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

**ON BORROWING AND LENDING ACTIVITIES OF THE EUROPEAN UNION IN
2010**

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1. INTRODUCTION

The Council decisions establishing the various lending instruments of the European Union require the Commission to inform the European Parliament and the Council, each year, of the use of these instruments.

In order to meet these information requirements, this report describes the lending operations (section 2) for each of the areas concerned as well as the respective borrowing activities (section 3). It includes the balance-of-payment support to non-euro area Member States (BOP)¹, the macro-financial assistance provided by the European Union to third countries (MFA), the Euratom activities and the financial measures taken in order to respond to the euro area sovereign debt crisis.

To complete the picture of EU activities, the final section provides a summary overview of European Investment Bank (EIB) lending and borrowing activities in 2010.

2. LENDING ACTIVITIES OF THE EUROPEAN UNION

Financial support for third countries and for Member States is provided by the Commission under different legal bases, depending on the geographical areas concerned and the objectives pursued.

2.1. Overview

Financial operations administered by the Commission under various Council decisions generally take the form of bilateral loans. These are financed from the capital markets with the guarantee of the EU budget.

2.2. BOP facility

BOP assistance takes the form of medium-term loans provided by the Union and is generally provided in conjunction with financing provided by the International Monetary Fund (IMF) and other multilateral lenders, such the EIB, the EBRD or the World Bank, or bilateral assistance from Member States.

2.2.1. Main characteristics of the BOP facility

The facility is exceptional in nature and is mobilised on a case-by-case basis by Council decision. Potential beneficiaries are the Member States outside the euro area being faced with serious balance-of-payments difficulties. The assistance is of a macro-economic nature (i.e. not linked to a specific use of the funds as in the case of project assistance). It is released subject to the fulfilment of economic policy conditions and is aimed at easing the recipient Member States' global external financing constraints and restoring the viability of the balance of payments. Such policy conditions are agreed by the Commission following consultation with the Economic and Financial Committee (EFC) and the Member State in a memorandum

¹ Council Regulation (EU) No 407/2010 of 11 May 2010 established a similar mechanism with the full support of the EU budget, the European financial stabilisation mechanism (EFSM), to support euro area Member States.

of understanding signed prior to the implementation of the loan agreements. The assistance underpins the implementation of adjustment measures designed to remedy these difficulties. The verification of such measures is a condition for the disbursement of further instalments under these loans.

Following the facility's inception in 1975², several operations aiming at supporting the balance of payments of Member States under particular financial threats or difficulties were carried out by the Community over the following twenty years. These operations consisted of loans funded by Community borrowings.

The intensity of the international financial crisis (that started in 2007/2008) called for the BOP facility to be activated again. In addition, the increased number of eligible Member States following enlargement and the worsening of the economic situation in several of them led to an increase of its lending ceiling in order to respond to the potential needs. In particular, the ceiling was increased in December 2008³ from EUR 12 billion to EUR 25 billion while a further increase to EUR 50 billion was decided in May 2009⁴ in order to retain the capacity to react quickly to any further demand for BOP assistance. Of this ceiling, an amount of EUR 14.6 billion has been granted at 31 December 2010 to Hungary⁵, Latvia⁶ and Romania⁷.

Table 1: situation of BoP at 31.12.2010 (in EUR million)

Country	Amount decided	Amount disbursed
Hungary	6,500	5,500
Latvia	3,100	2,900
Romania ⁸	5,000	3,650
Total	14,600	12,050

2.2.2. *BoP operations in 2010*

A total amount of EUR 2.85 billion was disbursed over several tranches in 2010.

² Council Regulation (EEC) No 397/75 of 17 February 1975 establishing a new mechanism known as the Community Loan Mechanism (CLM) to help some EC countries overcome unsustainable current account imbalances caused by the first oil shock.

³ 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' balances of payments.

⁴ 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' balances of payments.

⁵ Council Decision 2009/102/EC of 4 November 2008.

⁶ Council Decision 2009/290/EC of 20 January 2009.

⁷ Council Decision 2009/459/EC of 6 May 2009.

⁸ The 3rd tranche of EUR 1.2 billion to Romania was disbursed on 24.03.2011

Table 2: list of loan operations disbursed under BoP facility in 2010

Country	Decision	Tranche	Date	Amount in EUR million
Latvia	2009/290/EC	3 rd	11/03/2010	500
		4 th	20/10/2010	200
Romania	2009/459/EC	2 nd	11/03/2010	1,000
		3 rd	22/09/2010	1,150
			Total	2,850

Regarding the implementation of ongoing BoP operations:

- the availability period of the financial assistance to Hungary expired in November 2010. As a consequence, the last EUR 1 billion of the facility will not be disbursed. As for Latvia, EUR 200 million are still available until January 2012, but the Member State has no intention to request it. Consequently, a total amount of EUR 1.2 billion will not be disbursed under the current BoP operations.
- Furthermore, the 4th tranche for Romania of EUR 1.2 billion was disbursed in March 2011, and the 5th and last tranche was disbursed in June 2011.

2.3. MFA facility

Detailed information on MFA operations can be found in the annual Commission Report to the European Parliament and the Council on the implementation of MFA to third countries⁹.

2.3.1. Main characteristics of MFA

The purpose of the MFA instrument is to help candidate, potential candidate and neighbourhood countries resolve short-term balance of payments problems and stabilise public finances, and to encourage their implementation of structural reforms. MFA is provided on an exceptional and temporary basis, and based on strict conditionality. It is tied to adjustment and reform efforts to ensure that the economies of recipient countries are brought back to a sustainable path and improve their resilience to future macroeconomic shocks. MFA operations complement IMF adjustment programmes. MFA can take the form of grants and/or loans.

Regarding the methodology for deciding between the use of loans and grants in the individual MFA operations, a comprehensive note clarifying the criteria used was submitted in January 2011 by the Commission to the Economic and Financial Committee, which endorsed it. The methodology will also be presented in the 2010 MFA Annual report. The criteria agreed fall in two broad categories: the recipient country's level of economic and social development¹⁰ as

⁹ Not yet published for 2010. For 2009, see COM/2010/513, SEC/2010/1117.

¹⁰ Gross national income per capital is proposed as the primary indicator.

well as its debt sustainability and repayment capacity. Criteria applied by the World Bank and IMF for granting financial assistance are also taken into consideration.

The MFA loans are generally disbursed in several instalments, as and when macroeconomic conditionality milestones are met. Each disbursement is subject to a borrowing transaction by the Commission. Should a situation of default arise as a result of failure by the beneficiary country to honour its repayment obligations, the Commission may activate the Guarantee Fund for External Actions¹¹ so that the repayment of the corresponding borrowing by the Commission is secured¹².

2.3.2. MFA operations in 2010

The key MFA activities in 2010 relate to proposals of new operations and related negotiations with the relevant authorities. They focused on the following:

- The European Parliament and the Council adopted in July 2010 a decision to provide EUR 500 million to Ukraine¹³ in the form of a loan. Together with a EUR 110 million loan from a decision taken by the Council in 2002, a total of up EUR 610 million is available for Ukraine.
- Concerning the Republic of Moldova, a decision has been adopted in October 2010 to provide up to EUR 90 million in the form of *grant*.

There was no operation disbursed under the MFA *loan* facility in 2010¹⁴.

2.4. Euratom facility

2.4.1. Main characteristics

The Euratom loan facility may be used to finance projects within Member States (Council Decision 77/270/Euratom) or in certain third countries (Ukraine, Russia or Armenia) (Council Decision 94/179/Euratom).

These loans are off-budget operations that the Commission finances back to back by borrowing from the financial market. As in the case of MFA, the Commission may activate the Guarantee Fund for External Actions in case of default.

In 1990, the Council fixed a borrowing limit of EUR 4 billion, of which some EUR 3.4 billion have been decided and disbursed. In 2002 the Commission proposed an increase in the

¹¹ See Council Regulation (EC, Euratom) No 480/2009. No default has been registered so far for MFA loans.

¹² Although the repayment of the borrowing is covered in fine by the guarantee of the EU budget, the Guarantee Fund acts as liquidity buffer protecting the EU budget against the risk of calls resulting from 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).

¹³ Decision n° 388/2010/EU of the European Parliament and of the Council of 7 July 2010 providing macro financial assistance to Ukraine (OJ L 179 of 14.07.2010, p.1).

¹⁴ Regarding the implementation of ongoing financial *grant* assistance, payments of EUR 7.7 million and EUR 23 million in favour of Georgia were made in January and August. Furthermore, EUR 30 million, were disbursed in favour of Kosovo in September and the first tranche of the EUR 40 million, in favour of the Republic of Moldova was disbursed in December 2010.

borrowing limit from EUR 4 billion to EUR 6 billion, for which agreement has not yet been reached at the Council.

2.4.2. *Euratom operations in 2010*

In 2010, neither loan decisions were taken nor disbursements were carried out.

2.5. **EU response to the euro area sovereign debt crisis**

In addition to the balance of payments crisis mentioned in section 2.2, the global financial crisis and economic downturn led to a deterioration of the borrowing conditions of several euro area Member States. To overcome difficulties resulting from the financial crisis, unprecedented fiscal and monetary measures have been taken by governments and central banks of these Member States. However, short-term and long-term financing conditions remained difficult.

The Council and the euro area Member States have therefore decided in May 2010 a package of measures to preserve financial stability in the euro area and Europe at large.

2.5.1. *Measures decided for Greece*

Following a request by the Greek authorities, euro area Ministers unanimously agreed on 2 May 2010 to activate stability support to Greece via *bilateral* loans from the other euro area Member States, centrally pooled by the Commission, under the conditions set out in their statement of 11 April 2010.

The support was provided in the context of a three year joint programme with the IMF involving a financial package of EUR 110 billion to help Greece meet its financing needs. The programme was accompanied with strong policy conditionality¹⁵ negotiated with the Greek authorities by the Commission and the IMF, in liaison with the ECB.

Euro area Member States contributed for their part EUR 80 billion¹⁶. In addition, the IMF has reached an agreement with the Greek authorities to support this programme with a stand-by arrangement of about EUR 30 billion¹⁷.

The role of the Commission

Under the Greek Loan Facility, the Commission is not acting as a lender nor as a borrower. In particular, the representatives of the Member States of the European Union have decided on 5 May 2010 to entrust the Commission with the tasks in relation to the coordination and management of the pooled bilateral loans as set out in an Intercreditor Agreement concluded on 8 May 2010 by the euro area Member States providing the support.¹⁸ The role does not

¹⁵ The main elements of policy conditionality were enshrined in Council Decision of 10 May 2010 addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit (2010/320/EU). The conditionality was further detailed in a Memorandum of Understanding concluded between the Greek authorities and the Commission on behalf of euro area Member States.

¹⁶ Of which EUR 38 billion had been disbursed until March 2011.

¹⁷ Of which EUR 14.6 billion had been disbursed until March 2011.

¹⁸ These tasks *inter alia* comprise, on behalf and under the instruction of the euro area Member States providing the support, the negotiating and signing of a Loan Facility Agreement with Greece, the

imply an increase in the expenditure of the Commission or of any other item of expenditure under the EU budget¹⁹.

2.5.2. *European Financial Stabilisation Mechanism (EFSM)*

Council Regulation (EU) No 407/2010 of 11 May 2010 set up the European Financial Stabilisation Mechanism (EFSM) based on Art. 122(2)²⁰ of the Treaty on the Functioning of the European Union (TFEU) with the full backing of the EU budget. The maximum available amount under the mechanism is EUR 60 billion.

Union financial assistance under EFSM takes the form of a loan or of a credit line. The Commission is empowered on behalf of the European Union to contract borrowings on the capital markets or with financial institutions.

The activation of the mechanism is subject to strong conditionality, in the context of a joint EU/IMF support programme.

In particular, the Union financial assistance is granted by a decision adopted by the Council, acting by a qualified majority on a proposal from the Commission, containing (a) the terms of the loan/credit line, (b) the general economic policy conditions to the financial assistance and (c) the adjustment programme prepared by the beneficiary Member State to meet the economic conditions attached to the assistance.

The Commission and the beneficiary Member State conclude a Memorandum of Understanding (MoU) detailing the general economic policy conditions laid down by the Council. The Commission then communicates the MoU to the European Parliament and to the Council. The economic policy conditions are reviewed regularly and may be adjusted if required²¹.

The Commission is required to regularly report to the Economic and Financial Committee and to the Council on the implementation of the EFSM Regulation and on the continuation of the exceptional occurrences that justified its adoption.²² The first report has been published on 30 November 2010 concluding that the exceptional events and circumstances still exist and the EFSM should therefore be maintained.²³

opening of an account in the name of the Lenders with the ECB, and the use of that account for processing of all payments on behalf of the Lenders and from the Borrower, the co-ordination of the process for disbursements, certain calculations, distribution amongst Lenders of payments and the provision of information to Lenders regarding breaches of the Loan Facility Agreement or requests for waivers or amendments in respect thereof.

¹⁹ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/genaff/114338.pdf

²⁰ Art. 122.2 of the TFEU foresees financial support for Member States in difficulties caused by exceptional circumstances beyond Member States' control.

²¹ The review is conducted by the Commission, in consultation with the ECB, at least every six months. Any changes that may be needed to its adjustment programme are discussed with the beneficiary Member State. The Council, acting by a qualified majority on a proposal from the Commission, shall decide on any adjustments to be made to the initial general economic policy conditions and shall approve the revised adjustment programme as prepared by the beneficiary Member State.

²² The report should be submitted within six months following the entry into force of the Council Regulation (EU) No 407/2010 and where appropriate every six months thereafter (article 9 of Regulation).

²³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0713:FIN:EN:PDF>

2.5.3. *European Financial Stability Facility (EFSF)*

The European Financial Stability Facility (EFSF) was created by the euro area Member States as a Luxembourg-registered company owned by them, following the decisions taken on 9 May 2010 within the framework of the Ecofin Council.

EFSF is able to issue bonds guaranteed by euro-area Member States for up to EUR 440 billion for on-lending to euro-area Member States in difficulty, subject to conditions negotiated with the Commission in liaison with the European Central Bank and IMF and to be approved by the Eurogroup. The lending by the EFSF is not covered by an EU budget guarantee.

The Commission provides advice and support to the EFSF. It is represented in the Board of Directors and co-ordinates its own borrowing activities with EFSF's for the financing of the programmes where both are involved in order to optimize their capital market activities in terms of timing.

2.5.4. *Operations with EFSM participation*

- Operations decided in 2010: Ireland²⁴

In response to the Irish authorities' request on 21 November 2010, a three year joint EU/IMF financial support was decided. The total programme for Ireland will amount up to EUR 85 billion and will be disbursed in several tranches. EUR 17.5 billion will be financed by an Irish contribution through the Treasury cash buffer and investments of the National Pension Reserve Fund. The remainder of the overall package will be funded by:

- The EFSM up to EUR 22.5 billion²⁵;
- The EFSF for an amount up to EUR 17.7 billion;
- The IMF for an amount up to EUR 22.5 billion;
- Bilateral loans from United Kingdom (EUR 3.8 billion), Sweden (EUR 0.6 billion) and Denmark (EUR 0.4 billion).

- Operations decided after the end of 2010: Portugal²⁶

Following the formal request for financial assistance made on 7 April 2011 by the Portuguese authorities, 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 up to EUR 78 billion and will be shared equally amongst:

- The EFSM for an amount up to EUR 26 billion²⁷;

²⁴ Council implementing Decision n°77/2011/EU of 7 December 2010 on granting Union financial assistance to Ireland (OJ L 30 of 4.02.2011, p.34).

²⁵ On 12 January 2011, the first tranche of EUR 5 billion was disbursed to Ireland. Until June 2011, EUR 11.4 billion was disbursed.

²⁶ Council implementing Decision n°344/2011/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 159 of 30.05.2011, p.88).

²⁷ On 31 May 2011, the first tranche of EUR 1.75 billion was disbursed to Portugal. Until June 2011, EUR 6.5 billion was disbursed.

- The EFSF for an amount up to EUR 26 billion;
- The IMF for an amount up to EUR 26 billion.

3. BORROWING ACTIVITIES OF THE EUROPEAN UNION

3.1. Description

In order to finance the lending activities decided by the Council, the Commission is empowered to borrow funds on the capital markets on behalf of both the European Union and Euratom. For each instrument (BOP, MFA and Euratom loans) the borrowing and lending mechanism operation is determined in its respective legal base. There is a ‘back-to-back’ link between a borrowing operation and the related lending operation, which ensures that the EU budget does not take of any interest rate or foreign exchange risk. Outstanding borrowings are matched by outstanding loans.

Table 3: Total borrowing of the European Union — outstanding amounts of capital at the end of each year over the period 2002-2010⁽¹⁾ (EUR million)

	ECSC i.l. ⁽¹⁾ (2)	Euratom ⁽¹⁾	BOP	MFA	Total European Union
2002	713	80		1,379	2,172
2003	431	105		1,372	1,908
2004	423	170		1,214	1,807
2005	440	385		1,080	1,905
2006	436	436		969	1,841
2007	400	474		786	1,660
2008	266	484	2,000	654	3,404
2009	214	481	9,200	584	10,479
2010	219	466	12,050	500	13,235

(1)The conversion rates used are those of 31 December of each year.

(2)The European Coal & Steel Community is in liquidation since 2002. The last bond issued by ECSC matures in 2019.

3.2. BOP

Bond issuances succeeded in confirming the EU as a major issuer to the euro benchmark bond market. The bonds were very well received in the market. As investor interest remained very strong, the bonds were always quickly oversubscribed. All important investor classes were represented in the final distributions, including central banks, investment funds, bank treasuries and insurance companies²⁸. The bond prices were close to the best in their reference group, the Sovereign Supranational Agency Sector (SSA), in line with issuers such as

²⁸ Further information on the EU borrowing operations are provided in the investor presentation: http://ec.europa.eu/economy_finance/eu_borrower/documents/eu_investor_presentation_18_may_2011_rev.pdf

European Investment Bank (EIB), "Kreditanstalt für Wiederaufbau" (KfW) and "société de financement de l'économie française" (SFEF).

The secondary market performance was also very satisfactory and confirmed the EU's strong standing as a first class benchmark bond issuer.

Table 4: EU bond issued during 2010²⁹

Country	Description	Issue date	Maturity Date	Size (EUR)	Coupon
Latvia and Romania	EU 3.375/2019	11/03/2010	10/05/2019	1.5 bn	3.375%
Romania	EU 2.375/2017	22/09/2010	22/09/2017	1.15 bn	2.375%
			Total	2.65 bn	

One borrowing operation was raised on a back-to back basis for the funding of the 4th tranche of EUR 200 million for Latvia:

Table 5: EU private placement during 2010

Country	Description	Issue date	Maturity Date	Size (EUR)	Coupon
Latvia	EU 2.875/2025	20/10/2010	20/10/2025	0.2 bn	2.875%

3.3. MFA

In 2010, there was no borrowing operation under macro-financial assistance.

3.4. Euratom

In 2010, there was no borrowing operation under Euratom.

4. EUROPEAN INVESTMENT BANK

4.1. EIB lending activities

Loans granted by the EIB either finance individual projects *directly* or SMEs and smaller-scale local projects *through financial intermediaries*.

In 2010, the total volume of EIB signed operations reached EUR 72 billion, down by 9% versus the record level in 2009, marking a gradual return to pre-crisis territory.

As regards the geographic distribution of the lending and the coverage by the EU budget guarantee:

²⁹ http://ec.europa.eu/economy_finance/financial_operations/market/borrowing/benchmark_issues_2015-16_en.htm

- *In the EU*: an amount of EUR 63 billion was signed in EU Member States. This amount is *not* covered by the EU guarantee.
- *Outside the EU*: EUR 9 billion was signed outside the EU. Out of this, the EU guarantee covers EUR 5 billion.

EIB lending activities have an impact on the EU budget when they are accompanied by EU guarantees, interest rate subsidies or other EU/EIB risk-sharing provisions. In particular:

The majority of EIB loans *outside* the EU benefit from an EU budget guarantee covering the sovereign or the political risk, while the commercial risk is taken by the EIB. A separate report on the 2010 EIB external lending activity will be issued by the Commission during the second semester 2011.

At the same time, the EIB manages risk sharing facilities involving the use of the EU budget to support intra-EU policies (e.g. Risk Sharing Finance Facility for research and development projects and Loan Guarantee for TEN-Transport projects)³⁰.

4.2. EIB borrowing activities

Market uncertainty remained elevated throughout the year, making issuance challenging, particularly for issuance of large sized transactions and in longer maturities.

The setup of EFSF and the economic reforms undertaken contributed to a restoration of market confidence in EU issuers, although the market remained vulnerable to recurring headline risks. The EIB was able to navigate around such volatility by seizing windows for benchmark issuance and conducting more targeted issuance when volatility was elevated. The EIB's continued strong standing in the market facilitated this.

Consequently, the EIB was able to attain its objectives under the 2010 funding programme by raising an amount of EUR 67 billion on favourable terms.

³⁰ The Commission reports to the Council and Parliament on the implementation of new financial instruments financed by the EU budget on an annual basis in the framework of the annual budgetary exercise, in accordance with point 49 of the Inter-institutional Agreement between the EC, the EP and the Council.