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WORKING DOCUMENT

on ECA Special Report 16/2023 – NGEU debt management at the Commission
- An encouraging start, but further alignment with best practice needed

Committee on Budgetary Control

Rapporteur: Carlos Coelho

SUMMARY

In order to address the economic and social crisis caused by the **COVID-19 pandemic**, the Commission launched **NextGenerationEU** (NGEU), the biggest borrowing programme in EU history. With the Recovery and Resilience Facility (RRF) accounting for 90 % of its total budget, the NGEU programme financed entirely by debt will raise up to €806,9 billion in current prices by 2026 through the issuance of EU bonds.

However, the need to satisfy much bigger and less predictable funding needs under NGEU led to the replacement of the “**back-to-back funding**” system with the “**diversified funding strategy**” which resulted in the development of new procedures, organisational structure and risk management framework, as well as a higher level of engagement with a number of external service providers in record time. It should be noted that the establishment of the diversified funding strategy as the default borrowing method for the EU has also entailed a potential transfer of risks to future EU budgets.

Despite challenging circumstances and the quick development of a debt management system that allowed the funds required for NGEU to be borrowed in a timely fashion, some of the Commission’s debt management arrangements require adjustment to comply with best practice. Moreover, the measurement and reporting on NGEU debt management performance were limited due to the lack of clear debt management objectives.

With the aim to **contribute to the sound financial management of future debt management operations based on the new diversified funding strategy**, in particular, ECA examined, by assessing the effectiveness of the system developed by the Commission to manage the debt raised to finance NGEU, whether:

- The new operational and risk management structures and competences were in line with international debt management principles, and whether they had enabled the implementation of key aspects of the diversified funding strategy;
- NGEU debt management had brought good results in the first year of operation, in terms of borrowing costs, keeping a prudent degree of risk and compliance with regulatory requirements;
- The Commission had documented the analysis of trade-offs, between cost and risk of borrowing transactions and reported on debt management performance based on appropriate objectives and indicators.

The audit focused on **the design and early operation of the NGEU debt management system**, and covered the period **2021-2022**.

The Court concluded that, overall, the Commission has quickly put in place a debt management system which has provided the funds required for NGEU in good time. However, ECA issued the following **recommendations** to the Commission:

- 1) Establish a separate middle-office function with the aim of improving its analytical, risk evaluation, and reporting capacities;
- 2) Reinforce the role of the CRO to ensure that the CRO fulfils their mandate independently, effectively and efficiently;

- 3) Implement a workforce strategy for debt management staff given the complexity and importance of debt management tasks;
- 4) Formulate clear debt management objectives and report on performance in their implementation;
- 5) Document pricing decisions in a consistent way.

The Commission accepted the recommendations of the Court.

The rapporteur makes several recommendations to the Commission.

THE COURT'S OBSERVATIONS

1.- The new structures and competences allowed NGEU funding to begin quickly, but they need reinforcement.

Best practice in debt management requires that staff responsible for setting and monitoring the risk management framework and assessing performance are independent of the staff responsible for executing market transactions. Having a separate middle-office function supports this independence. The middle office is usually responsible for risk analysis, including different risk and cost scenarios¹.

The lack of a separate middle-office function in NGEU's debt management arrangements weakens the assessment of performance in terms of implementing debt management objectives by the front office. Thereby, hindering, in both scope and number, the Commission's analyses of risk and cost scenarios when planning issuances of NGEU bonds.

The distinction between the roles of the Deputy Director-General and the Chief Risk Officer (CRO) is not clear which could lead to the assignment of additional tasks, which may conflict with their mandate or increase their workload.

There is a number of recruitment-related risk identified, in particular, the lack of backup for some key debt management roles; the impact that the unavailability of key staff members could have on the directorate's activities; and the relative lack of attractiveness of the initial salaries offered.

2.-The Commission borrowed the funds on time, in compliance with regulatory limits and at costs corresponding to its market position.

The Commission's procedures enable it to communicate its borrowing needs to financial markets and stakeholders in advance and correct the borrowing schedules in good time if necessary.

At the end of June 2022, the entire NGEU debt portfolio satisfied regulatory requirements concerning borrowing ceilings, currency of borrowing transactions and maximum average maturity. The maturities and amounts of borrowing transactions executed until the end of June 2022 do not impede the repayment of the NGEU debt in a steady and predictable way up to 2058.

In terms of performance, most rating agencies assign the highest ratings to EU debt. Moreover, the Commission can borrow funds on capital markets at a lower cost than most EU member states.

It should be noted that the Commission can avoid temporary adverse market conditions for borrowing by using the liquidity reserve or by holding cash in the NGEU ECB account if necessary. In 2021, short-term debt instruments, which are used to finance liquidity reserves, had a negative yield resulting in revenue for the EU.

3.- The Commission's measurement and reporting on NGEU debt management performance

¹ International Monetary Fund Policy Paper, Revised Guidelines for Public Debt Management, 2014, p. 21.

was limited.

The Commission's debt management strategy does not clearly outline its debt management objectives and how it will meet them since references to some of the relevant debt management principles are scattered throughout the strategy.

The Commission has also not clarified which indicators it uses to report on the achievement of specific performance-related objectives.

The scope of the reporting envisaged in the Commission's implementing decision of December 2022 establishing the arrangements for the diversified funding strategy does not include a clear requirement to inform the EU budgetary authority about achieving debt management objectives.

Concerning the reporting on NGEU green bonds, some of the proceeds from NGEU green bonds will not be used in accordance either with the EU Taxonomy or with the upcoming EU green bonds standard. In fact, none of the current reporting arrangements provide information on the actual amount of expenditure financed through the NGEU green bonds that the Commission considers to be aligned with the EU Taxonomy.

Moreover, the Commission's analyses of underlying decisions on the pricing and maturity of bonds were not consistently documented since it had not consistently documented its own detailed market research and pricing analyses explaining the rationale behind its pricing decisions, nor the analyses of the trade-offs between different bond maturities and costs when planning future bond issuances.

THE COURT'S CONCLUSIONS AND RECOMMENDATIONS

The Court concluded that, overall, the Commission has quickly put in place a debt management system which has provided the funds required for NGEU in good time. In this context, the Court considered that in the first year of operation, borrowing costs reflected the Commission's market position. The Commission also met all key regulatory requirements concerning debt portfolio and risk management. However, it was found that NGEU's rapidly built debt management capacities do not comply with established best practice in all respects.

The Court also concluded that the Commission did not pay enough attention to setting clear debt management objectives and measuring and reporting on performance in debt management. In this respect, ECA issued the following recommendations to the Commission:

- 1) **Establish a separate middle-office function.** Taking into consideration the scale, complexity and increased prominence of debt management activities, the Commission should establish a discrete middle-office function with the aim of improving its analytical, risk evaluation, and reporting capacities. It should be responsible, for example, for monitoring and reporting on debt management trade-offs, and assessing the performance of front-office debt managers against strategic objectives;
- 2) **Reinforce the role of the CRO.** To ensure that the CRO fulfils their mandate independently, effectively and efficiently, the Commission should prepare a charter explaining which operational management tasks fall under the responsibility of the CRO in their capacity as a Deputy Director-General and reinforce the capacity of the CRO's team so that it is commensurate with its assigned tasks, particularly by establishing back-ups;
- 3) **Implement a workforce strategy for debt management staff.** Given the complexity and importance of debt management tasks, and the need to attract and retain suitable staff, the Commission should implement an appropriate workforce strategy for staff dealing with debt management;
- 4) **Formulate clear debt management objectives and report on performance in their implementation.** To improve the accountability and transparency of the Commission's debt management performance, the Commission should adopt a debt management strategy encompassing all borrowing instruments, including a clear statement of debt management objectives with the relevant indicators, and regularly report on their achievement; and, publish regular information on the proportion of NGEU green bond proceeds actually spent in accordance with the EU Taxonomy.
- 5) **Document pricing decisions in a consistent way.** To improve accountability and the audit trail for its pricing decisions for syndications of EU bonds, the Commission should clearly document, for internal use, the analyses and decision-making processes which led to the final price determination.

The Commission accepted all the recommendations of the Court.

THE RAPPORTEUR'S RECOMMENDATIONS

The Rapporteur,

- welcomes the ECA Special Report 16/2023, its findings and the Commission's acceptance of the Court's recommendations; commends the Commission for quickly putting in place a debt management system which has provided the funds required for NGEU in good time; highlights that issuances have taken place at a steady pace since the first issuance in 2021 and have all been heavily oversubscribed, revealing strong investor interest and enabling the Commission to meet its funding targets; notes with satisfaction that, as is consistent with the Union's AAA-rating, EU products have been traded at attractive interest rates that are on a par with other large European and supranational issuers; draws attention to the fact that the proposed move from back-to-back funding towards the diversified funding strategy had benefits, but that it also entailed a potential transfer of risks to future EU budgets;
- invites the Commission to continue to coordinate closely with the debt agencies of the Member States and with the European Central Bank, the European Investment Bank and the European Stability Mechanism; reiterates the importance of spreading the trading of EU debt through other EU stock exchanges in line with the principles of the capital markets union;
- encourages the Commission, in line with ECA's recommendations, to further comply with best practice in debt management so that a separate middle-office function is established in order to improve its analytical, risk evaluation, and reporting capacities;
- calls on the Commission to draw a clear distinction between the roles of the CRO and the Deputy Director-General so that the CRO fulfils their mandate independently, effectively and efficiently; notes with concern that the Commission reliance on temporary staff to manage its debt operations can put business continuity at risk, as well as, it may jeopardise the quality and efficiency of debt management activities; encourages the Commission to implement an appropriate workforce strategy for staff dealing with debt management aimed at ensuring an adequate staff retention and succession policies;
- recalls that under the Own Resources Decision, the Commission must comprehensively inform Parliament and the Council on a regular basis about all aspects of its debt management strategy, including an issuance calendar with expected issuance dates and volumes for the forthcoming year, and a plan setting out the expected principal and interest payments;
- underlines that transparency regarding the Commission's borrowing strategy and operations is key to achieving successful coordination with other market players and ensuring accountability, notably for Parliament, as well as awareness and ownership among decision-makers and the general public; calls on the Commission, in this context, to swiftly and systematically inform Parliament by providing disaggregated data on all charges incurred in issuing EU debt, including the Commission's charges to EURI as administrative costs as well as the costs incurred by Member States when taking on loans under the RRF;

- highlights, in particular, that the Union could set benchmarks for sustainable investment as the largest global issuer of green bonds, as well as by diversifying its investor base and securing lower borrowing costs; stresses the important role of green bonds in financing the assets needed for the low-carbon transition; urges the Commission to prevent any kind of greenwashing and to ensure high-quality reporting on the use of proceeds so as not to put the green premium at risk; stresses that by issuing part of the NGEU debt as green bonds, Member States and the Commission have a responsibility to do their utmost to ensure that the commitments made towards investors on climate spending are fulfilled;
- recalls, that, despite Parliament's demands, the financing costs of the European Union Recovery Instrument (EURI) are repaid from within the MFF ceilings, exerting further pressure on the MFF and jeopardising funding for programmes already agreed, especially in a context of rising interest rates and NGEU borrowing costs; In the context of the ongoing MFF revision, remains committed to its previous position and demands that the budgetary appropriations for the EURI repayment costs be entered in the EU budget over and above the MFF ceilings in order to safeguard the margins and flexibility mechanisms for their intended purposes;
- reiterates the importance of a clear and sustainable repayment strategy of NGEU, which will ultimately ensure the credibility and success of the instrument; believes that in order to avoid a negative impact on the EU Budget and on future generations of Europeans, the repayment of the NGEU debt should be entirely covered by the introduction of new own resources.

Annex I

European Parliament's earlier work related to the subject provided by the European Parliament Research Service (EPRS)

1. EP resolutions

[European Parliament resolution of 22 November 2022](#) on the implementation of the borrowing strategy to finance NextGenerationEU, the Union's recovery instrument ([2021/2076\(INI\)](#)) (all paragraphs).

2. A selection of parliamentary questions

[Explosion of the European common debt](#), answer E-002029/2023, Question for written to the Commission, Rule 138, Jean-Paul Garraud (ID).
Commission answer pending.

[Current forecasts for the total debt financing costs for NextGenerationEU](#), E-001956/2023, Question for written answer to the Commission, Rule 138, Moritz Körner (Renew).
Commission answer pending.

[Next Generation EU and Article 311 of the TFEU](#), O-000043/2020, Question for oral answer to the Commission, Rule 136, Hélène Laporte on behalf of the ID Group.

[Repayment of funds borrowed by the European Union in connection with the European recovery plan](#), P-005232/2020, Priority question for written answer to the Commission, Rule 138, Manon Aubry (GUE/NGL).
[Commission answer](#)