EUROPEAN
COMMISSION

Brussels, 31.10.2013
COM(2013) 752 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON BORROWING AND LENDING ACTIVITIES OF THE EUROPEAN UNION IN 2012

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1. INTRODUCTION

The Commission is required to inform every year the European Parliament and the Council on the use of the various lending instruments of the European Union.

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 in the form of bilateral loans financed from the capital markets with the guarantee of the EU budget is provided by the Commission under various legal acts of the Council or of the Council and the European Parliament, depending on the objectives pursued[1]. The consistency of financial support to third countries with the overall objectives of the EU external action is ensured by the Commission and the High Representative, assisted by the EEAS.

2.1. BOP facility

Balance-of-payments (BOP) assistance under Article 143 of the Treaty on the Functioning of the European Union (TFEU) and Council Regulation (EC) No 332/2002 of 18 February 2002 establishing a facility providing medium term financial assistance for Member States' balances of payments[2] 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.

BOP assistance is exceptional in nature and is granted on a case-by-case basis by the Council acting by qualified majority. 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 decided by the Council – after consultation with the Economic and Financial Committee (EFC) on a draft adjustment programme – and agreed by the Commission and the beneficiary Member State in a Memorandum of Understanding (MoU) prior to the conclusion of a loan agreement. The continued compliance with measures in the adjustment programme is reviewed regularly and is a condition for the disbursements of further instalments. The required funds are raised by the Commission on behalf of the European Union in capital markets.

The Commission reports regularly to the Economic and Financial Committee (EFC) and to the Council on the implementation of the BOP Regulation.

[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.

[2] OJ L 53, 23.2.2002, p.1.

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 December 2008[3] while a further increase to EUR 50 billion was decided in May 2009[4] to enable the EU to respond quickly to any further demand for BOP assistance. By 31 December 2012, a total amount of EUR 14.6 billion had been committed to Hungary[5], Latvia[6] and Romania[7] of which EUR 13.4 billion were disbursed by end 2012.

In addition to the EUR 5 billion of BOP assistance which expired on 6 May 2012, the Council decided in 2011 to provide precautionary financial assistance (PFA) for Romania of up to EUR 1.4 billion[8]. However, no disbursements were made and the facility expired on 31 March 2013.

The financial assistance granted to Hungary and Latvia expired in November 2010 and in January 2012, respectively.

In 2012, no decisions/disbursements were made under the BOP facility.

Table 1: BoP assistance as of 31.12.2012 (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 (BOP)	5.0	5.0	0	5.0	7.0
Romania (PFA)	1.4	0	0	0.0	0
Total	**16.0**	**13.4**	**2.0**	**11.4**	

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 (OJ L 352, 31.12.2008, p. 11).

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 (OJ L 128, 27.5.2009, p.1).

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 Council Decision 2011/288/EU of 12 May 2011 providing precautionary EU medium-term financial assistance for Romania (OJ L 132, 19.5.2011, p. 15).

2.2. EFSM

Council Regulation (EU) No 407/2010 of 11 May 2010 set up the European Financial Stabilisation Mechanism (EFSM) based on Article 122(2)[9] . The EFSM is fully backed by the EU budget and has a total lending capacity of up to EUR 60 billion.

Potential beneficiaries for the EFSM assistance are the Member States in the euro-area faced with difficulties caused by a serious deterioration in the international economic and financial environment. The use of EFSM is subject to policy conditionality in the context of an economic and financial adjustment programme as agreed under a Memorandum of Understanding concluded between the Commission and the beneficiary Member State and it follows a similar decision making process as for the BOP assistance. The assesment of the financial needs and regular surveillance in the programme implementation are made in consultation with ECB, at least every six months regarding the general economic policy conditions of the adjustment programme and every three months for the verification of fulfilment by the Member State of economic policy conditions attached to the assistance. Any changes that may be needed to the 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.

The Commission reports regularly to the Economic and Financial Committee (EFC) and to the Council on the implementation of the EFSM Regulation and on the continuation of the exceptional occurrences that justified its adoption.

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 EFSF, the IMF and other Member States amount to up to EUR 85 billion and EUR 78 billion respectively:

Table 2: 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.

Furthermore, in line with the statement of the Heads of State or Government of the euro-area and EU institutions of 21 July 2011, an extension of maturities[10] and a reduction in the interest rate margin[11] had been decidedand applied retroactively to all disbursed loan tranches.

[9] Article 122(2) TFEU foresees financial support for Member States in difficulties caused by exceptional circumstances beyond their control.

In line with Council Implementing Decision 2011/77/EU[12] and Council Implementing Decision 2011/344/EU,[13] EUR 7,800 million were disbursed to Ireland and EUR 8,000 million to Portugal in 2012. The total outstanding amount of the Facility is EUR 43,800 million at the end of 2012.

10 Council Implementing Decision No 2013/313/EU of 21 June 2013 amending implementing Decision 2011/77/EU (Ireland) (OJ L 173, 26.6.2013, p. 40), and Council Implementing Decision No 2013/323/EU of 21 June 2013 amending implementing Decision 2011/344/EU (Portugal) (OJ L 175, 27.6.10.2013, p.47).

11 Council Implementing Decision No 2011/682/EU of 11 October 2011 amending implementing Decision 2011/77/EU (Ireland) (OJ L 269, 14.10.2011, p. 31), and Council Implementing Decision No 2011/683/EU of 11 October 2011 amending implementing Decision 2011/344/EU (Portugal) (OJ L 269, 14.10.2011, p. 32).

12 Council Implementing Decision No 2011/77/EU of 7 December 2010 on granting Union financial assistance to Ireland (OJ L 30, 4.2.2011, p. 34).

13 Council Implementing Decision No 2011/344/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 159, 30.5.2011, p. 88).

Table 3: List of loan operations disbursed under EFSM facility in 2012 (in EUR million)

Country	Decision	Amount granted	Instalment date	Amount disbursed	Coupon	Maturity	Average loan maturity (yrs)
Ireland	2011/77/EU	22,500	16/01/2012	1,500	3.75 %	04/04/2042	10.2
			05/03/2012	3,000	3.375 %	04/04/2032	11.8
			03/07/2012	2,300	2,875 %	04/04/2028	12.3
			30/10/2012	1,000	2.50 %	04/11/2027	12.4
Sub-total				**7,800**			**12.4**
Portugal	2011/344/EU	26,000	16/01/2012	1,500	3.75 %	04/04/2042	10.9
			24/04/2012	1,800	3.375 %	05/04/2038	12.5
			04/05/2012	2,700	2.75 %	04/04/2022	12.2
			30/10/2012	2,000	2.50 %	04/11/2027	12.4
Sub-total				**8,000**			**12.4**
Total		**48,500**		**15,800**			

2.3. MFA facility

Macro-Financial Assistance (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 loans and/or non-reimbursable grants.

Should a beneficiary country fail to honour its repayment obligations, the Commission may activate the Guarantee Fund for External Actions[14] so that the repayment of the corresponding borrowing by the Commission is done from its funds[15].

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[16].

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

[15] Although the repayment of the borrowing is covered in fine by 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).

In 2012, the MFA operation for Armenia adopted in 2009[17] was completed. The loan component of the second and last tranche amounting to EUR 39 million was disbursed to the Armenian authorities in February 2012. The first tranche and the grant part of the second tranche had been disbursed in 2011. This closed the EUR 100 million MFA operation, comprised of EUR 65 million in loans and EUR 35 million in grants.

With respect to the MFA to Moldova[18], consisting of a EUR 90 million grant, the Commission released the third and last tranche (EUR 30 million) in April 2012.

The implementation of the MFA to Ukraine, approved in 2010[19], which, together with the funds available from a previous operation approved in 2002, amounts to EUR 610 million in loans, was further delayed in 2012 due to the need to agree with the Ukrainian authorities certain conditions of the Memorandum of Understanding (MoU) as well as the fact that the IMF programme had gone off-track and then expired in December 2012. An agreement on the MoU was reached in mid-2012 and the MoU was signed in the framework of a Ukraine-EU summit in February 2013. However, the first disbursement of this MFA operation remains subject to the Ukrainian authorities and the IMF agreeing on a new financial aid programme.

Regarding the MFA to Bosnia and Herzegovina[20], approved in 2009 (amounting to a total of EUR 100 million in loans), the validity of the Memorandum of Understanding and the Loan Agreement was extended by one year until November 2013. The first tranche of this operation, amounting to EUR 50 million, was disbursed in February 2013.

In 2012, the European Parliament and the Council discussed two legislative proposals for new MFA operations adopted by the Commission in 2011: the proposal to extend MFA to Georgia for EUR 23 million in loans and EUR 23 million in grants; and the proposal to extend an exceptional[21] MFA to the Kyrgyz Republic for EUR 15 million in loans and EUR 15 million in grants. The decision on Georgia was adopted in August 2013.

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 to EUR 6 billion, but the Council postponed its decision until disbursements reach EUR.3.8 billion.

Discusssions are on-going for a EUR 300 million loan to Ukraine, which will be dedicated to the upgrade of existing nuclear facilities.

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16 COM (2013)426 and SWD(2013)211.

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

18 Council and European Parliament Decision No 938/2010/EU of 7 September 2010.

19 Council and European Parliament Decision No 388/2010/EU of 7 July 2010.

20 Council Decision 2009/891/EC of 30 November 2009.

21 "Exceptional" in the sense that it is granted to a country outside the normal geographical scope of MFA, i.e.candidate/potential candidate and neighbourhood countries.

In 2012, no loan decisions were taken or disbursements carried out under the Euratom loan facility.

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 back to back operations, which ensures that the EU budget does not take any interest rate or foreign exchange risk[22]. Outstanding borrowings are matched by outstanding loans.

Table 4: Evolution of total borrowing of the European Union (outstanding amounts of capital(1) in EUR million)

	ECSC i.l.(1) (2)	Euratom (1)	BOP	MFA	EFSM	Total
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
2012	183	423	11,400	545	43,800	56,351

(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 2012, under the BOP facility, no loans were raised in the market.

3.2. EFSM

During 2012, EUR 15.8 billion were raised, funded by six EU benchmark bonds ("benchmark" referring to bonds with an outstanding nominal amount of EUR 1 billion or more for each bond series).

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.

[22] 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*." However, any resultant cost of carry is borne by the borrower.

The secondary market performance of these EU bonds was positive and confirmed the EU's standing as a strong benchmark bond issuer. According to our calculations and using input from 22 banks secondary market turnover in EU benchmark bonds was EUR 50 billion in 2012 (which compares to EUR 40 billion in 2011).

Table 5: Overview on EFSM funding and loan disbursements (in EUR billion)

Country	Raised on	Maturity date	Size
Ireland (1.5), Portugal (1.5)	16/01/2012	04/04/2042	3.00
Ireland	05/03/2012	04/04/2032	3.00
Portugal	24/04/2012	05/04/2038	1.80
Portugal	04/05/2012	04/04/2022	2.70
Ireland	03/07/2012	04/04/2028	2.30
Ireland (1), Portugal (2)	30/10/2012	04/11/2027	3.00
Total			**15.80**

The total amount raised for EFSM is EUR 43.8 billion in the end of 2012.

3.3. MFA

In 2012, one borrowing operation was executed successfully (EUR 39 million to Armenia).

Table 6: EU private placement during 2012 (in EUR million)

Country	Description	Issue date	Maturity Date	Size
Armenia	SSD EU 3.137/2026	09/02/2012	04/12/2026	39
Total				**39**

3.4. Euratom

In 2012, 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 2012, EIB signed a total financing volume of EUR 52.2 billion (compared to EUR 61 billion in 2011).

Financing in EU Member States represented EUR 44.8 billion. This amount is not covered by the EU guarantee. EUR 7.4 billion was signed outside the EU, of which EUR 4 billion under the External Mandate covered by the EU guarantee.

Following the entry into force at the end of 2012 of the Member States' decision to increase the EIB's paid-in capital by EUR 10 billion, the EIB is expected to increase its volume of lending by EUR 60 billion over the years 2013-2015.

EIB financing activities have an impact on the EU budget when they are accompanied by EU guarantees. This is the case for:

- EIB loans carried out under the External Mandate (covering Pre-Accession countries, Neighbourhood and Partnership countries, Asia and Latin America, South Africa as well as a Climate Change mandate) benefit from an EU budget guarantee covering risks of sovereign or political nature. A separate report on the 2012 EIB external lending activity will be issued by the Commission during the second semester of 2013.

- 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 the Project Bond Initiative).

4.2. EIB borrowing activities

In a volatile market context, execution risk remained high throughout the year, especially for large benchmark transactions. The solid demand for EIB bonds first supported a tightening of shorter dated spreads, especially in EUR. Rating agencies preserved the Bank's AAA rating, supported by the plans on a capital increase, whereas certain European supranational peers did not benefit from such an outcome.

By flexibly navigating such market conditions, the Bank was able to complete the originally foreseen funding programme of EUR 60 billion already in September, and continued to seize opportunities for issuance at attractive levels until markets became less liquid near year end. In 2012, EIB borrowing activity amounts to EUR 71.3 billion with an average maturity of 8.4 years.

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 outlined below and are not guaranted by the EU Budget.

5.1. Greek Loan Facility (GLF)

Following the unanimous agreement of the euro-area Finance Ministers on 2 May 2010[23] to support Greece, a three-year joint programme with the IMF involving a financial package of up to EUR 110 billion to help Greece was set-up, accompanied with strong policy conditionality[24] negotiated with the Greek authorities by the Commission and the IMF, in liaison with the ECB. The euro-area Member States initial financial package (EUR 80 billion) – IMF committed EUR 30 billion - was in the end reduced by 2.7 billion given that Slovakia decided not to participate and that Ireland and Portugal stepped down from the GLF when asking for financial assistance for themselves. The loans granted by the euro-area Member States under this first programme amount to EUR 52.9 billion and to EUR 20.1 billion from the IMF.

The financial terms of the facility were re-adjusted in December 2012. The final maturity being extended to 30 years while maintaining a 10-year grace period. In addition, the margin was reduced to 0.5%. The margin equal to 1.5% will however continue to apply in relation to amounts due to the euro-area Member States that are under a full financial assistance programme funded by the EFSF or EFSM.

On 14 March 2012, a Second Economic Adjustment Programme was approved by the euro-area finance ministers and the IMF, adding EUR 130 billion to the undisbursed amounts of the first programme. This second programme foresees therefore a total financial assistance of EUR 164.5 billion, the IMF contribution amounting to EUR 19.8 billion. While the first programme was set up as an Inter-creditor Agreement of pooled bilateral loans from the supporting euro-area Member States, with the Commission providing coordination and management, the second one is financed via the EFSF.

At 31 December 2012, total disbursements for Greece amount to EUR 182.9 billion.[25]

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.

It was designed as a temporary rescue mechanism for on-lending to euro-area Member States in difficulty by issuing bonds guaranteed by euro-area Member States. In October 2010, it was decided to create a permanent rescue mechanism, the European Stability Mechanism (ESM).

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[23] 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.

[24] 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.

[25] Additional details on the Greek Loan Facility is available at http://ec.europa.eu/economy_finance/assistance_eu_ms//greek_loan_facility.

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 and inaugurated on 8 October 2012. The mechanism should assume the tasks currently fulfilled by the EFSF in providing, where needed, financial assistance to euro-area Member States with a maximum lending capacity of EUR 500 billion, while the combined lending ceiling of the EFSF/ESM is set at EUR 700 billion. The authorised capital is EUR 700 billion of which EUR 80 billion paid-in capital by euro-area Member States. Subscription to the paid-in capital is planned to be made in five installments to be completed by the first half of 2014. Authorized unpaid capital may be called in to restore the level of paid-in capital if the latter is reduced by the absorption of losses. Minimum 15% ratio between paid-in capital and outstanding amount of ESM issuance will be maintained during the capital phase-in period; paid-in capital is not available for lending - it is invested in high quality liquid assets.

From October 2012, the ESM[26] should be the main instrument to finance new programmes.

[26] Additional details on the ESM are available at http://esm.europa.eu.