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PROPOSAL

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To:	Ms Thérèse BLANCHET, Secretary-General of the Council of the European Union
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Subject:	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

Delegations will find attached document COM(2022) 596 final.

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2022/0370 (COD)

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**

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

- **Reasons for and objectives of the proposal**

The Commission has been conducting borrowing and lending operations to provide financial assistance in the form of loans to a beneficiary country for several decades. The borrowing and lending operations are guaranteed under the Union's budget and come under the wider scope of budgetary implementation. General rules for such operations are laid down in Article 220 of Regulation (EU, Euratom) 2018/1046¹ ("Financial Regulation"), which provides that the Commission can be empowered in a basic act to borrow on behalf of the Union or Euratom to on-lend the corresponding amounts to the beneficiary Member States or third countries under the conditions applicable to the borrowings. The cash flows between the borrowed funds and the loans are matched one-to-one. This means that market operations are based on disbursement needs, which limits the possibility to plan various borrowing operations coherently with the best market opportunities and structure maturities to achieve the best costs.

The funding needs for Ukraine require mobilisation and disbursement in a cost-effective flexible and financially sound manner, integrating all funding needs including for NextGenerationEU ("NGEU"). It is of paramount importance that this funding be organised under a single funding method in order to allow different policy needs to be met concurrently. To that end, it is necessary to amend Regulation (EU, Euratom) 2018/1046 to establish the diversified funding strategy, currently implemented for borrowings under Decision (EU, Euratom) 2020/2053² as the baseline method for the implementation of borrowing operations. This strategy has allowed the successful mobilisation of funds for non-repayable support and loans under Regulation (EU) 2021/241³ and a range of other EU policies in 2022.

This will allow the Commission to finance the assistance to Ukraine under the proposed Regulation establishing an instrument to provide support to Ukraine⁴ in a cost-efficient, flexible and financially sound manner to ensure parallel financing of all Union programmes relying on borrowing. The extension of the scope of application of the diversified funding strategy goes beyond the funding needs for Ukraine and would be available to any future programmes. It will enable the Commission to use the infrastructure, which allows an integrated funding planning and communication to markets.

In the absence of such a single funding method, the Commission would be required to continue financing different programmes of financial assistance separately. This would create

¹ Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012(1) OJ-L 193/30.07.2018, p.1.

² Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, OJ L 424, 15.12.2020, p. 1.

³ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, OJ L 57, 18.2.2021, p. 17.

⁴ Proposal for a Regulation of the European Parliament and of the Council establishing an instrument to provide support to Ukraine (macro-financial assistance +), COM(2022)597.

cost and complexity as the different programmes of financial assistance would compete for a limited number of funding opportunities. It would fragment the supply of Union's debt and reduce liquidity and investor interest in the separate programmes. Financing all financial assistance through a single funding method would therefore enhance the liquidity of the Union's bonds their attractiveness and cost-effectiveness.

The diversified funding strategy is a financing method through which funding transactions are organised in a manner consistent with the limits of financial liability authorised in the basic acts in order to achieve the policy objectives. The implementation of a diversified funding strategy does not change the financial liabilities arising from the borrowing. It provides the Commission with more flexibility in how the Union mobilises resources through bond issuance.

Recourse to a diversified funding strategy as a single funding method will allow the Commission to decouple the timing and the maturity of single funding transactions from the disbursements to beneficiaries. A common liquidity pool financed by the issuance of short-term funding (EU-bills) enables the Commission to organise payments in accordance with a regular and agreed schedule, independently of the exact timing of the long-term bond issuance. This then allows payments to be made to beneficiaries independently of market conditions prevailing at the time of the disbursement, and avoids having to raise fixed amounts in volatile or adverse conditions. Over the lifetime of the programme of financial assistance, the net liabilities generated are fully matched by countervailing assets (amounts outstanding, still to be repaid under loans as they mature⁵). On this basis, the principles of budgetary neutrality and budgetary balance as set out in Article 310(1) TFEU are respected. The costs are fully borne by the beneficiaries based on a single cost allocation methodology that ensures transparent and proportional allocation of costs. The repayment obligations should remain with the beneficiaries of the financial assistance, in compliance with Article 220(5)(e) of the Financial Regulation.

The common liquidity pool should be maintained at levels that would allow the Commission to meet all expected outflows over the short-term, based on a robust liquidity forecasting capacity. The existence of a large, well-stocked liquidity buffer, capable of managing disbursements over long periods, allows the diversified funding strategy to function without the need for other solutions to address temporary cash shortfalls.

To support the most successful implementation of the diversified funding strategy, the Commission should, as far as possible, ensure a continuous market presence and to this end implement all necessary transactions aiming at achieving the best possible funding costs and at facilitating of transactions in debt securities of the Union and Euratom. The latter is crucial in supporting the active involvement of the widest range of investors to markets for Union's debt instruments.

The conduct of the diversified funding strategy requires that a single set of rules is followed in respect of all borrowing and lending programmes which rely on it. The Financial Regulation in its role of a single rulebook for the implementation of the EU budget should provide the basis for those rules.

⁵ Or by repayments from the Union's budget for external assigned revenue under NGEU.

Following the entry into force of this amendment of the Financial Regulation, the Commission will adopt and implement a wider governance framework, risk management procedures, and cost allocation methodology.

These new rules of the Financial Regulation should only apply to new financial assistance to third countries for which the basic acts enter into force on or after the date of entry into force of these amendments of the Financial Regulation and the parallel amendment of Regulation (EU, Euratom) 2020/2093.

The Commission proposed a recast of the Financial Regulation⁶ that is being examined by the European Parliament and the Council. The present stand-alone proposal should be adopted as a matter of urgency and the changes incorporated in the pending recast during the legislative process.

- **Consistency with existing policy provisions in the policy area**

The diversified funding strategy has been introduced for NGEU borrowing and has proven successful so far in that context.

- **Consistency with other Union policies**

The diversified funding strategy will allow efficient use of borrowing capacity for Union policies which may make use of borrowing and lending operations.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The proposal is based on Article 322(1) of the Treaty on the Functioning of the European Union (TFEU).

- **Subsidiarity (for non-exclusive competence)**

The adoption of EU general financial rules falls under the exclusive competence of the EU.

- **Proportionality**

This proposal introduces changes necessary to conduct the diversified funding strategy as a single borrowing method and does not go beyond that objective. This single funding method is indispensable for the Union to be able to place on the market issuances which can satisfy increasing funding needs of all respective programmes. Conversely, continuing with disbursement-based funding would lead to higher costs and complexity and put at risk the successful funding of different Union programmes on cost-advantageous terms. The proposal does not contain rules that would not be necessary to achieve the objectives of the Treaty.

⁶ COM/2022/223 final of 16 May 2022.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Stakeholder consultations**

No stakeholder consultation has been conducted for this limited amendment.

The investors and capital markets appreciate the regularity and predictability of Union's borrowing operations. This was made possible thanks to the diversified funding strategy.

Experience has shown that diversified funding strategy allows the EU to engage more effectively with investors and issue debt more efficiently than a continuation of a piecemeal borrowing and lending approach, whereby cash flows between the borrowed funds and the loans are matched one-to-one, which is what is currently required for financial assistance in line with Article 220(7) of the Financial Regulation. The members of the primary dealers network also emphasized the importance of regular market presence.

- **Impact assessment**

In line with the Commission's statement on future revisions of the Financial Regulation⁷, no impact assessment is required. The Financial Regulation provides the general rules and the toolbox for the implementation of the Union's spending programmes. To accommodate the new instrument for financial support to Ukraine, technical targeted amendments are required in the Financial Regulation. These targeted amendments do not imply viable policy options for the Commission and therefore no impact assessment is required. There are no direct economic, environmental or social impacts that result from revisions of the legislation, which could effectively be analysed in an impact assessment.

Regulatory fitness and simplification

While this amendment of the Financial Regulation does not fall under the Regulatory Fitness and Performance Programme (REFIT), it contributes to the Better Regulation agenda. This proposal responds to the need to improve the provisions on funding for financial assistance and generalise the possibility of using a diversified funding strategy. The proposed approach is fully in line with the better regulation framework and simplification efforts.

Fundamental rights

The proposal complies with the Charter of Fundamental Rights of the Union.

4. BUDGETARY IMPLICATIONS

The proposal has no direct implications for the level of appropriations in the Union budget. The repayment obligations will remain with the beneficiaries of the financial assistance, in compliance with Article 220(5)(e) of the Financial Regulation and in line with the budgetary principles of sound financial management and equilibrium. The borrowing costs are borne by the beneficiaries based on a single cost allocation methodology that ensures transparent and equitable allocation of costs.

⁷ 2018/C 267 I/01.

5. OTHER ELEMENTS

- **Implementation plans and monitoring, evaluation and reporting arrangements**

The monitoring and reporting obligations under the Financial Regulation apply.

- **Detailed explanation of the specific provisions of the proposal**

Paragraph 1 of Article 1 deletes Article 220(2) and (7) of the Financial Regulation to adjust to the borrowing methods of the diversified funding strategy.

Paragraph 2 of Article 1 inserts a new Article 220a in the Financial Regulation to establish the diversified funding strategy as a single funding method.

Article 2 provides for the entry into force and for the transitional rule according to which the amendments will only apply to the financial assistance for which the basic acts enter into force after 9 November 2022.

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

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 322(1) thereof,

Having regard to the Treaty establishing the European Atomic Energy Community, and in particular Article 106a thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the Court of Auditors⁸,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Article 220 of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council (the “Financial Regulation”) currently provides that the Commission borrows on behalf of the Union or Euratom to on-lend the corresponding amounts to beneficiary Member States or third countries under the conditions applicable to the borrowings. In this regard, the cash flows between the borrowed funds and the loans are matched one-to-one. This means that the Union must carry out market operations based on disbursement needs for each specific case of lending, which limits the possibility to plan coherently various borrowing operations and structure maturities to achieve the best costs.
- (2) Financing individual programmes of financial assistance through separate funding methods creates cost and complexity as the different programmes of financial assistance compete for a limited number of funding opportunities. It fragments the supply of Union’s debt securities and reduces liquidity and investor interest in the separate programmes, even though all Union debt securities have the same high credit standing. Financial assistance should be organised under a single funding method that enhances the liquidity of Union’s bonds and the attractiveness and cost-effectiveness of Union’s issuance.

⁸ OJ C [...], [...], p. [...].

- (3) This is emphasised in particular in the current context of financial support to Ukraine given its urgent financial needs. Recent experience with the funding needs for Ukraine has highlighted the disadvantages of a fragmented approach to the organisation of the Union's debt. In order to assert the Union's position as an issuer of euro-denominated debt, it would be of paramount importance to organise all new issuance through a single funding method.
- (4) The diversified funding strategy has allowed the successful mobilisation of funds for grants and loans under Regulation (EU) 2021/241 of the European Parliament and of the Council⁹ and a range of other Union programmes referred to in Article 2(2) of Regulation (EU) 2020/2094¹⁰. 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, it is appropriate to establish a diversified funding strategy as the single funding method for implementation of borrowing operations.
- (5) The model for such single funding method, and most elements of the infrastructure needed for its implementation, have already been established in the form of the diversified funding strategy under Decision (EU, Euratom) 2020/2053¹¹ to finance measures under Regulation (EU) 2020/2094. The use of this strategy should allow a flexible implementation of the funding programme, while fully respecting the principles of budgetary neutrality and budgetary balance as set out in Article 310(1) of the Treaty on the Functioning of the European Union ("TFEU"). The costs should be fully borne by the beneficiaries based on a single cost allocation methodology that ensures transparent and proportional allocation of costs. The repayment obligations should remain with the beneficiaries of the financial assistance, in compliance with Article 220(5), point (e) of the Financial Regulation.
- (6) The implementation of the diversified funding strategy would require a single set of rules to be followed in respect of all borrowing and lending programmes relying on it. These rules should therefore be added to horizontal financial rules in the Financial Regulation, adopted by the European Parliament and the Council on the basis of Article 322 TFEU.
- (7) A diversified funding strategy should provide the Commission with more flexibility concerning the timing and the maturity of single funding transactions and allow regular and steady disbursements to different beneficiary countries. The strategy should be based on the pooling of funding instruments. This would give the Commission flexibility to organise payments to the beneficiaries independently of market conditions at the time of disbursement, and avoid as much as possible that the Commission would have to raise fixed amounts in volatile or adverse conditions.

⁹ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

¹⁰ Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis (OJ L 433I, 22.12.2020, p. 23).

¹¹ Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, OJ L 424, 15.12.2020, p. 1.

- (8) This would require putting into place a common liquidity pool. Such a centralised liquidity function would render the Union's funding capacity more resilient, and able to withstand temporary mismatches between all inflows and outflows, based on a robust liquidity forecasting capacity.
- (9) The Commission should implement all necessary transactions aiming at a continuous market presence, at achieving the best possible funding costs and at facilitating of transactions in debt securities of the Union and Euratom.
- (10) In extending the diversified funding strategy to a wider range of programmes, it is therefore appropriate that the Commission establishes the necessary arrangements for its implementation. They should comprise a governance framework, risk management procedures, and a cost allocation methodology, which should respect Article 220(5), point (e) of Regulation (EU, Euratom) 2018/1046. To ensure transparency, the Commission should regularly and comprehensively inform the European Parliament and the Council about all aspects of its issuance and debt management strategy.
- (11) In the interest of legal certainty and clarity in respect of already granted financial assistance and in respect of financial assistance under Regulation establishing an instrument to provide support to Ukraine¹² proposed simultaneously, this Regulation should only apply to new financial assistance the basic acts of which enter into force on or after 9 November 2022.
- (12) In view of the urgency entailed by the exceptional circumstances caused by Russia's unprovoked and unjustified war of aggression, it is considered to be appropriate to invoke the exception to the eight-week period provided for in Article 4 of Protocol No 1 on the role of national Parliaments in the European Union, annexed to the Treaty on European Union, to the Treaty on the Functioning of the European Union and to the Treaty establishing the European Atomic Energy Community.
- (13) In light of the current situation in Ukraine, this Regulation should enter into force as a matter of urgency on the day following that of its publication in the *Official Journal of the European Union*.
- (14) The respective provisions of the Financial Regulation should therefore be amended,

HAVE ADOPTED THIS REGULATION:

Article 1

Regulation (EU, Euratom) 2018/1046 is amended as follows:

- (1) In Article 220, paragraphs 2 and 7 are deleted.
- (2) The following Article 220a is inserted after Article 220:

'Article 220a

Diversified funding strategy

¹² Proposal for a Regulation of the European Parliament and of the Council establishing an instrument to provide support to Ukraine (macro-financial assistance +), COM(2022)597.

1. Except in duly justified cases, the Commission shall implement a diversified funding strategy comprising borrowing and debt management operations to fund programmes of financial assistance and the borrowings authorised under Article 5(1) of Decision (EU, Euratom) 2020/2053. The diversified funding strategy shall be implemented through all necessary transactions aiming at a regular capital market presence, shall be based on pooling of funding instruments and shall make use of a common liquidity pool.
2. The Commission shall establish the necessary arrangements for the implementation of the diversified funding strategy. The Commission shall regularly and comprehensively inform the European Parliament and the Council about all aspects of its issuance and debt management strategy.’

Article 2

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

It shall apply to programmes of financial assistance for which the basic acts enter into force on or after 9 November 2022.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President