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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 2011

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1. INTRODUCTION

The Council Decisions establishing the various lending instruments of the European Union require the Commission to inform every year the European Parliament and the Council on the use of these instruments.

In order to meet these information requirements, this report describes the lending operations for each instrument as well as the respective borrowing activities.

2. LENDING ACTIVITIES OF THE EUROPEAN UNION

Financial support for third countries and Member States is provided by the Commission under various Council Decisions, depending on the geographical areas concerned and the objectives pursued. They usually take the form of bilateral loans financed from the capital markets with the guarantee of the EU budget.[1]

2.1. BOP facility

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

The facility is exceptional in nature and is mobilised on a case-by-case basis by Council Decision. Potential beneficiaries are Member States outside the euro area being faced with serious balance-of-payments difficulties. It aims at easing the recipient Member States' external financing constraints and at restoring the viability of a country's balance-of-payments. It is released subject to the fulfilment of economic policy conditions agreed by the Commission and the Member State - in consultation with the Economic and Financial Committee (EFC) - and the signature of a Memorandum of Understanding (MoU) prior to the conclusion of the loan agreements. The verification of the measures' implementation is a condition for disbursements of further instalments.

The BOP facility was re-activated in 2008 in response to the international economic and financial crisis and its ceiling was increased from EUR 12 billion to EUR 25 billion in

1 Detailed presentation of the borrowing and lending activities of the Commission is available at http://ec.europa.eu/economy_finance/eu_borrower/index_en.htm.

December 2008[2] while a further increase to EUR 50 billion was decided in May 2009[3] to enable the EU to respond quickly to any further demand for BOP assistance. By 31 December 2011, a total amount of EUR 14.6 billion had been committed to Hungary[4], Latvia[5] and Romania[6] of which EUR 13.4 billion were disbursed by end-2011.

Table 1: BoP assistance as of 31.12.2011 (in EUR billion)

Country	Amount granted	Amount disbursed	Amount reimbursed	Amount outstanding	Average loan maturity (years)
Hungary	6.5	5.5	2.0	3.5	6.1
Latvia	3.1	2.9	0	2.9	6.6
Romania	5.0	5.0	0	5.0	7.0
Total	**14.6**	**13.4**	**2.0**	**11.4**	

2.1.1. BoP operations in 2011

In 2011, a total amount of EUR 1.350 billion was disbursed in two tranches:

Table 2: List of loan operations disbursed under BoP facility in 2011 (in EUR million)

Country	Decision	Instalment date	Maturity	Coupon	Amount disbursed
Romania	2009/459/EC	24/03/2011	04/04/2018	3.25%	1,200
		22/06/2011	04/10/2018	3.13%	150
Total					**1,350**

The financial assistance granted to Hungary and Latvia, expired in November 2010 and in January 2012, respectively. As a result the remaining EUR 1 billion allocated to Hungary and EUR 0.2 billion to Latvia will not be disbursed under the current BoP operations.

2 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.

3 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.

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

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

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

In addition to the EUR 5 billion of BOP assistance, already provided, the Council decided on 12 May 2011 to provide precautionary financial assistance for Romania of up to EUR 1.4 billion[7] of which no disbursements has been made yet.

2.2. EFSM

Council Regulation (EU) No 407/2010 of 11 May 2010 set up the European Financial Stabilisation Mechanism (EFSM) based on Art. 122(2)[8] of the Treaty on the Functioning of the European Union (TFEU). The EFSM is fully backed by the EU budget and has a total lending capacity of up to EUR 60 billion.

The Commission is empowered to raise funds on behalf of the European Union in capital markets or directly from financial institutions. The use of the EFSM is subject to policy conditionality in the context of a joint EU/IMF structural adjustment and assistance programme. Financial assistance under EFSM is provided by a Council Decision taken by a qualified majority.

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 required[9].

The Commission reports regularly to the EFC and to the Council on the implementation of the EFSM Regulation and on the continuation of the exceptional occurrences that justified its adoption[10].

2.2.1. EFSM operations in 2011

The EFSM facility was activated in 2011 for Ireland and Portugal, commiting a loan amount of up to a EUR 22.5 billion and EUR 26 billion for these two beneficiary countries respectively. The total commitments, including also the EFSM, the IMF and other Member States amount to up to EUR 85 billion and EUR 78 billion respectively:

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7 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).

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

9 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.

10 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).

Table 3: Breakdown of commitments (in EUR billion)

Country	EFSM	EFSF	IMF	Others	Total
Ireland	22.5	17.7	22.5	22.3*	85
Portugal	26.0	26.0	26.0		78
Total	48.5	43.7	48.5	22.3	163

* EUR 4.8 billion from other Member States (United Kingdom, Sweden, Denmark) and EUR 17.5 billion from the Irish State.

In line with Council Decision 2011/77/EU[11] and Council Decision 2011/344/EU[12] EUR 13,900 million were disbursed to Ireland and EUR 14,100 million to Portugal in 2011 .

Table 4: List of loan operations disbursed under EFSM facility in 2011 (in EUR million)

Country	Decision	Amount granted	Instalment date	Amount disbursed	Coupon	Maturity	Average loan maturity (yrs)
Ireland	2011/77/EU	22,500	12/01/2011	5,000	2.50 %	04/12/2015	4.9
			24/03/2011	3,400	3.25 %	04/04/2018	5.8
			31/05/2011	3,000	3.50 %	04/06/2021	6.9
			29/09/2011	2,000	3.00 %	04/09/2026	8.1
			06/10/2011	500	2.375%	04/10/2018	8.0
Sub-total				**13,900**			**8.0**
Portugal	2011/344/EU	26,000	31/05/2011	1,750	3.50%	04/06/2021	10.0
			01/06/2011	4,750	2.75%	03/06/2016	6.4
			21/09/2011	5,000	2.75%	21/09/2021	7.9
			29/09/2011	2,000	3.00%	04/09/2026	9.0

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

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

			06/10/2011	600	2.375%	04/10/2018	8.9
Sub-total				**14,100**			**8.9**
Total		**48,500**		**28,000**			

Additional disbursements were carried out in 2012:

- on 16 January: EUR 1,500 million to Ireland and EUR 1,500 million to Portugal and
- on 5 March: EUR 3,000 million to Ireland,
- on 24 April: EUR 1,800 million to Portugal,
- on 4 May: EUR 2,700 million to Portugal.

This has increased the total outstanding amount of the Facility to EUR 38,500 million.

Furthermore, in line with the conclusions of the Heads of State or Government of the euro area and EU institutions of 21 July 2011 regarding the European Financial Stabilisation Mechanism lending, an extension of maturities - and a reduction in the interest rate margin has been decided[13]. The maximum average maturity has been increased from 7.5 to 12.5 years and the maturity of individual loan tranches may be extended to up to 30 years. In addition, the margin on the loans to the beneficiary country has been eliminated. As a result, a beneficiary country will only pay the total cost of funding of the EU. These Decisions will be applied retroactively to all disbursed loan tranches.

2.3. MFA facility

Macro-Financial Assisstance (MFA) is being provided to support EU candidate, potential candidate and neighbourhood countries to resolve short-term balance-of-payments problems, to stabilise public finances and to encourage structural reform implementation. MFA is provided on an exceptional and temporary basis and is based on strict economic policy conditionality. MFA operations typically complement IMF adjustment programmes. MFA can be provided in the form of grants and/or loans.

A comprehensive note clarifying the criteria for deciding between the use of loans and grants was submitted by the Commission to the Economic and Financial Committee in January 2011, which endorsed it. The criteria fall in two broad categories: the recipient country's level of economic and social development[14] as 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 methodology and the selection of indicators used by the

13 Council implementing Decisions n° 2011/682/EU of 11 October 2011 amending implementing Decision 2011/77/EU (Ireland) and n° 2011/683/EU of 11 October 2011 amending implementing Decision 2011/344/EU (Portugal), (OJ L 269 of 14.10.2011, resp. page 31 and 32).

14 Gross national income per capita is proposed as the primary indicator.

Commission are detailed in the Staff Working Document[15] accompanying the 2010 MFA annual report.

The Commission has also made a proposal for a Regulation of the European Parliament and of the Council laying down general provisions for MFA to third countries[16]. This Framework Regulation will make the decision process more efficient while aligning it with other EU financial assistance intruments. Moreover, following the entry into force of the Lisbon Treaty, MFA decisions are to be taken in accordance with the ordinary legislative procedure (co-decision).

Should a beneficiary country fail to honour its repayment obligations, the Commission may activate the Guarantee Fund for External Actions[17] so that the repayment of the corresponding borrowing by the Commission is secured[18].

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 countries[19].

2.3.1. MFA operations in 2011

In 2011, the Commission proposed to provide MFA to Georgia and the Kyrgyz Republic but no decisions were taken yet. An outcome is expected during 2012.

In February 2012, Egypt requested MFA in the amount of a EUR 500 million, which could be partly disbursed as a grant and would complement funds provided by the IMF and other donors. The Commission and the IMF are currently analysing residual external financing needs in preparation of a reply to Egypt's request.

In July 2011, two loan disbursements were carried out:

- EUR 100 million to Serbia as the first tranche of a Decision adopted in 2009[20]:

- EUR 26 million to Armenia as the first tranche of a Decision adopted in 2009[21].

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15 SEC(2011)874 final.

16 COM(2011)396 final.

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

18 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).

19 Not yet published for 2011. For 2010, see COM(2011)408 final.

20 Council Decision 2009/892/EC of 30 November 2009.

In February 2012, the second and last instalment of MFA to Armenia has been disbursed in an amount of EUR 39 million.

Furthermore, a total of EUR 55 million in grants have been disbursed in 2011 (EUR 35 million to Armenia and EUR 20 million to Moldova[22]).

2.4. Euratom facility

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).

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

2.4.1. Euratom operations in 2011

In 2011, neither loan decisions were taken nor disbursements were carried out.

3. BORROWING ACTIVITIES OF THE EUROPEAN UNION

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. Borrowing and lending is conducted as a back to back operation, which ensures that the EU budget does not take any interest rate or foreign exchange risk[23]. Outstanding borrowings are matched by outstanding loans.

Table 5: Total borrowing of the European Union — outstanding amounts of capital (1) (EUR million)

	ECSC i.l.(1) (2)	Euratom (1)	BOP	MFA	EFSM	Total European Union

21 Council Decision 2009/890/EC of 30 November 2009.

22 Council and European Parliament Decision 2010/0162(COD) of 7 September 2010

23 The EFSM Regulation allows resorting to pre-funding as it authorises the Commission "*to borrow on the capital markets or from financial institutions at the most appropriate time in between planned disbursements so as to optimise the cost of funding and preserve its reputation as the Union's issuer in the markets*."

2008	266	484	2,000	654		3,404
2009	214	481	9,200	584		10,479
2010	219	466	12,050	500		13,235
2011	225	447	11,400	590	28,000	40,662

(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.

3.1. BOP

In March 2011, under the BOP facility one loan of EUR 1.2 billion had to be raised in the market. In order to ensure a smooth and efficient execution, it was decided to raise these funds jointly with funds needed for a loan to Ireland under the EFSM programme (EUR 3.4 billion). An additional 0.15 billion were raised for Romania in June.

Table 6: EU bond issued during 2011 (in EUR billion)

Country	Description	Issue date	Maturity Date	Size (EUR)
Romania	EU 4.6bn 3.25%/2018	24/03/2011	04/04/2018	1.20 (+ 3.4 for EFSM Ireland)
Romania	EU 0.15bn 3.125%/2018	22/06/2011	04/10/2018	0.15
Total				**1.350**

3.2. EFSM

The Commission, on behalf of the European Union, had very substantial funding needs under the EFSM programme in order to finance support for Ireland and Portugal. The EU share (complemented by the IMF and the EFSF) was deployed relatively fast, as the EU was an already established issuer compared to the EFSF. This front-loading of the EFSM programme lead to a record issuance on behalf of the EU and amounted to EUR 28 billion for EFSM, funded by six EU benchmark bonds (with an outstanding nominal amount of EUR 3 billion or more for each bond series) and one smaller transaction.

These EU bonds met high demand in the market resulting in largely oversubscribed order books. All important groups of investors and in particular long-term investors (investment funds, asset managers, insurance and pension funds) as well as official institutions purchased these EU bonds[24].

The secondary market performance of these EU bonds was positive and confirmed the EU's standing as a strong benchmark bond issuer. For the bond with a maturity of 15-years, the EU received an award as " Sovereign Supranational Agency Sector deal of the year" from *International Financing Review* and the "deal of the year"-award from *Euromoney*.

Table 7: Overview on EFSM funding and loan disbursements (in EUR billion)

Country	Raised on	Maturity date	Size
Ireland	05/01/2011	04/12/2015	5.00
Ireland (plus 1.2 for BOP Romania, see above)	17/03/2011	04/04/2018	3.40
Ireland (3), Portugal (1.75)	24/05/2011	04/06/2021	4.75
Portugal	25/05/2011	03/06/2016	4.75
Portugal	14/09/2011	21/09/2021	5.00
Ireland (2);Portugal (2)	22/09/2011	04/09/2026	4.00
Ireland (0.5), Portugal 0.6	29/09/2011	04/10/2018	1.10
Total			**28.00**

Additional bond issues were carried out in 2012:

- in January: EUR 3 billion (EUR 1.5 billion to Ireland and EUR 1.5 billion to Portugal), and
- in March: EUR 3 billion to Ireland,
- in April: EUR 1.8 billion to Portugal,
- in May: EUR 2.7 billion to Portugal.

increasing the total raised for EFSM to EUR 38.5 billion.

24 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_en.pdf

3.3. MFA

In 2011, two borrowing operations have been executed successfully (EUR 100 million to Serbia and of EUR 26 million to Armenia). Both were funded by private placements.

Table 8: EU private placement during 2011 (in EUR million)

Country	Description	Issue date	Maturity Date	Size
Serbia	EU 3.382%/2019	05/07/2011	12/07/2019	100
Armenia	EU 3.691%/2026	20/07/2011	27/07/2026	26
Total				**126**

3.4. Euratom

In 2011, there was no borrowing operation under Euratom.

4. EUROPEAN INVESTMENT BANK

4.1. EIB lending activities

The EIB provides financing either *directly* to individual investment projects or *through financial intermediaries* to smaller-scale projects undertaken by SMEs or by local authorities and municipalities. The EIB also provides loan guarantees, technical assistance and venture capital.

In 2011, EIB signed a total financing volume of EUR 61 billion (compared to EUR 72 billion in 2010), reflecting a gradual return to pre-2008 lending levels after exceptional additional lending efforts made in 2008, 2009 and 2010.

Financing in EU Member States represented EUR 54 billion. This amount is *not* covered by the EU guarantee. EUR 7.3 billion was signed outside the EU, of which EUR 3.1 billion under the External Mandate covered by the EU guarantee.

EIB financing activities have an impact on the EU budget when they are accompanied by EU guarantees, EU/EIB risk-sharing provisions or other blending mechanisms. In particular, EIB loans carried out under the External Mandate (covering Pre-Accession, Southern and Eastern Neighbourhood, Asia, Latin America and South Africa) benefit from an EU budget guarantee covering risks of sovereign or political nature. A separate report on the 2011 EIB external lending activity will be issued by the Commission during the second semester of 2012.

The EIB also manages risk sharing financing facilities involving the use of the EU budget to support EU policies (e.g. Risk Sharing Finance Facility for research and development projects and Loan Guarantee for TEN-Transport projects)[25].

4.2. EIB borrowing activities

In 2011, markets proved more inhospitable as concerns about Europe mounted, but the EIB was able to maintain rather stable funding levels and market access in the first ten months. The market then became especially challenging during November/December. At this time, a sharp deterioration in market perceptions of the European sovereign context caused substantial spread widening and curtailed demand, as was the case for most European issuers. Uncertainty peaked in December with Standard and Poor’s and Fitch putting EIB’s rating on watch.

[25] 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.

Under these circumstances, EIB's endeavour to complete its funding programme relatively early, and achieving this by end October, proved vital. The EUR 76 billion issuance was the second largest ever (2010: EUR 67 billion).

5. ENSURING FINANCIAL STABILITY IN THE EURO AREA

In response to the global economic and financial crisis, the Council and the euro area Member States have decided on measures to preserve financial stability in the euro area and Europe at large. These measures are outined below.

5.1. Greek Loan Facility (GLF)

Following the unanimous agreement of the euro area Finance Ministers on 2 May 2010[26] to support Greece, a three-year joint programme with the IMF involving a financial package of EUR 110 billion to help Greece was set-up, accompanied with strong policy conditionality[27] negotiated with the Greek authorities by the Commission and the IMF, in liaison with the ECB.

Contributions amount to EUR 80 billion from the Euro area Member States and to EUR 30 billion from the IMF. At 31 December 2011, total disbursements for Greece amount to EUR 73 billion (EUR 52.9 billion from the Euro area Member States and EUR 20.1 billion from the IMF[28]).

<u>The role of the Commission</u>

Under the GLF, the Commission is not acting as a lender nor as a borrower. However, the representatives of the Member States of the European Union have decided on 5 May 2010 to entrust the Commission with 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[29]. The role does not imply an increase in

[26] The support is provided 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.

[27] 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.

[28] Additional details on the Greek Loan Facility is available at http://ec.europa.eu/economy_finance/eu_borrower/greek_loan_facility/index_en.htm

[29] 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 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.

the expenditure of the Commission or of any other item of expenditure under the EU budget[30]. Starting from 28 March 2012, the remaining undrawn amounts have been cancelled. The financial terms of the facility have also been adjusted, the final maturity being extended up to 15 years and the grace period up to 10 years. In addition, the margin was reduced to 1.5%.

5.2. 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 on-lending to euro-area Member States in difficulty, subject to conditionality negotiated with the Commission in liaison with the European Central Bank and the IMF and to be approved by the Eurogroup. The lending by the EFSF is not covered by an EU budget guarantee.

The Commission co-ordinates its own borrowing activities with the EFSF's for the financing of the programmes where both are involved in order to optimize their capital market activities in terms of timing.

5.3. European Stability Mechanism (ESM)

The establishing of a new permanent crisis mechanism, the European Stability Mechanism (ESM), was agreed on 2 February 2012. The entry into force of the ESM Treaty is planned for mid-2012 after ratification by the 17 euro area Member States. The ESM will assume the tasks currently fulfilled by the EFSF and the EFSM in providing, where needed, financial assistance to euro area Member States.

For this purpose, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties. The initial maximum lending volume of the ESM is set at EUR 500 billion, including the outstanding EFSF lending capacity.

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