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COURT
OF AUDITORS

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Opinion 07/2022

(pursuant to Article 322(1), TFEU)

**concerning the proposal
for a Regulation of the European
Parliament and of the Council
amending Regulation
(EU, Euratom) 2018/1046
as regards the establishment
of a diversified funding strategy
as a general borrowing method
[2022/0370 (COD)]**

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Introduction

01 On 9 November 2022, the Commission published its [proposal](#) for a Regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) 2018/1046 ('the Financial Regulation') as regards the establishment of a diversified funding strategy as a general borrowing method, as part of a package of three legislative proposals. The legal basis of the Commission's proposal means that consultation with the European Court of Auditors is mandatory¹. The Council and the European Parliament wrote to us asking for our views on 10 November 2022 and 11 November 2022 respectively. This opinion fulfils the consultation requirement.

02 In parallel to its proposal to amend the Financial Regulation, the Commission [proposes](#) to mobilise up to €18 billion for loans to satisfy the urgent financial needs of Ukraine with maturities of up to 35 years, and repayment of the 'principal' (i.e. the original amount of money lent, without the interest costs) no earlier than 10 years from now (as provided in its proposed new instrument, Macro-Financial Assistance (MFA+)). The Commission also [proposes](#) that these loans would be guaranteed by the EU budget headroom rather than a specific provision. We address these two proposals in the legislative package in this opinion where we consider appropriate.

03 The Commission justifies the amendment to the Financial Regulation with the need to plan various borrowing operations coherently with the best market opportunities and structure maturities to achieve the best costs. Additionally, in view of the expected complexity of operations needed to satisfy the urgent financial needs of Ukraine, and to anticipate possible future borrowing and lending operations concerning Member States and non-Member States, the Commission considers that it is appropriate to establish a diversified funding strategy as the single funding method for implementation of borrowing operations.

04 Currently the Commission borrows on behalf of the EU or Euratom to on-lend the corresponding amounts to beneficiary Member States and non-Member States under the conditions applicable to the borrowings. The Financial Regulation requires the cash flows between the borrowed funds and the loans to be matched one-to-one. This means that the EU must carry out market operations based on disbursement needs for each specific case of lending. The Commission considers that financing individual programmes of financial assistance through separate funding methods creates cost and complexity as the different programmes of financial assistance compete for a

¹ [Treaty on the Functioning of the European Union](#), Article 322(1)(a).

limited number of funding opportunities. This is emphasised in particular in the current context of financial support to Ukraine given its urgent financial needs and the uncertainty about its longer-term financial needs.

05 A diversified funding strategy was established to mobilise funds for grants and loans under NextGenerationEU (NGEU), comprising the [Recovery and Resilience Facility](#) (RRF) and [some other Union programmes](#). The Commission's proposal would apply such a diversified strategy to all future borrowings, except in duly justified cases.

General observations

06 The Commission's proposal presents reasonable arguments for establishing a diversified funding strategy, currently implemented for borrowings under NGEU as the baseline method for the implementation of all borrowing operations. NGEU borrowing operations do not use traditional 'back-to-back funding' but use the approach similar to that employed by sovereign states, where the borrowed amounts can be temporarily held on a bank account. The use of a diversified funding strategy allows the Commission to use also short-term debt instruments (with maturity below one year), like EU bills or credit lines. Therefore, the timing of disbursement of loans or the needs of EU budget do not determine entirely the type of borrowing instruments, timing, volume and maturity of EU debt issuances for financing the NGEU programme. The approach would provide the Commission more room for manoeuvre to choose the best available borrowing option.

07 Our [opinion 06/2020](#) on the Commission's proposal for a regulation establishing the RRF already mentioned that moving away from back-to-back funding could have benefits but nevertheless also entails an interest rate risk, which arises when the cost of borrowing changes between borrowing and disbursement. A diversified funding strategy requires the development of an appropriate governance framework and rules.

08 The Commission used the exceptional fast track procedure under Article 4 of [Protocol No 1](#) in view of the urgent need to provide aid to Ukraine. We draw attention to the fact that the diversified funding strategy is a long-term measure proposed for all future borrowing operations, which will likely concern amounts that are much higher than the MFA+ support for Ukraine. While using a diversified funding strategy is the standard approach for sovereign borrowers, the legislative authorities have limited time and supporting analyses to consider this proposed long-term change.

09 In our [2021 annual report](#), published in October 2022, we noted that the war in Ukraine increased risks to the EU budget, with a higher risk of contingent liabilities to the EU budget being triggered.

Specific comments

10 In the following paragraphs, we draw attention to specific aspects of the Commission's package of proposals.

Comments related to the proposed revision of the Financial Regulation

Wording of the new Article 220a

11 The reading of the first sentence of Article 220a paragraph 1 might lead to the conclusion that the Commission proposes to introduce an exception (in duly justified cases) from applying the [diversified funding strategy](#) to the NGEU programme, referred to in Article 5(1) of [Decision 2020/2053](#) on the system of own resources, which would not be possible under existing legislation. Further, it can be interpreted as referring only to NGEU borrowing activities authorised by Decision 2020/2053. As those are not the intentions of the Commission, the wording should be amended.

12 Article 220a paragraph 2 refers in the second sentence to 'issuance and debt management', while the Article 220a paragraph 1 refers to the 'borrowing and debt management'. The term 'issuance' is used in relation to securities (bonds and bills) and does not relate to money market borrowing operations that form also part of the diversified funding strategy. The wording in paragraph 2 of Article 220a should be amended to include all instruments used under diversified funding strategy in the information to the European Parliament and the Council.

Important actions to be implemented by the Commission

13 Recital 8 calls for important action from the Commission on putting into place a common liquidity pool. Recital 10 calls for establishing the necessary arrangements in relation to the diversified funding strategy, namely a governance framework, risk management procedures and a cost allocation methodology, as well as regular and comprehensive information to the European Parliament and the Council about all aspects of borrowing and debt management strategy. The details of those important actions are not provided for in the revised legislation itself, and will require a sound treasury management and additional actions from the Commission to effectively manage the new funding strategy. The Court is currently auditing NGEU debt management at the Commission.

14 Article 1 of the Commission's proposal would delete *inter alia* paragraph 2 of Article 220 of the Financial Regulation, which requires that borrowing and lending shall not involve the Union in the transformation of maturities, or expose it to any interest risk or to any other commercial risk. The proposal does not provide sufficient clarification on the risk mitigation measures that could replace this provision.

Comments related to the other proposals in the package

Potential transfer of risks to the future budgets

15 Up until now, the relevant assets have been set aside as a provision to honour any calls relating to guarantee of MFA loans. To create provisions for previous loans to Ukraine, the EU budget has used annual commitment and payment appropriations. This means that part of the risk has already been carried by the current or previous budgets. In parallel to its proposal to amend the Financial Regulation, the Commission [proposes](#) to change this approach so that the MFA+ loans to Ukraine would not be provisioned anymore but instead would be guaranteed by the EU 'budget headroom'.

16 'Budget headroom' is the difference between the own resources ceiling and the own resources necessary to finance the EU budget. It represents the EU's financial capacity to cover additional outflows relating to the materialisation of contingent liabilities arising from financial assistance to EU Member States, for which the provision is not created.

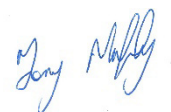
17 The Commission's proposal would mean that the related risks of possible defaulted payments are transferred to the future. This could potentially put pressure on future budgets and payment needs. The headroom would also cover the risk of defaulted repayments of MFA+ loans to Ukraine. Currently, there are no plans to increase the size of the headroom correspondingly.

Concluding remarks

18 The Commission's proposal to amend the Financial Regulation is presented in parallel with a package of proposals mobilising up to €18 billion for loans to support Ukraine. We consider that the Commission presents reasonable arguments to establish the use a diversified funding strategy as the baseline method for implementation of future borrowing operations. While focusing this opinion on the Commission's proposal to amend the Financial Regulation, we highlight that financing EU loans, guarantees or expenditure by borrowing means putting the responsibility of repayment on future budgets, and that lending to Ukraine might involve relatively high risks for the EU budget.

This opinion was adopted by Chamber V headed by Mr Jan Gregor, Member of the Court of Auditors, in Luxembourg at its meeting of 22 November 2022.

For the Court of Auditors



Tony Murphy
President