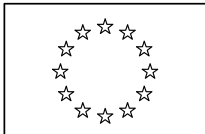

EUROPEAN COMMISSION

Brussels, 20.2.2012
COM(2012) 66 final

# REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

## on guarantees covered by the general budget
## Situation at 30 June 2011

{SWD(2012) 15 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 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 BUDGET

The risks covered by the budget of the European Union Budget (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 Member States experiencing difficulties 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")[5] that are covered by EU guarantees[6].

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"),[7] while BoP and EFSM loans are directly covered by the Budget.

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1 COM(2011)528 and SEC(2011)1011 make up the previous report on the guarantees covered by the Budget at 31 December 2010.

2 MFA may also take the form of grants to third countries. For more information on MFA, see Commission report COM(2011)408 and SEC(2011)874.

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

4 The EFSM was 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). It functions in a similar way as the Balance of Payments facility but is available to all Member States, i.e. including Euro area Member States.

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

6 At 30.6.2011 the guarantee was covering the period 1 February 2007—31 October 2011 in line with 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. In the meantime the period has been extended to 31.12.2013 by Decision 1080/2011/EU of the European Parliament and of the Council of 25 October 2011 (OJ L 280, 27.10.2011, p. 1).

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).

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

– 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 non-member 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 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, the Budget will have to provide the necessary funds.

## 3. EVENTS SINCE THE LAST REPORT AT 31 DECEMBER 2010

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

During the first semester 2011, two operations took place for a total amount of EUR 1.35 billion. The fourth instalment of EUR 1.2 billion of the loan granted to Romania was disbursed on 24 March 2011. On 22 June 2011 the fifth instalment of EUR 0.15 billion of the loan granted to Romania was disbursed.

Furthermore, the Council decided on 12 May 2011 to provide precautionary EU medium-term financial assistance for Romania amounting to a maximum of EUR 1.4 billion[9].

### 3.2. Macro-financial assistance

During the first semester 2011, no loan disbursement took place.

### 3.3. Euratom

No loan disbursements took place during the reported period.

### 3.4. European Financial Stabilisation Mechanism

- Background

Council Regulation (EU) No 407/2010 of 11 May 2010 set up the European Financial Stabilisation Mechanism (hereafter referred to as the EFSM) based on Art.122(2)[10] of the Treaty on the Functioning of the European Union (TFEU). The maximum available amount

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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(2010)418 and the accompanying Staff Working Document (SEC(2010)968).

[9] Council Decision (2011/288/EU) of 12 May 2011 providing precautionary EU medium-term financial assistance for Romania (OJ L 132 of 19.05.2011, p.15).

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

under the mechanism is EUR 60 billion with the full backing of the Budget which guarantees the repayment of the borrowings in case of default of the Member State concerned.

Union financial assistance under EFSM takes the form of a loan, or of a credit line, granted to the Member State concerned. To this end, the Commission is empowered, on behalf of the European Union, to contract borrowings on the capital markets.

- New operation since 31.12.2010

On 30 May 2011, the Council decided to grant Union financial assistance to Portugal for a maximum amount of EUR 26 billion under EFSM in the context of a three-year joint EU/IMF programme amounting to EUR 78 billion. This decision comes in addition to the Decision taken by the Council in December 2010 to grant Union financial assistance to Ireland for a maximum amount of EUR 22.5 billion under the EFSM.

In total EUR 48.5 billion were granted under the EFSM programme (for addititional details on these operations see paragraph 4.4 Evolution of risk).

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

– *European Financial Stability Facility (EFSF[11])* which is guaranted by participating Member States, on a pro-rata basis, and

– *the Greek Loan Facility*[12] which is financed via bilateral loans from the other euro area Member States, centrally pooled by the Commission.

### 3.5. Budget guarantee for EIB external financing

Under the 2007-2013 external mandate, the loan signature increased by 7% during the first semester of 2011 and amounted to EUR 1,090 million. The amount of loans disbursed was EUR 1,050 million for the reported period. Thus, the *cumulative* amount of loans disbursed under the mandate reached the amount of EUR 7,028 million at 30 June 2011, up by 17% compared to 31 December 2010.

## 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[13].

[11] About EFSF: http://www.efsf.europa.eu/about/index.htm

[12] The Greek Loan Facility - ECFIN - European Commission: http://ec.europa.eu/economy_finance/eu_borrower/greek_loan_facility/index_en.htm

– 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[14].

## 4.2. Risk composition

Until 2010 the maximum risk in terms of total outstanding amounts covered was mainly linked to the operations granted to third countries. In 2011 the financial crisis has impacted heavily on the public finances of 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 as of 30 June 2011:

- 64% of the total outstanding amount guaranteed concerned borrowing operations linked to loans to Member States which are directly covered by the Budget.

- 36% of the total outstanding amount guaranteed relates to borrowings and loans in third countries which are covered by the Guarantee Fund for external actions ("the Fund").

[13] See Table 1 of the Report.

[14] 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 2011 is presented in the following table 1.

Table 1: Total outstanding amounts covered by the Budget at 30 June 2011 in EUR million

| | **Outstanding Capital** | **Accrued Interest** | **Total** | **%** |
|---|---|---|---|---|
| **Member States*** | | | | |
| **MFA** | 38 | 0 | 38 | <1% |
| **Euratom** | 410 | 2 | 412 | 1% |
| **BoP** | 13,400 | 177 | 13,577 | 25% |
| **EIB***** | 3,061 | 28 | 3,088 | 6% |
| **EFSM** | 17,900 | 113 | 18,013 | 33% |
| **Sub-total Member States** | 34,808 | 320 | 35,129 | 64% |
| **Third Countries**** | | | | |
| **MFA** | 460 | 3 | 462 | 1% |
| **Euratom** | 45 | 0 | 45 | <1% |
| **EIB***** | 19,191 | 151 | 19,342 | 35% |
| **Sub-total third countries** | 19,695 | 154 | 19,849 | 36% |
| **Total** | **54,503** | **474** | **54,978** | **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.

***About 83% 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 (as of 31 December 2010).

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 significantly increased to EUR 54.98 billion up by 55% compared to 31.12.2010. This increase is explained by the disbursements of EUR 17.9 billion under the EFSM (EUR 11.4 billion to Ireland and EUR 6.5 billion to Portugal). Furthermore, EUR 1.35 billion was disbursed under the BoP facility to Romania as final instalments of Council Decision 2009/459/EC of 6 May

2009. EIB net disbursements to third countries increased by EUR 486 million during the first semester 2011.

### 4.3. Annual risk covered by the Budget

For the second semester 2011, the Budget will cover (directly and via the Fund) EUR 3.6 billion[15] representing the amounts which fall due during this period out of the total amount outstanding at 30 June 2011.

Of this, EUR 2.6 billion - approximately 73% - is due from Member States while the remaining balance is due from third countries.

[15] Representing the amounts due during the second semester 2011 (out of the total outstanings at 30 June 2011) and 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 as well as MFA and 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 shows that Hungary and Romania are ranked first and second among Member States in terms of repayments falling due in the second semester 2011.

Table 2: Ranking of the Member States according to the maximum risk borne by the Budget during the second semester 2011 (EUR million)

| **Ranking** | **Country** | **Maximum risk** | **% of the total maximum risk** |
|---|---|---|---|
| 1 | Hungary | **2,145.6** | 81.9% |
| 2 | Romania | **197.0** | 7.5% |
| 3 | Ireland | **111.7** | 4.3% |
| 4 | Poland | **40.1** | 1.5% |
| 5 | Bulgaria | **37.5** | 1.4% |
| 6 | Czech Republic | **36.7** | 1.4% |
| 7 | Slovak Republic | **26.7** | 1.0% |
| 8 | Latvia | **9.1** | 0.3% |
| 9 | Slovenia | **5.9** | 0.2% |
| 10 | Cyprus | **4.6** | 0.2% |
| 11 | Lithuania | **2.7** | 0.1% |
| 12 | Estonia | **0.5** | 0.0% |
| 13 | Malta | **0.3** | 0.0% |
| | **Total** | **2,618.4** | **100.0%** |

### *4.3.2. Risk linked to third countries*

The Fund covers guaranteed loans concerning third countries with maturities extending up to 2040. In the second semester 2011, in particular, the Fund will bear a maximum annual risk related to third countries of EUR 961 million[16] (27% of the total annual risk).

The top ten (out of fourty-four) countries are ranked below according to their total outstanding. They account for EUR 754.2 million or 78% of the annual risk borne by the Fund related to third countries. 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 maximum risk borne by the Fund during the second semester 2011 (EUR million).

| **Ranking** | **Country** | **Maximum risk** | **% of the total maximum risk** | **Euromoney credit risk ranking[17]** | |
|---|---|---|---|---|---|
| | | | | **09/2010** | **03/2011** |
| 1 | Turkey | 220.7 | 29.3% | 50/185 | 54/100 |
| 2 | Egypt | 91.7 | 12.2% | 64/185 | 88/100 |
| 3 | Morocco | 87.8 | 11.6% | 62/185 | 67/100 |
| 4 | Tunisia | 86.6 | 11.5% | 69/185 | 81/100 |
| 5 | Serbia | 75.8 | 10.1% | 70/185 | 86/100 |
| 6 | Lebanon | 54.0 | 7.2% | 76/185 | 91/100 |
| 7 | South Africa | 47.9 | 6.4% | 44/185 | 48/100 |
| 8 | Syria | 39.3 | 5.2% | 128/185 | NA |
| 9 | Bosnia and Herzegovina | 27.0 | 3.6% | 113/185 | NA |
| 10 | Brazil | 23.2 | 3.1% | 41/185 | 42/100 |
| Total of the 10 | | 754.2 | 100.0% | | |

[16] Representing the amounts due during the second semester 2011 (out of the total outstanding at 30 June 2011) and assuming that defaulting loans are not accelerated. For details see Table A2 in SWD.

[17] The higher the ranking number, the lower the creditworthiness of the country. Countries are rated on a scale of zero to 185 or to 100 (the number of countries has been reduced from 185 to 100 from January 2011). 185, respectively 100, represents the highest risk of default. A given country may improve its rating and still fall in the ranking if the average global rating for all rated countries improves.

### 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 some third countries.

- *Balance of payments facility*

The EU medium-term financial assistance under the balance of payments 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. The first loan repayment of EUR 2 billion from Hungary will take place in December 2011.

The BoP facility with its overall ceiling of EUR 50 billion has a remaining capacity of EUR 35 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 2011. Issuing conditions for peripheral euro-area sovereigns remain stressed despite the activation of the EFSM and the EFSF supplemented by bilateral loans. 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[18], 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[19].

In early 2011 Portugal came under pressure on the financial markets increasing pressure on the government debt and its servicing costs. On 7 April 2011 Portugal officially requested financial assistance from the European Union and the International Monetary Fund ('IMF')[20].

Following this request the terms and conditions of a three-year financial assistance package were agreed by the Eurogroup and the Council on 17 May 2011. The financial package will cover Portugal's financing needs for up to EUR 78 billion and will be shared equally amongst:

– The EFSM for an amount up to EUR 26 billion[21] (which is directly covered by the Budget);

– The EFSF for an amount up to EUR 26 billion;

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[18] 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)

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

[20] Council Implementing Decision n°344/2011/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 159 of 17.06.2011, p.88).

[21] On 31 May 2011, the first instalment of EUR 1.75 billion was disbursed to Portugal. Until June 2011, EUR 6.5 billion was disbursed.

– The IMF for an amount up to EUR 26 billion.

The Decision to support Portugal under the EFSM came in addition to the Decision taken in December 2010 for Ireland[22] for up to EUR 22.5 billion.

Out of its maximum volume of EUR 60 billion, the EFSM has a remaining capacity of EUR 11.5 billion to provide further assistance if required[23] .

On 21 July 2011 the Euro area summit decided several measures including the extension of maturities and the lowering of lending rates of future EFSF loans to Greece to alleviate the Greek debt crisis and ensure the financial stability of the euro area as a whole. In line with the summit conclusions, the impact on the EFSM is twofold:

a) the EFSM margin will be reduced retroactively for lending operations for Portugal and Ireland and

b) the maturities of future disbursements will be extended.

- *Macro-financial assistance loans*

MFA loans to third countries have been subject to individual decisions by the Council and since the entry into force of the Lisbon Treaty by the European Parliament and the Council. A new legislative proposal for a MFA Framework Regulation has been prepared to improve the decision–making process under the Lisbon Treaty[24].

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[25].

No MFA loans operations were implemented during the first semester 2011. Two MFA loans operations for a total amount of EUR 126 million[26] were disbursed in July 2011.

- *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 amount is about EUR 600 million and could be used for financing new projects.

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22 http://ec.europa.eu/economy_finance/eu_borrower/ireland/index_en.htm

23 For further information on EFSM, see also the report from the Commission on borrowing and lending activities of the European Union in 2010, COM(2011)485.

24 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 (codecision).

25 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.

26 EUR 26 million to Armenia and EUR 100 million to Serbia.

- *EIB loans*

Under the EIB general mandate covering the period 2007-2013 a total amount of EUR 17,691 million had been signed at 30 June 2011, of which EUR 7,180 million had been disbursed at that date (see Table A6 of the SWD).

Following the mid-term review of the EIB external mandate, the European Parliament and the Council adopted on 13 October 2011 a new Decision (n° 1080/2011/EU of 25 October 2011) granting an EU guarantee to the EIB against losses under loans and loan guarantees for projects outside the Union and repealing Decision No 633/2009/EC. The new Decision entered into force on 30 October 2011. As a consequence the aggregate amount of credits disbursed and guarantees provided under EIB Financing Operations, less amounts reimbursed plus all related sums, would be increased from EUR 25,800 million to a maximum ceiling of EUR 29,484 million[27]. The EU guarantee is restricted to 65% of the aggregate amount of credits disbursed and guarantees provided under EIB Financing Operations.

Regarding the ongoing geopolitical tensions affecting some Southern Mediterranean countries it can not be excluded that the Fund would be called to cover potential defaults on loans or loan guarantees benefitting from the EU guarantee in this geographical area (for more information on the countries covered by the EU guarantee see Tables A1 and A2 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[28].

### 5.2. Payments from the Budget

As no default was recorded during the first half of 2011, 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[29]

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[30].

The Fund was not called during the first half of 2011.

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[27] The increase by EUR 3,684 million is to be split between an additional mandate of EUR 2,000 million for financing climate change operations and EUR 1,684 million to enhance EIB risk-operations.

[28] 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).

[29] Since its inception in 1994, the Fund has been called for a cumulative amount of EUR 478 million.

[30] For more details, see Section 1.4.3 of the SWD.

## 6. GUARANTEE FUND FOR EXTERNAL ACTIONS

### 6.1. Recoveries[31]

At 30 June 2011, the Fund had no arrears to recover.

### 6.2. Assets

At 30 June 2011, the net assets[32] of the Fund amounted to EUR 1,487,416,919.

### 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 1,487,416,919) and outstanding capital liabilities[33] (EUR 19,848,481,968) within the meaning of the Fund Regulation has increased from 7.7% at 31 December 2010 to 8.8% at 30 June 2011.

At year-end 2010, the Fund resources were lower than the target amount. According to the provisioning rules of the Fund Regulation, a provisioning of EUR 260,170,000 was inserted in the preliminary Budget of 2012. This amount will be paid from the Budget to the Fund in February 2012.

## 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. This section, which is completed by the section 3 of the SWD, provides a macroeconmic analysis of the third countries having the largest exposure to the Budget 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 2011.

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[31] 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).

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

[33] Including accrued interests.