States or in certain eligible non-member countries (Russian Federation, Armenia, Ukraine) has a ceiling of EUR 4 billion of which around 85% have already been used. The remaining margin is about EUR 600 million. Under the existing loan agreement of 2004 to Energoatom in Ukraine (EUR equivalent of USD 83 million Loan Facility Agreement), a new tranche of USD 22 million was disbursed on 10 October 2008.

- EIB loans

The previous general mandate to the EIB expired on 31 July 2007. At this date, contracts corresponding to a total 98% of the overall ceiling under this mandate (EUR 20 060 million – see Table A5 of the SWD) had been signed. At 31 December 2008, a total amount of EUR 5 307 million remained to be disbursed under this mandate and should be disbursed within 10 years from the end of the mandate, as the guarantee of the Community lapses at the end of this period[14].

The most important item that will impact the risk for the Budget in future is the Community guarantee granted to the EIB under the general mandate 2007-2013. The Community

10 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' balance of payments.

11 Council Decision 09/102/EC of 4 November 2008.

12 Council Decision 09/290/EC of 20 January 2009.

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

14 See Article 1.06 of the Restated and Amended Guarantee Agreement signed between the EC and the EIB on 30 August/2 September 2005.

guarantee is restricted to 65% of the aggregate amount of credit 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[15]. A total amount of EUR 5 943 million had been signed at 31 December 2008 under this mandate, of which EUR 5 053 million was undisbursed at that date (see Table A6 of the SWD).

4. DEFAULTS, ACTIVATION OF BUDGET GUARANTEES AND ARREARS

4.1. Payments from cash resources

The Commission draws on its cash resources in order to avoid delays and resulting costs in servicing its borrowing operations when a debtor is late in paying the Commission[16].

4.2. Payments from the Budget

No appropriation was requested under Budget Article 01 04 01, "European Community guarantees for lending operations", as no default was recorded in the second half of 2008.

4.3. Activation of the Guarantee Fund for external actions

In the event of late payment by the beneficiary of a loan (third countries) granted or guaranteed by the Community, the Fund is called on to cover the default within three months of the date on which payment is due.[17]

During the second half of 2008, the Fund was not called.

5. GUARANTEE FUND FOR EXTERNAL ACTIONS

5.1. Recoveries

A recovery of USD 1 448 433.44 penalty interests from the Republic of Argentina took place on 12 December 2008.

As of 31 December 2008, the Fund had no arrears to recover.

5.2. Assets

At 31 December 2008, the net assets[18] of the Fund amounted to EUR 1 182 717 413.

5.3. Target amount

The Fund has to reach an appropriate level (target amount) set at 9% of the total outstanding capital liabilities arising from each operation, plus accrued interest. The ratio between the

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15 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 to be decided upon by the Council.

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

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

18 Total asset of the Fund minus accrued payables (EIB fees and Audit fees).

Fund's resources (EUR 1 182 717 413) and outstanding capital liabilities[19] (EUR 14 183 712 379) within the meaning of the Fund Regulation has slightly increased from 8.29% at 30 June 2008 to 8.34% at 31 December 2008.

At year-end 2008, the Fund resources were lower than the target amount. According to the new provisioning rules adopted by the Council on 30 January 2007[20], a provisioning of EUR 93 100 000 was inserted in the Preliminary Draft Budget of 2010. This amount will be transferred from the Budget to the Fund in January 2010.

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

6.1. Objectives

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

6.2. Risk assessment methods

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

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

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19 Including accrued interests.

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