Supranational risk-taking: Assessing EU budget guarantees, EIB credit enhancements and member states' contingent liabilities

Scope Ratings

Supranational institutions support investment activities to stimulate sustainable growth and related public-policy goals whose operations rely on shareholders' capital and guarantees for funding. Their challenge is to strike the right balance between preserving capital – and thus protecting shareholders – and fulfilling their public-policy mandates, which may call for riskier lending. This report analyses the financial interdependence between EU member states, the European Commission, and the latter's guarantees on external and EFSI-related operations[1] conducted by the European Investment Bank. Overall, we find that available buffers far exceed the total risk exposure of the EU budget, shielding EU member states from possible fiscal impacts from EU guarantees. However, net buffers have been declining in recent years, especially given the increasing guarantees to EFSI.

In Europe, public institutions are looking for efficient ways to use budgetary resources to stimulate the economy. In this context, the loan portfolio of the European Investment Bank (EIB) benefits from credit enhancements provided by either its shareholders, the EU member states, or the EU budget. Since the member states backing the EU budget and the EIB's shareholders are the same sovereigns – namely, the EU-28 member states – it is important for our credit risk assessments to fully account for the direct and indirect risks faced by the member states.

We consider these risks to be accounted for if member states reflect the guarantees in either their i) debt figures, influencing our quantitative 'public finance risk' assessment, or ii) contingent liabilities, thus being captured in our qualitative assessment of a sovereign's 'debt sustainability'. However, Eurostat's accounting of member states' debt and contingent liabilities does not include the borrowings and guarantees of 'institutions and bodies of the European Union', including the European Commission (EC).

Therefore, we need to determine whether available buffers can provide protection to the EU budget directly, and thus the EU member states backing the EU budget, in the event that guarantees by the EU budget are called upon. This is important for our sovereign and supranational risk assessments, since our sovereign ratings are the starting point for our assessment of a supranational's creditworthiness.

Overall, the total annual risk borne by the EU budget via its guarantees has increased, from around EUR 3.8bn in 2012 to EUR 9.9bn at end-2018, while the disbursed EFSI-related exposure has increased to EUR 15.8bn since its inception in 2015. At the same time, assets at the EC's disposal – two guarantee funds, the cash buffer and budgetary flexibility – have hovered around EUR 75bn-90bn, mainly reflecting the cyclical nature of disbursements from structural and cohesion funds. These developments have reduced available net assets, from a peak of EUR 80bn in 2014 to around EUR 61bn in 2018.

Our analysis shows that the EU's available buffers can still mitigate the impact of any shock that can result in a guarantee call. Consequently, so long as available buffers exceed the total annual risk borne by the EU budget, member states' contingent liabilities to the EU do not increase. This could change, however, if available buffers fall short of outstanding guarantees. In such a situation, we would reassess the need to add the EU's budget guarantees to Eurostat's accounting of member state contingent liabilities. This would ensure that these risks to EU member states, including those due to the credit enhancements to the EIB via EU budget guarantees, are adequately accounted for in our sovereign and supranational risk assessments.

[1] EFSI = European Fund for Strategic Investments. Appendix I provides an explanation of several acronyms.

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Related Research

European Union and Euratom rating report
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Supranational Methodology
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Scope's supranational methodology: shareholders and credit enhancements

Supranationals are policy-oriented institutions whose shareholders mostly comprise sovereigns. Our assessment of supranationals (see Supranational Methodology) starts with the strength of its shareholders, complemented with the analysis of its operations.

Key shareholders' credit strength as starting point for supranational analysis

We determine an indicative rating of a supranational via a quantitative analysis of its 'key shareholder rating'. Key shareholders include governments that influence and determine the supranational's decisions and are therefore more likely to support the institution's capacity to fund obligations. We define key shareholders as those whose cumulative capital share, starting with the largest shareholder, comprises at least 75% of the supranational's capital. We use the average capital-weighted rating to determine the overall strength of an institution's shareholders. Shareholder strength is thus a key driver for our ratings.

Credit enhancements from shareholders: competition for or additionality of resources?

Our assessment of supranationals' asset quality also considers credit enhancements. Here, we assess the ultimate guarantor to avoid any double-counting with the support granted by shareholders, as well as the extent to which this guarantor improves the risk level of the supranational's asset portfolio. In the event the same shareholders of the institution provide the additional credit enhancements, the key question would be whether these resources i) reduce the value of other resources pledged by the shareholders to the institution, specifically, callable capital, implying a 'competition of resources' or ii) add to total resources pledged by the shareholders, implying an 'additionality of resources'.

EIB credit enhancements provided by EU budget guarantees and EU-28 member states

Use of credit enhancements to support infrastructure development and growth

In the European context, this is particularly relevant as public institutions are looking for more efficient ways to use budgetary resources for aims such as scaling up infrastructure investments and stimulating growth in key economic sectors. Here, the EIB's loans benefit from credit enhancements provided by either its shareholders, the EU member states, or the EU budget.

Specifically, EU member states directly guarantee the loans financed under the Cotonou Agreement and the Overseas Association Decision. The EU budget provides guarantees on the bulk of the EIB's other operations outside of the EU, including pre-accession countries (provided under the External Lending Mandate), and those under the European Fund for Strategic Investments (EFSI).

EU and EIB shareholders are the same sovereigns

Since EU member states and the EIB's shareholders are the same sovereigns – namely, the EU-28 member states – it is important for our assessments to fully and adequately account for the direct and indirect risks faced by the member states.

EU budget contributions

The EU's borrowings and guarantees are ultimately backed by the EU budget in the absence of paid-in capital. Most budgeted revenues (around 75%) are provided by GNI-based transfers from member states. As the EU budget must not run a deficit, the GNI-based resource plays the budget-balancing role, financing annual expenditure not covered by other revenues.

Therefore, it is important for our assessments to determine whether

i) the risks faced by the EU budget are included in our sovereign rating assessment of EU member states, or

ii) available internal buffers can shield the EU and, thus, its member states, from risks stemming from EU budget guarantees.

To answer the first question, we point out that one of the five pillars of our sovereign methodology measures 'public finance risks'. These risks are quantitatively assessed via four ratios: i) the general government primary balance as a percentage of GDP, ii) gross financing needs as a percentage of GDP, iii) general gross government debt as a percentage of GDP, and iv) interest payments as a percentage of government revenues. In addition, we qualitatively assess sovereigns' i) fiscal policy framework, ii) debt sustainability, and iii) market access and funding sources.

Are EU budget risks included in Eurostat's debt and contingent liability accounts?

As such, risks stemming from EU budget guarantees need to be accounted for in either member states' i) debt figures, thus influencing our quantitative 'public finance risk' assessment, or ii) contingent liabilities, thus captured in our qualitative assessment of sovereign 'debt sustainability'. In this context, Eurostat's method of accounting for member states' debt and contingent liabilities matters.

Does the EC dispose of enough assets to shield member states from any risks?

If Eurostat does not account for these risks in its debt or contingent liability figures, we would need to assess whether the European Commission, which administers the EU budget, disposes of sufficient internal buffers and assets to shield member states from potential guarantee calls.

Eurostat's accounting of member states' debt and contingent liabilities

Contingent liabilities only become actual liabilities if specific conditions prevail. Eurostat's data include i) government guarantees granted directly by EU member states, ii) liabilities related to public-private partnerships recorded off-balance sheet by the government, iii) liabilities of government-controlled entities (public corporations) classified outside the general government, and iv) non-performing loans (government assets), which can result in losses for the government if these loans were not repaid.

Conversely, Eurostat's guarantee data do not include: i) government guarantees issued within the guarantee mechanism under the Framework Agreement of the European Financial Stability Facility (EFSF); ii) derivative-type guarantees meeting the ESA2010 definition of a financial derivative; iii) deposit insurance guarantees and comparable schemes; and iv) government guarantees on events that would be difficult to cover via commercial insurance (such as earthquakes, and large-scale flooding).

Eurostat clarifies that the EFSF is not regarded an institutional unit given its lack of autonomy – notably because decisions require the unanimity of shareholders. As a result, debt issued by the EFSF is reallocated to the public accounts of member states providing the guarantees, in proportion to their share of the guarantees for each debt-issuing operation. Therefore, EFSF debt is accounted for in the government debt of the member states providing the guarantees.

EU budget guarantees are not included in Eurostat debt

Conversely, for entities classified as 'institutions and bodies of the European Union' (including the EIB and the EC) or treated as a European Union international organisation (the ESM), borrowings are not re-routed to shareholders. These institutions' obligations are thus not included in member states' debt or contingent liabilities[2].

As multilateral development banks and the ESM have paid-in capital, among other institutional features, it seems appropriate to exclude their liabilities from the contingent liabilities of member states. This is less straightforward for the EU, however, because it has no paid-in capital. In fact, in a bilateral exchange, Eurostat acknowledged that:

'Evidently, in a wider economic sense, it could be interpreted that the EU institutions are (partly) financed by the contributions from the Member States. The potential guarantee

[2] https://ec.europa.eu/eurostat/documents/3859598/7203647/KS-GQ-16-001-EN-N.pdf/5cfae6dd-29d8-4487-80ac-37f76cd1f012

calls might lead to the gap in the EU budget requiring (in the future) additional cash contributions from Member States, which might eventually be financed by borrowing in some cases.

However, these possible indirect impacts are not taken into account in the statistical approach to the calculation of Member States debt figures. Those theoretical and very indirect impacts will be shown in the debt figures of the Member States at the time when the contributions are made but as part of the general financing needs of the Member States in the context of their EU membership.'

It is this assertion as regards guarantees provided by the EU budget that we assess in greater detail below.

Scope's comprehensive accounting of EU member states' contingent liabilities

Risk assessment for member states requires accounting for EU budget risks and available buffers

Since Eurostat's debt and contingent liability figures do not include risks stemming from the EU budget, we look at the liabilities of the EU budget against available buffers to determine whether these figures should be included in member states' contingent liabilities. Several mechanisms can absorb potential shocks to the EU budget and subsequent materialisation in members states' budgets. The size of contingent liabilities[3], available buffers and their balancing is explored in detail below.

I. Scope's assessment of guarantees provided by the EU budget

On top of its budgetary cash flows, the EU budget guarantees i) borrowing and lending by the EC, ii) EIB-related operations implemented under an EU mandate, and iii) legal cases. An overview of the contingent liabilities is provided below.

➢ **Guarantees for borrowings of the European Commission**

The EC's borrowings finance lending to member and non-member states in back-to-back transactions. Specifically, EU borrowings are only permitted to finance loans to i) EU member states, via the European Financial Stabilisation Mechanism (EFSM) and Balance-of-Payments (BoP) financial assistance programmes, and ii) non-EU countries benefiting from an IMF programme through its Macro-Financial Assistance (MFA)[4].

Lending to crisis countries largest direct exposure of EU budget

In addition, borrowings are also used for the European Atomic Energy Community (Euratom), which lends to EU member states and non-member states, and to entities of both, to finance projects relating to energy installations. However, guarantees from third parties are the first point of coverage for all outstanding Euratom loans; external lending amounts that third-party guarantees cannot provide for would be covered by the Guarantee Fund for External Actions (GFEA)[5].

Highest exposure to crisis countries but timely repayment

Potential liquidity risk from EU borrowings is offset by equivalent loan repayments from member states under the EFSM and BOP back-to-back operations. The EU's main exposures for honouring its borrowings relates to financial assistance provided to Ireland (A+/Stable) and Portugal (BBB/Positive) under the EFSM. The countries' combined share of around 90% of the EU's total exposure significantly mitigates risks to the EU budget and consequently to member states. To date, the EU has always been repaid in full and on time. As of end-2018, total guarantees amounted to around EUR 53.9bn.

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[3] Scope defines contingent liabilities as those liabilities which pose a risk to the EU budget which are not fully covered in the budget via commitment appropriations. Consequently, financial instruments related to various programmes, including Horizon 2020, Risk Sharing Finance Facility and Connecting Europe Facility are excluded from this analysis since the EU already provides for the full coverage in the budget for any obligation that may stem from any of these instruments.
[4] MFA loans are firstly guaranteed by the Guarantee Fund for External Actions and then by the EU budget.
[5] For completion, Scope notes that the European Coal and Steel Community (ECSC) in Liquidation loans are not covered by an EU budgetary guarantee but by the financial assets of the ECSC in Liquidation.

Table 1: EU budget guarantees for borrowings, EUR m

	2012	2013	2014	2015	2016	2017	2018
EFSM	44,476.0	44,468.0	47,507.0	47,509.0	47,456.0	47,456.0	47,400.0
BOP	11,623.0	11,623.0	8,590.0	5,811.0	4,272.0	3,114.0	1,734.0
MFA*	549.0	569.0	1,842.0	3,024.0	2,964.0	3,924.0	4,388.0
Euratom	425.0	387.0	349.0	301.0	252.0	250.0	254.0
ECSC	221.0	211.0	221.0	229.0	191.0	100.0	98.0
Sub-total	57,294.0	57,258.0	58,509.0	56,874.0	55,135.0	54,844.0	53,874.0

*First guaranteed by Guarantee Fund for External Actions.

Sources: Annual accounts of the European Union 2012-18 (2018 Report: Section 2.4.3.1. Loans for financial assistance), Scope Ratings

➢ **Guarantees to EIB operations implemented under an EU mandate**

The EU's ultimate credit risk also includes guarantees on activities conducted by the EIB under an EU mandate, including for operations outside of the EU and under the EFSI. Crucially, these contingent liabilities are not funded on the capital markets but are backed by the EU budget, making them an important part of the EU's overall credit risk.

a. Guarantee fund for the EIB's external (non-EU) activities

Under the External Lending Mandate, the EU budget guarantees certain non-EU financing operations of the EIB. The maximum ceiling for such financing operations is fixed at EUR 32.3bn for 2014-20[6], of which the guarantee will cover up to 65% of the aggregate amount disbursed and guaranteed under such EIB financing operations, less amounts reimbursed, plus all related amounts via the GFEA.

Assets of GFEA at EUR 2.6bn

The GFEA covers any losses from EIB external financing, MFA, and Euratom loans to third countries; the EU budget has provisioned for the potential losses at a minimum 9% of outstanding loans and guarantees covered by the GFEA. If GFEA resources are insufficient, the EU budget will provide the necessary funds. As of December 2018, about 90% of the amount covered by the GFEA consisted of guarantees related to EIB loans. The GFEA covers defaults within three months of the EIB's request[7], and the EIB undertakes recovery proceedings on behalf of the EU for defaulted payments. As of December 2018, the GFEA's assets amounted to EUR 2.6bn.

Finally, based on end-2018 data, we note that since November 2011, the EIB has seen defaults on payments from the Syrian Government. The EIB has called on the GFEA to cover these defaults 63 times since May 2012[8], for a total of EUR 421.1m. The EIB also called on the fund to cover overdue amounts from TAV Tunisie S.A. (Enfidha airport) – four times during 2016-17 for a total of EUR 33.8m (of which EUR 0.14m was recovered in January 2018). These loans are now impaired in full by EUR 502m (2017: EUR 432m) and classified as subrogated loans[9].

b. Guarantee for operations implemented by EIB Group under the EFSI mandate

The EU budget also guarantees part of the signed investments under EFSI, which are implemented by the EIB and EIF (via the Infrastructure and Innovation Window and the SME Window, respectively). The EFSI Guarantee Fund is provisioned progressively, accounting for the increase in exposures borne by the EU guarantee, thus constituting a liquidity cushion from which the EIB can be paid in case an EU guarantee is called upon.

6 On 14 March 2018 the ceiling was increased from EUR 27bn to EUR 32.3bn.
7 For Euratom and MFA loans, the EC draws on the fund to cover the default and to replenish its treasury resources.
8 Each guarantee call refers to an instalment due, not a stand-alone operation.
9 These are defaulted loans granted by the EIB and guaranteed by the EU budget, for which all rights have been subrogated to the EU following the payment from the GFEA. Under an agreement between the EU and the EIB, recovery proceedings are undertaken by the EIB on behalf of the EU with an aim to recover any sums due.

Assets of EFSI Guarantee Fund at EUR 5.5bn

Following the EFSI's extension in 2017, the EU budget now sets a EUR 26bn guarantee ceiling on the EIB's EFSI investments, which, on average, are riskier than the traditional risk profile of the EIB's portfolio. Based on EU annual accounts as of end-2018, disbursed exposures covered by the EU guarantee stood at EUR 15.8bn and signed exposures at EUR 19.8bn[10]. The first-loss coverage would not necessarily affect the EU's budget balance as the EFSI Guarantee Fund covers any guarantee calls. Assets of the EFSI Guarantee Fund totalled EUR 5.5bn at end-2018.

The EFSI Guarantee Fund started in April 2016 and its resources were originally foreseen to gradually reach EUR 8bn by 2022, thus providing for 50% of the maximum exposure of the original EU guarantee (EUR 16bn). Following the EFSI's extension, its guarantee fund is now expected to gradually reach EUR 9.1bn, i.e. 35% of the EU's total EFSI-related guarantee obligations. During 2018, the fund paid EUR 61m of guarantee calls. As highlighted in Table 2, guarantees on both EIB-related activities amount to around EUR 36.3bn as of end-2018.

Table 2: EU budget guarantees related to EIB operations, EUR m

EIB-related guarantees							
	2012	2013	2014	2015	2016	2017	2018
EIB external lending mandate guarantees	21,314.0	21,156.0	19,198.0	19,450.0	21,145.0	19,972.0	20,510.0
EIB EFSI	-	-	-	202.0	4,392.0	10,128.0	15,764.0
Sub-total	21,314.0	21,156.0	19,198.0	19,652.0	25,537.0	30,100.0	36,274.0
Assets: Guarantee Fund for External Actions (GFEA)	2,079.0	2,125.0	2,372.0	2,342.0	2,506.0	2,561.0	2,610.0
Assets: EFSI Guarantee Fund	-	-	-	-	1,000.0	3,504.0	5,452.0

Sources: Annual accounts of the European Union 2012-18 (2018 Report: Section 4.1.1. Budgetary guarantees), NB. Liabilities refer to disbursed amounts as presented in EU annual accounts. Scope Ratings

➢ Guarantees for legal cases

These amounts mainly concern fines imposed by the EC for infringement of competition rules that are provisionally paid but under appeal by the fined companies. Should the EU lose any of these cases, amounts returned to the companies will have no budgetary impact as the revenue is only recognised after the Court of Justice decision. Other legal cases refer to liabilities to member states for rural development and cohesion policies. As of end-2018, contingent liabilities amounted to EUR 5.7bn, or EUR 2.5bn, excluding fines.

Table 3: EU budget guarantees for legal cases, EUR m

	2012	2013	2014	2015	2016	2017	2018
Fines	6,378.0	5,227.0	5,602.0	3,951.0	1,834.0	3,242.0	3,187.0
Agriculture	1,188.0	1,537.0	505.0	1,377.0	1,711.0	1,737.0	653.0
Cohesion policy	546.0	137.0	9.0	3.0	3.0	3.0	26.0
Legal cases and other disputes	91.0	689.0	789.0	795.0	600.0	481.0	1,867.0
Other contingent liabilities	1.0	-	5.0	58.0	-	-	-
Sub-total	8,204.0	7,590.0	6,910.0	6,184.0	4,148.0	5,463.0	5,733.0
Sub-total excluding fines*	1,826.0	2,363.0	1,308.0	2,233.0	2,314.0	2,221.0	2,546.0

* Fines have been provisionally paid and the cash is held in separate accounts (no impact on EU budget).

Sources: Annual accounts of the European Union 2012-18 (2018 Report: Section 4.1.4. Legal cases; Section 2.10), Scope Ratings

[10] As of 31 December 2018, total cumulated signatures under EFSI amounted to EUR 53.6 billion covering 28 Member States, of which EUR 39.1 billion was signed under the IIW (407 operations) and EUR 14.5 billion was signed under the SMEW (470 operations).

➢ Total outstanding guarantees vs total annual risk borne by the EU budget

Based on our 'mandate-driven' approach to assessing supranationals, we account for total outstanding risks adjusting for the amortisation profile of guaranteed loans, as this significantly reduces the annual direct exposure to the EU budget.

Non-profit-maximising nature of EU and EIB loans justifies accounting for risks to member states in terms of annual risk borne as opposed to total outstanding

This adjustment is important as operations guaranteed by the EU budget, including those related to the EIB, are driven by policy and not by profit-maximisation. As such, defaulting loans cannot be accelerated by either the EC or the EIB. Consequently, only the due payments each year ought to be considered when assessing the annual risk exposure.

The EC provides a breakdown of the amortisation profile for exposures under guarantees for the EC's borrowings (EFSM, BOP, MFA, Euratom) and for EIB operations under the external lending mandate. The total outstanding and total annual risk borne by these programmes is summarised below. Taking the amortisation profile into account, the exposure of the abovementioned programmes whose amortisation profile is made public decreases from EUR 74.3bn to EUR 9.9bn as of end-2018.

Table 4: EU budget guarantees' annual risk borne, EUR m

	2012	2013	2014	2015	2016	2017	2018
EIB external lending mandate guarantees	21,314.0	21,156.0	19,198.0	21,437.0	21,145.0	19,972.0	20,510.0
Guarantees relating to financial assistance							
EFSM	44,476.0	44,468.0	47,507.0	47,509.0	47,456.0	47,456.0	47,400.0
BOP	11,623.0	11,623.0	8,590.0	5,811.0	4,272.0	3,114.0	1,734.0
*MFA**	549.0	569.0	1,842.0	3,024.0	2,964.0	3,924.0	4,388.0
Euratom	425.0	387.0	349.0	301.0	252.0	250.0	254.0
Total outstanding							
EFSM, BOP, MFA, Euratom, EIB external	78,387.0	78,203.0	77,486.0	78,082.0	76,089.0	74,716.0	74,286.0
Annual risk borne:							
EFSM, BOP, MFA, Euratom, EIB external	3,782.5	4,347.6	7,394.9	12,379.8	10,718.5	5,777.0	9,965.0

Annual risk borne includes interest payments whereas total outstanding does not. No data is available for the amortisation profile of the operations covered by EFSI guarantees. EIB exposure relates to disbursed amounts as shown in EU accounts. Source: EC reports on guarantees covered by the general budget 2011-17 (2018 report refers to Table A4); Scope Ratings – as at 31 December 2017

II. Scope's assessment of the available buffers of the EU budget

In this part of the analysis, we acknowledge the use of the guarantee funds, the EU's conservative liquidity management and budgetary practices, including high cash buffers, and the significant budgetary flexibility, which mitigate risks to the EU budget arising from its liabilities and thus the potential for a guarantee call to EU member states. An overview of the available budgetary resources is provided below.

➢ Guarantee funds for EIB operations implemented under EU mandates

The GFEA covers potential losses stemming from EIB operations under the external lending mandate, MFA and Euratom loans to third countries; the EU budget provisions for the potential losses at a minimum 9% of outstanding operations covered by the GFEA.

For EFSI-related activities by the EIB covered by the EU guarantee, any guarantee calls would be first covered by the EFSI Guarantee Fund. As of end-2018, assets of the EFSI Guarantee Fund and the GFEA were EUR 5.5bn and EUR 2.6bn, respectively.

➢ Cash balances

The EU's conservative liquidity management and budgetary practices consider that 30-40% of expenditures are incurred during the first quarter of each year and that debt redemptions usually follow thereafter and at the beginning of each month, when cash balances are highest. Consequently, there is a cyclical nature to the EU's cash balances, but they remain very high throughout the year and have never dropped below EUR 10bn over the past three years. The EU's cash balance was EUR 18.1bn at end-2018.

- **Budgetary flexibility**

An important tool to mitigate the impact of any shocks to outstanding guarantees – and, thus, potential liquidity shortfalls – is the EU's budgetary flexibility. Specifically, this relates to the EC's ability to delay significant amounts of EU annual expenditure, about EUR 40bn-60bn, from European structural and investment funds. These funds are earmarked to support economic development across all EU countries[11] and could, in principle, be temporarily used by the EU to fulfil its legal obligations to third parties[12], which would shield member states from an immediate fiscal impact of EU guarantees.

Structural and investment funds can be postponed to compensate third parties in case of need

Arguably, all else equal, in the event these funds are diverted to compensate third parties, the fiscal impact from a guarantee call would only be postponed, not avoided. However, in our opinion, should these funds be used to avoid a non-payment to third parties, and thus not be available for their original purpose, it is likely that member states would re-negotiate the size and timing of any related budgetary flows. Consequently, these funds constitute assets at the EC's disposal to absorb shocks to EU guarantees.

We determine budgetary flexibility for 2018 by including the following budgetary headings: 'economic, social and territorial cohesion' (EUR 46.4bn), the European Agricultural Fund for Rural Development (EUR 12.1bn) and the European Maritime and Fisheries Fund (EUR 0.5bn). An overview of the available liquid assets is provided below.

Table 5: EU available liquid assets, EUR m

	2012	2013	2014	2015	2016	2017	2018
Guarantee Fund for External Actions (GFEA)	2,079.0	2,125.0	2,372.0	2,342.0	2,506.0	2,561.0	2,610.0
EFSI Guarantee Fund	-	-	-	-	1,000.0	3,504.0	5,452.0
Cash and cash equivalents*	10,674.0	9,510.0	17,545.0	21,671.0	28,585.0	24,111.0	18,113.0
Budgetary flexibility	62,053.4	9,823.6	65,839.4	63,104.4	50,001.9	41,033.3	58,977.7
Total assets	**74,806.4**	**81,458.6**	**85,756.4**	**87,117.4**	**82,092.9**	**71,209.3**	**85,152.7**

*This amount partially overlaps with the Guarantee Funds, for which part of the money is held in cash and cash equivalents. The EFSI Guarantee Fund had cash assets of EUR 450mn, the GFEA EUR 41.6mn as of end-2018.
Source: Annual accounts of the European Union 2012-18 (budgetary flexibility refers to the sum of budgetary headings 'economic, social and territorial cohesion', the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund, Scope Ratings

III. Balance of EU guarantees and available buffers

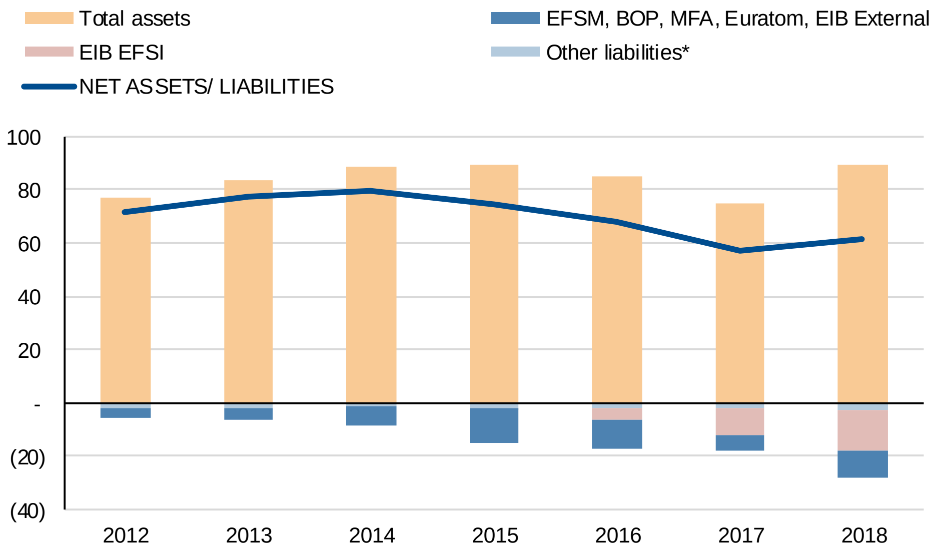
Finally, we balance the contingent liabilities with the available budgetary resources. Overall, the total annual risk borne by the EU budget via its guarantees (back to back loans and EIB external lending mandate) has increased, from around EUR 3.8bn in 2012 to EUR 9.9bn at end-2018. In addition, based on EU annual accounts as of end 2018, the disbursed EFSI-related exposure to the EU amounted to EUR 15.8bn.

Available net assets are declining but remain sufficient to shield EU budget risks from EU member states

At the same time, assets at the EC's disposal – the two guarantee funds, the large cash buffer, and significant budgetary flexibility – have hovered around EUR 75bn-90bn, mainly reflecting the cyclical nature of disbursements from structural and cohesion funds. These developments have reduced available net assets, from a peak of EUR 80bn in 2014 to around EUR 61bn in 2018.

[11] The EU has five main funds: European Regional Development Fund (ERDF), European Social Fund (ESF), Cohesion Fund (CF), European Agricultural Fund for Rural Development (EAFRD) and European Maritime and Fisheries Fund (EMFF).
[12] Treaty on the Functioning of the European Union. Article 323. The European Parliament, the Council and the Commission shall ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties.

Chart 1: EU budget guarantees annual risk borne and net assets, EUR bn



Sources: Annual accounts of the European Union 2012-18, EC reports on guarantees covered by the general budget 2011-18, * Other liabilities refers to legal cases. EFSI exposure relates to disbursed amounts. Scope Ratings

Implications for sovereign and supranational credit risk

Sufficient buffers adequately protect member states from EU budget guarantees

Our analysis shows that while Eurostat does not account for the EU guarantees in its debt and contingent liabilities statistics, the EC's available buffers can still mitigate the impact of any shock to its guarantees. This is despite the increasing level of guarantees, including to the EIB for its external and EFSI-related operations.

The EC's net assets are positive when balancing its available buffers against the total annual risk borne via its guarantees (back to back loans and EIB external lending mandate) and its EFSI-related exposure. Therefore, for the purpose of our 'public finance risk' assessment on EU member states, as long as these net assets are positive, there is no rationale for adding the EU budget guarantees to Eurostat accounts regarding member states' contingent liabilities. Consequently, our view on EU member states' creditworthiness is currently not affected by the risks stemming from the EU guarantees.

EU guarantees are in addition to existing commitments of EU member states to EIB

Finally, since the credit enhancements to the EIB via the EU budget guarantees are legally distinct from the commitments made by the EU member states to the EIB, these resources can be viewed as additional to those already pledged by the EIB shareholders. Consequently, the EU guarantees can be considered as credit enhancements to the EIB's asset quality, despite being ultimately backed by the same EU-28 member states.

Risks resulting from the EU guarantees are captured in our analysis of the EC's net assets and, if needed, incorporated to our assessment of the EU member states' contingent liabilities. This is relevant since the credit quality of sovereigns is the starting point of the analysis for assessing supranationals, reflecting our 'mandate-driven' approach to analyse these institutions.

Annex I: Glossary

Institutions/ bodies

EC = European Commission

EU = European Union

EP = European Parliament

EIB = European Investment Bank

EIF = European Investment Fund

ESM = European Stability Mechanism

EFSF = European Financial Stability Facility

Instruments/ programmes

BoP = Balance-of-Payments financial assistance programme

MFA = Macro-Financial Assistance programme

EFSI = European Fund for Strategic Investments

EFSM = European Financial Stabilisation Mechanism

Guarantee funds

GFEA = Guarantee Fund for External Actions

EFSI Guarantee Fund

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