EN 2023 16

Special report

NGEU debt management at the Commission

An encouraging start, but further alignment with best practice needed

EUROPEAN COURT OF AUDITORS

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I In June 2021, the Commission launched the biggest borrowing programme in EU history. NextGenerationEU, financed entirely by debt, will raise up to €806.9 billion by 2026 through the issuance of EU bonds. The introduction of NextGenerationEU required the Commission to urgently develop a new debt management strategy, procedures, organisational structure and risk management framework. It also required it to engage a number of external service providers. The Commission calls its new approach to debt management a “diversified funding strategy”.

II From December 2022, the diversified funding strategy became the EU’s default debt management approach. With this report, we aim to contribute to the sound financial management of debt management operations. To do this, we assessed whether the Commission had developed effective systems to manage the debt raised to finance NextGenerationEU.

III We conclude that the Commission quickly developed a debt management system which allowed the funds required for NextGenerationEU to be borrowed in a timely fashion. In this context, we consider 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, we found that some of the Commission’s debt management arrangements require adjustment to comply with best practice. We also found that the Commission had not clearly set out debt management objectives. Consequently, the measurement and reporting on NextGenerationEU debt management performance was limited.

IV Despite challenging circumstances, the Commission established a skilled and experienced core team. But it relies heavily on temporary staff to manage its debt operations. This can put business continuity at risk. The Commission has established the necessary risk management framework for NextGenerationEU debt management activities. It includes the newly created function of Chief Risk Officer for all borrowing programmes. However, the Chief Risk Officer is supported by few staff, and has additional operational responsibilities aside from risk management.

V We found that the NextGenerationEU debt portfolio satisfied regulatory requirements concerning borrowing ceilings, currency of borrowing transactions and maximum average maturity. The Commission communicated well with the capital markets and EU member states on its borrowing plans, and it managed the liquidity of the NextGenerationEU bank account in an efficient manner. The development of the market yields of NextGenerationEU bonds was comparable to the market yields of member states' bonds with similar credit ratings.

VI We found that neither the relevant legislation nor the Commission's funding strategy provided a clear requirement for the Commission to report on the performance of its debt management activities. As a result, the Commission is accountable mainly for providing a sufficient amount of funds in good time to finance NextGenerationEU. Accountability for other objectives of NextGenerationEU debt management remains unclear. The Commission has not consistently documented the basis on which decisions on the pricing and maturity of syndicated bonds were reached.

VII The Commission reports annually on how the measures financed by NextGenerationEU green bonds align with the economic activities set out in the EU's sustainability classification system, the EU Taxonomy. However, the Commission does not report on the proportion of NextGenerationEU green bond proceeds actually spent in accordance with the EU Taxonomy.

VIII We recommend that the Commission should:

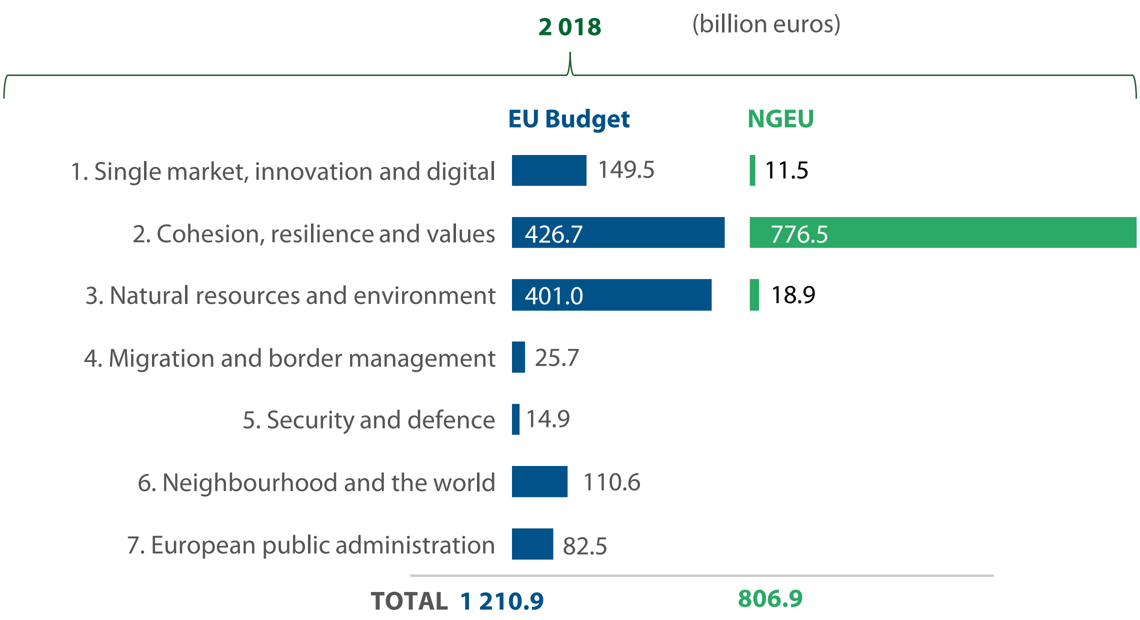
- establish a separate middle-office function to improve its analytical, risk evaluation, and reporting capacities;
- reinforce the role of the Chief Risk Officer to ensure the officer can fulfil their mandate effectively and efficiently;
- implement a workforce strategy for the staff dealing with debt management;
- formulate clear debt management objectives and report on performance in their implementation;
- document the basis for pricing decisions in a consistent way when EU bonds are syndicated.

Introduction

Background of the NextGenerationEU funding programme

01 In December 2020, the Council empowered[1] the Commission to borrow funds on capital markets on behalf of the EU, up to €806.9 billion in current prices, for the NextGenerationEU (NGEU) programme. The programme intends to address the economic and social crisis caused by the COVID-19 pandemic. The NGEU funds come in addition to the long-term EU budget of €1 211 billion for 2021-2027. See ***Figure 1***.

Figure 1 – EU budget 2021-2027 and NGEU

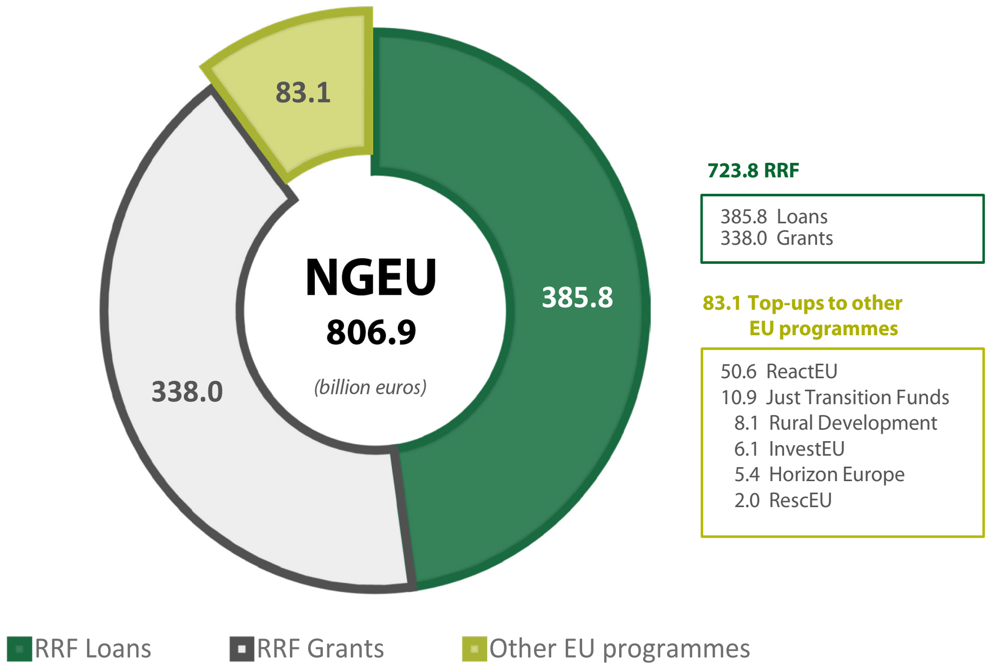


Source: ECA, based on Commission data.

02 The NGEU programme finances the post-pandemic recovery, and the green and digital transformation of the European economy, with the Recovery and Resilience Facility (RRF) accounting for 90 % of its total budget. The Commission will use the borrowed funds for loans to member states and, for the first time in the EU's history, for grants (see ***Figure 2***). The actual amount borrowed by the Commission for the NGEU will depend mainly on the implementation of the RRF by the member states.

[1] Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

Figure 2 – NGEU distribution



Source: ECA, based on Commission data.

03 Over a period of 40 years, the Commission has run several lending programmes by applying "back-to-back funding", a system where each single borrowing transaction is linked to a single disbursement. Under this system, beneficiary countries have received repayable financing at the same cost and repayment deadline (maturity) as the dedicated EU bonds issued by the Commission. ***Table 1*** shows the amounts borrowed by the Commission using this approach.

Table 1 – Back-to-back borrowings by the Commission up to 30 June 2022

Borrowing programmes	Maximum debt allowed under programme	Outstanding amounts of the EU debt on 30.6.2022
Support to mitigate Unemployment Risks in an Emergency (SURE)	€100 billion	€91.8 billion
European Financial Stabilisation Mechanism (EFSM)	€60 billion	€46.3 billion
Balance of Payments Assistance Facility (BoP Assistance Facility)	€50 billion	€0.2 billion
Macro-Financial Assistance (MFA)	Depending on EU budget limits	€8.9 billion
Euratom	€4 billion	€0.3 billion
Total		**€147.5 billion**

Source: ECA, based on Commission data and the European Parliament.

04 In order to satisfy much bigger and less predictable funding needs under NGEU, in April 2021 the Commission adopted a new funding strategy to finance NextGenerationEU (the "NGEU funding strategy"), which differs from back-to-back funding. The NGEU funding strategy introduces a new approach, the "diversified funding strategy", which decouples the timing, volume and maturity of the borrowing transactions from the timing of the disbursements of these funds. ***Table 2*** shows a comparison between the two approaches.

Table 2 – Differences in funding approaches used by the Commission

Criterion	Back-to-back funding	Diversified funding
Funding instruments	Mainly long-term EU bonds	Both long-term EU bonds and short-term EU bills
Funding method	Bond syndications and private placements	A mixture of bond syndications, auctions and private placements
Timing of issuances	Determined entirely by beneficiary's needs	Flexible and not determined by beneficiary's needs
Disbursements to beneficiaries	Disbursement is linked to a single borrowing transaction	The time and amount of disbursement is not linked to a single borrowing transaction
Management of proceeds	Proceeds are transferred directly to beneficiaries	Proceeds are pooled together and held in a centralised bank account until disbursement

Criterion	Back-to-back funding	Diversified funding
Calculation of borrowing costs	The same as the borrowing costs of the dedicated EU bonds issued	Based on the costs of all borrowing transactions within a 6-month time period
Guarantee to the borrowings	EU budget and Common Provisioning Fund	EU budget and commitment of member states to provide additional funds up to 0.6 % of their gross national income (GNI), if necessary

Source: ECA, based on Commission information.

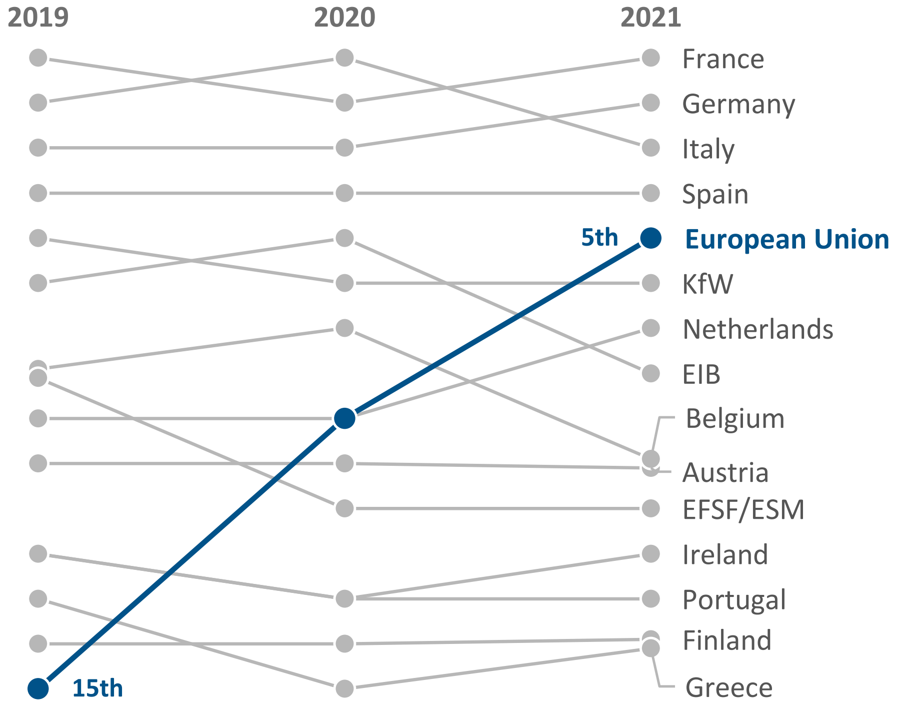
05 In December 2022, the legislative authorities adopted the Commission proposal to amend the Financial Regulation[2] to make the diversified funding strategy, developed for the NGEU, the default borrowing method for the EU. In our opinion on this proposal[3], we concluded that the proposed move from 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.

06 In June 2021, the Commission issued the first NGEU debt securities. By the end of 2021, the EU had become one of the largest debt issuers in Europe. See ***Figure 3*** for details.

[2] Regulation (EU, Euratom) 2022/2434 on the establishment of a diversified funding strategy as a general borrowing method.

[3] Opinion 07/2022 on the proposal for establishment of a diversified funding strategy as a general borrowing method.

Figure 3 – Large debt issuers in the EU in 2019, 2020, and 2021



Source: ECA, based on Commission data.

07 NGEU debt is guaranteed by EU budget "headroom", which is the difference between the EU's own resources ceiling[4] and the own resources necessary to finance the EU budget. By ratifying the Council decision on own resources, in 2021 member states agreed to make additional cash resources available through the increased own resources ceiling, up to 0.6 % of their GNI, until the end of 2058. The Commission can use these resources if the EU budget is not sufficient to cover liabilities arising from NGEU debt. The borrowing transactions come under the scope of budgetary implementation within the meaning of the Financial Regulation. This also requires the NGEU funding strategy to be implemented in accordance with the principle of sound financial management.

Key roles and responsibilities in funding NGEU

08 The implementation of the diversified funding strategy required new organisational arrangements and debt management procedures. The Commission issued several decisions changing the structure and competences of Directorate-General for Budget (DG BUDG), establishing reporting and cost allocation procedures,

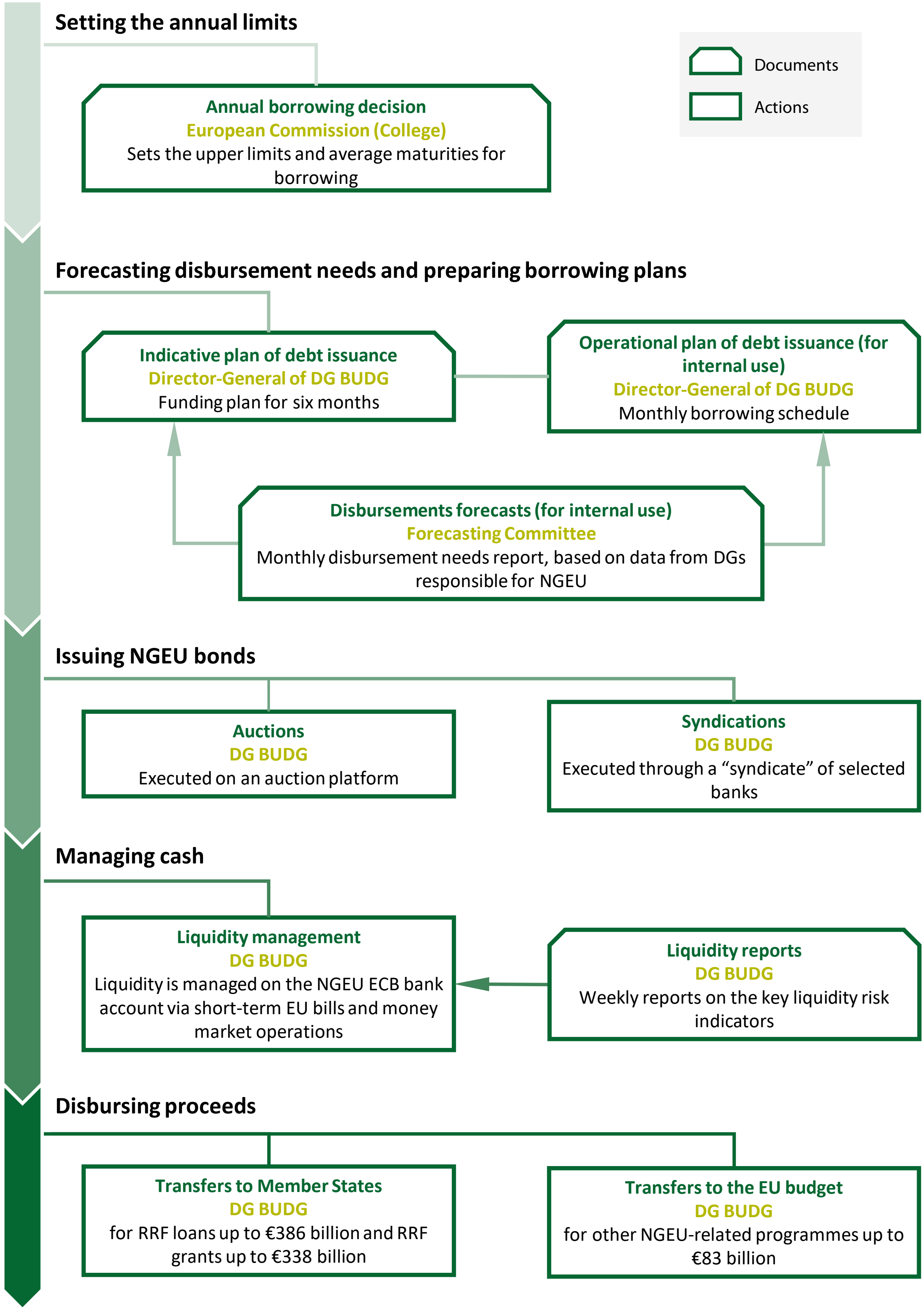
[4] Article 6 of Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

and putting into place the EU primary dealer network (PDN). The Commissioner responsible for the EU budget adopted the High Level Risk and Compliance Policy (HLRCP), which applied to NGEU debt. DG BUDG implemented internal procedures for liquidity management, syndications and auctions of bonds.

09 DG BUDG fulfils the core functions of NGEU debt management, including front office, back office, legal service and the new function of Chief Risk Officer (CRO). ***Annex I*** describes the key responsibilities in the Commission's debt management structures.

10 ***Figure 4*** shows the key roles and responsibilities in the process of funding the NGEU programme through the issuances of NGEU bonds.

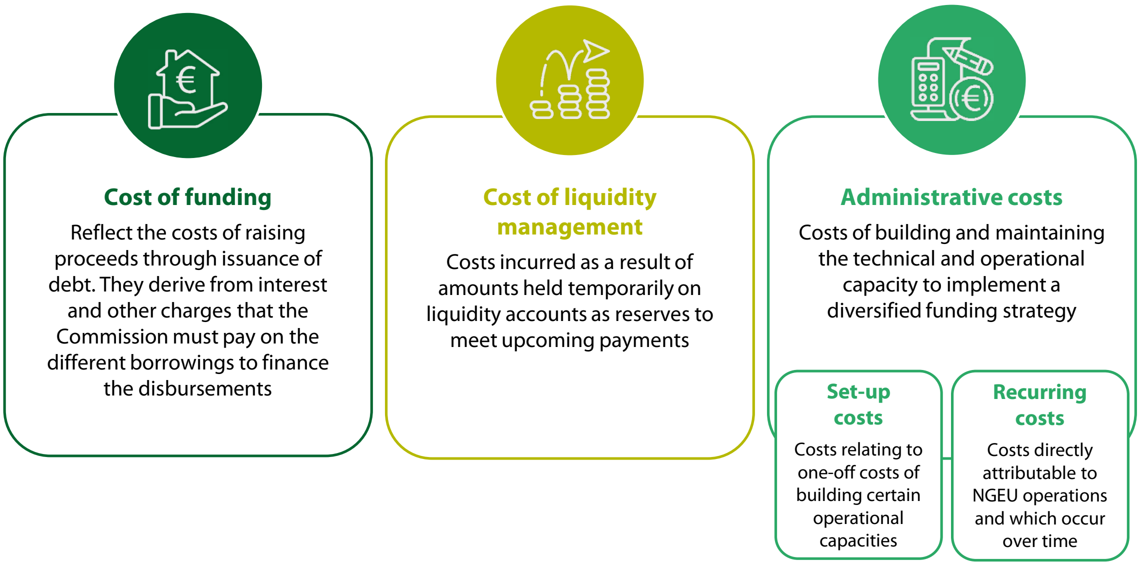
Figure 4 – Key roles and responsibilities in the issuance of NGEU bonds



Source: ECA, based on Commission information.

11 Together with the NGEU funding strategy, the Commission developed a new method of allocating borrowing costs between the EU budget and the member states[5]. It links the borrowings and disbursements that occur within the same six-month time periods. The beneficiaries pay the cost of funding corresponding to the cost incurred within the six-month pool of borrowed funds that they used. Under this procedure, member states pay the costs of the RRF loans received, while the EU budget pays the costs associated with all NGEU grants. ***Figure 5*** describes types of costs under the NGEU funding strategy.

Figure 5 – Types of borrowing costs under the diversified funding strategy



Source: ECA, based on Commission information.

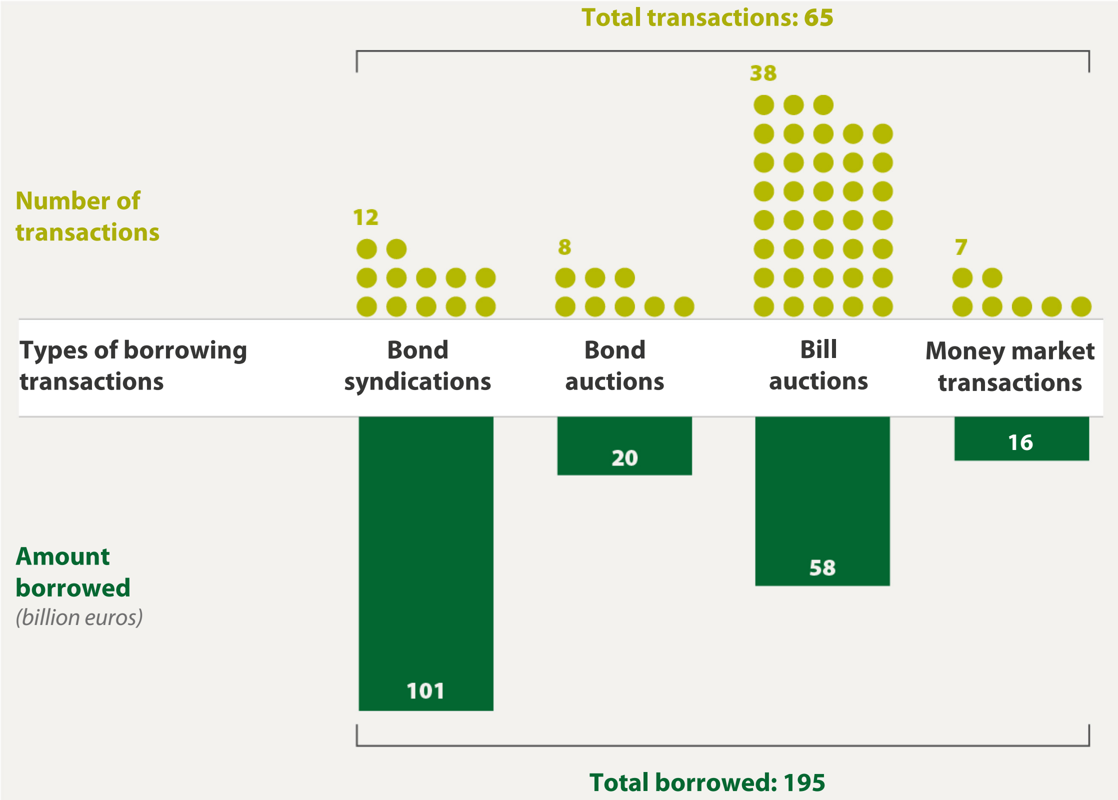
Borrowing transactions up to the end of June 2022

12 The Commission was able to start NGEU borrowing transactions after the Council decision on EU own resources entered into force on 1 June 2021. From 15 June 2021[6] until the end of June 2022, the Commission carried out 65 NGEU borrowing transactions amounting to €195 billion. All borrowing transactions were in euros. The single long-term issuances were between €2.5 billion and €20 billion. ***Figure 6*** provides information about the types and amounts of all NGEU borrowing transactions in this period.

[5] Commission Implementing Decision (EU) 2021/1095 on allocation of costs of borrowing and debt management under NGEU.

[6] European Commission website: Transactions data.

Figure 6 – NGEU borrowing transactions until 30 June 2022



The Commission used **four different types** of NGEU borrowing transactions:

1 Bond syndications

- one or two transactions per month;
- executed with selected primary dealers;
- syndication fee based on transaction volume;
- used for funding NGEU.

2 Bond auctions

- one or two transactions per month;
- EU primary dealers can bid on a dedicated auction platform;
- bids accepted from the lowest yield until achievement of the needed volume;
- no fees paid to the primary dealers;
- used for funding NGEU.

3 Bill auctions

- debt securities with a tenor of up to 12 months;
- typically two transactions per month;
- same bidding process as with bond auctions;
- used for liquidity management.

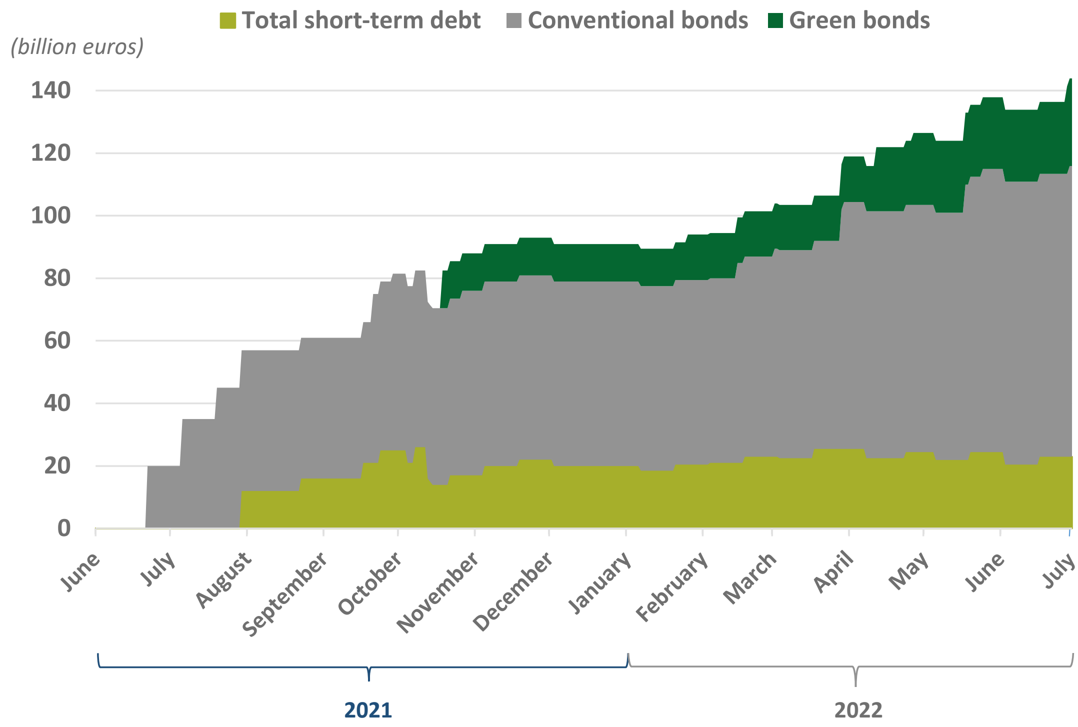
4 Money market transactions

- based on three short-term credit lines with large EU financial institutions;
- used to cover additional, unforeseen liquidity needs.

Source: ECA, based on Commission data.

13 Following the repayment of all credit lines and part of the EU bills, on 30 June 2022, the outstanding debt associated with NGEU amounted to €144 billion. ***Figure 7*** shows the outstanding short- and long-term NGEU debt over the period from June 2021 to June 2022.

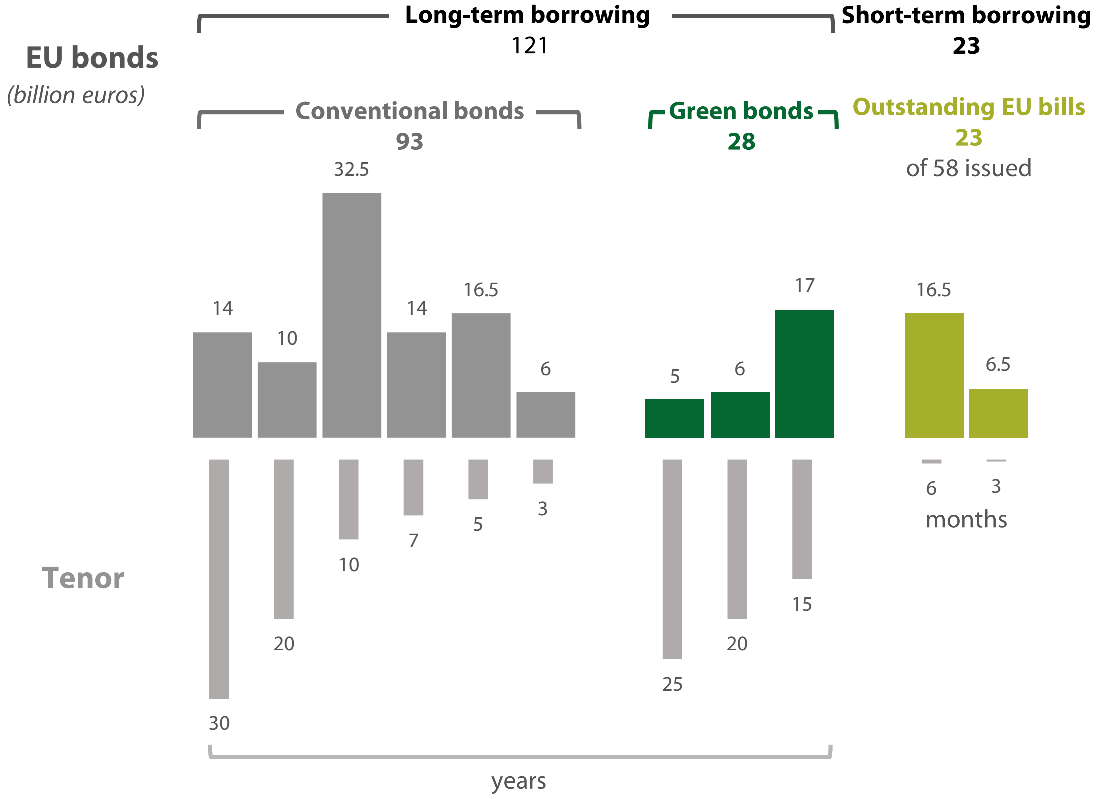
Figure 7 – NGEU outstanding debt



Source: ECA, based on Commission data.

14 ***Figure 8*** provides details on types of debt instrument and their size.

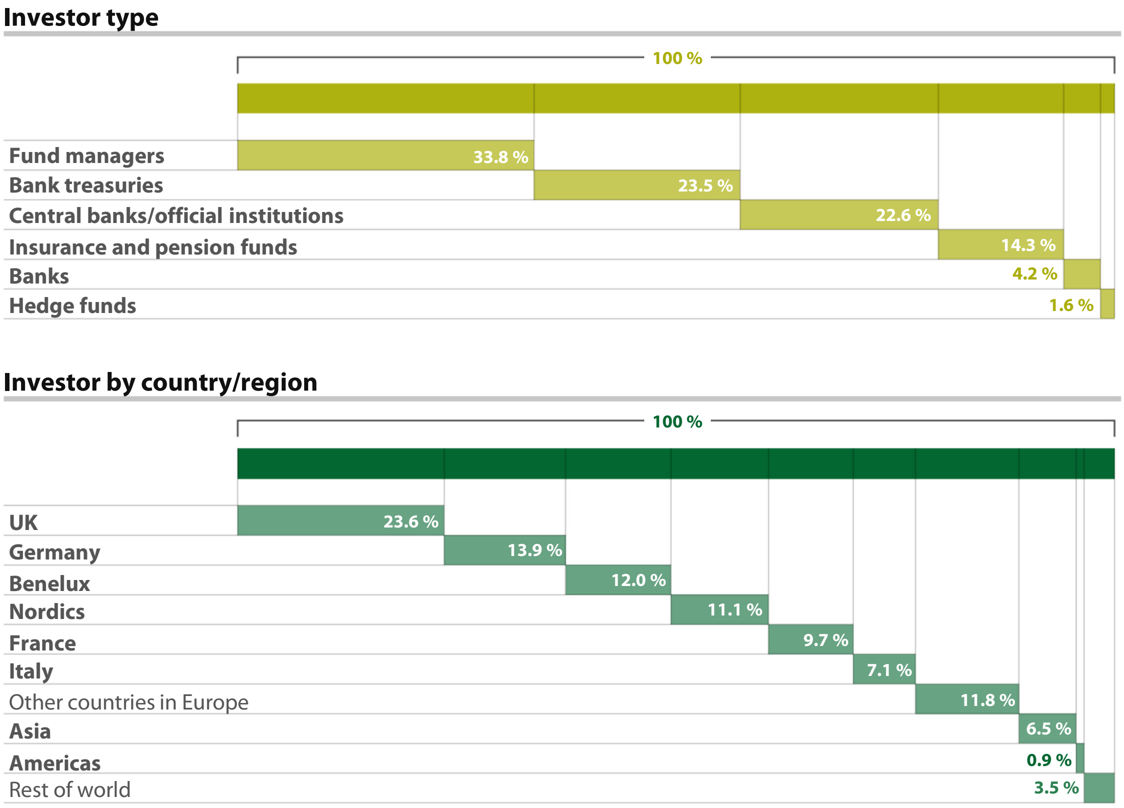
Figure 8 – NGEU debt at 30 June 2022



Source: ECA, based on Commission data.

15 From June 2021 until June 2022, the syndicated issuances of EU bonds represented the biggest share (52 %) of NGEU borrowings including bonds, bills and money market transactions. According to the Commission, the investor base for NGEU syndicated transactions comprised more than 1 000 different investors from 70 different countries in August 2022. ***Figure 9*** shows the geographical structure and main types of investors in syndicated transactions.

Figure 9 – Investor base of NGEU syndicated transactions on 1 August 2022



Source: ECA, based on Commission data.

Audit scope and approach

16 With this audit, we aim to contribute to the sound financial management of future debt management operations based on the new diversified funding strategy, which in December 2022 became the EU's default debt management approach.

17 Our main audit question was whether the Commission had developed an effective system to manage the debt raised to finance NGEU. We focused on the design and early operation of the NGEU debt management system from June 2021 to June 2022. We examined 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.

18 We did not assess the functioning of the information systems (IT) used by the Commission for debt management, or the processes of disbursement of funds raised from the NGEU debt to the member states and EU budget. We limited our checks of administrative costs to the accuracy of the amounts included in the budgetary accounting.

19 We applied assessment criteria based on legislation and decisions related to NGEU, internationally recognised public debt management principles, and the INTOSAI guidance and handbook for auditing public debt management[7]. Our audit was based on:

- an analysis of the relevant regulatory, contractual and organisational arrangements setting up the operational and risk management frameworks;

[7] INTOSAI, Audit of Public Debt Management: A Handbook for Supreme Audit Institutions.

- evidence collected through desk reviews and analyses of documentation provided by DG BUDG, and through interviews with Commission staff responsible for NGEU debt management;
- an assessment of selected documentation concerning 10 individual borrowing decisions and 10 applications for the PDN.

20 In May 2022, we sent a survey to the 27 member states' national debt management offices aimed at collecting their opinions on the potential improvements to the EU's debt management arrangements. We received replies from 12. In addition, we consulted debt management experts to discuss the results of our analyses and our preliminary audit conclusions.

Observations

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

21 In this section, we focus on the organisational framework set up for NGEU funding. We assessed whether the structure, operational capacities and cooperation with external providers were in line with internationally recognised best practice in public debt management and were adequate to implement NGEU's borrowing activities.

The Commission's rapidly established debt management capacities require adjustment to comply with best practice

22 We examined whether the Commission had established the new structures and competences necessary for the implementation of the diversified funding strategy, in a timely manner, including in particular:

- clearly structured operational responsibilities for debt management, separated into front-, middle-, and back-office functions, in line with internationally recognised best practice developed by the International Monetary Fund (IMF), the International Organization of Supreme Audit Institutions (INTOSAI), and the United Nations Conference on Trade and Development (UNCTAD);
- clearly defined risk management accountabilities, roles and responsibilities, not constrained from reporting on risks when relevant issues arise;
- adequate staff retention and succession policies, and arrangements for staff dealing with debt management.

Operational functions for NGEU debt management

23 According to the NGEU funding strategy[8], the Commission planned to organise funding transactions in a way similar to that employed by sovereign states. Debt management offices in countries where capital markets are the main source of

[8] Communication from the Commission to the European Parliament and the Council on a new funding strategy to finance NextGenerationEU, COM(2021) 250.

financing (similarly to the Commission) usually have an organisational structure that includes back, middle and front offices, as illustrated in ***Table 3***.

Table 3 – Usual responsibilities of front, middle and back office

Front office	Middle office	Back office
o borrowing transactions o relations with investors and primary dealers o implementation of debt management strategy o management of debt portfolio against a benchmark	o analysis and advice for senior management on suitable debt management strategies o monitoring of front office performance against strategic targets and benchmarks o analysis, monitoring and reporting on risks	o settlements of borrowing transactions o accounting and validation of debt data o reporting on debt o monitoring and control of disbursements

Source: INTOSAI, Audit of Public Debt Management, A Handbook for Supreme Audit Institutions.

24 The Council decision on EU own resources was adopted in December 2020[9], and entered into force on 1 June 2021. The Commission's organisational arrangements enabled the borrowing transactions to start on 15 June 2021. The organisational set-up of NGEU debt management at the Commission (see ***Annex I***) combines the front- and some middle-office functions in one unit (BUDG E3). This unit is responsible both for developing the strategy and implementing it, activities which are usually allocated to different units within an organisation.

25 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[10]. Having a separate middle-office function supports this independence. The middle office is usually responsible for risk analysis, including different risk and cost scenarios.

26 We consider that 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. We found that these organisational arrangements limited, in both scope and number, the Commission's

[9] Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

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

analyses of risk and cost scenarios when planning issuances of NGEU bonds. The Commission considered this structure to be the most appropriate given the nature of the activities and the need to build capacity at speed with the resources available.

Establishment of the new risk and compliance framework

27 The Commission decided[11] that the Chief Risk Officer (CRO) is responsible for establishing the risk and compliance framework for implementing the NGEU funding strategy. Under the back-to-back funding approach, no CRO was appointed. However, since the NGEU funding programme is complex and large, and given the risks associated with the new diversified funding strategy, the Commission appointed a CRO responsible for managing the risks associated with NGEU operations. These new governance arrangements were intended to allow the CRO to work independently from the execution of debt management operations.

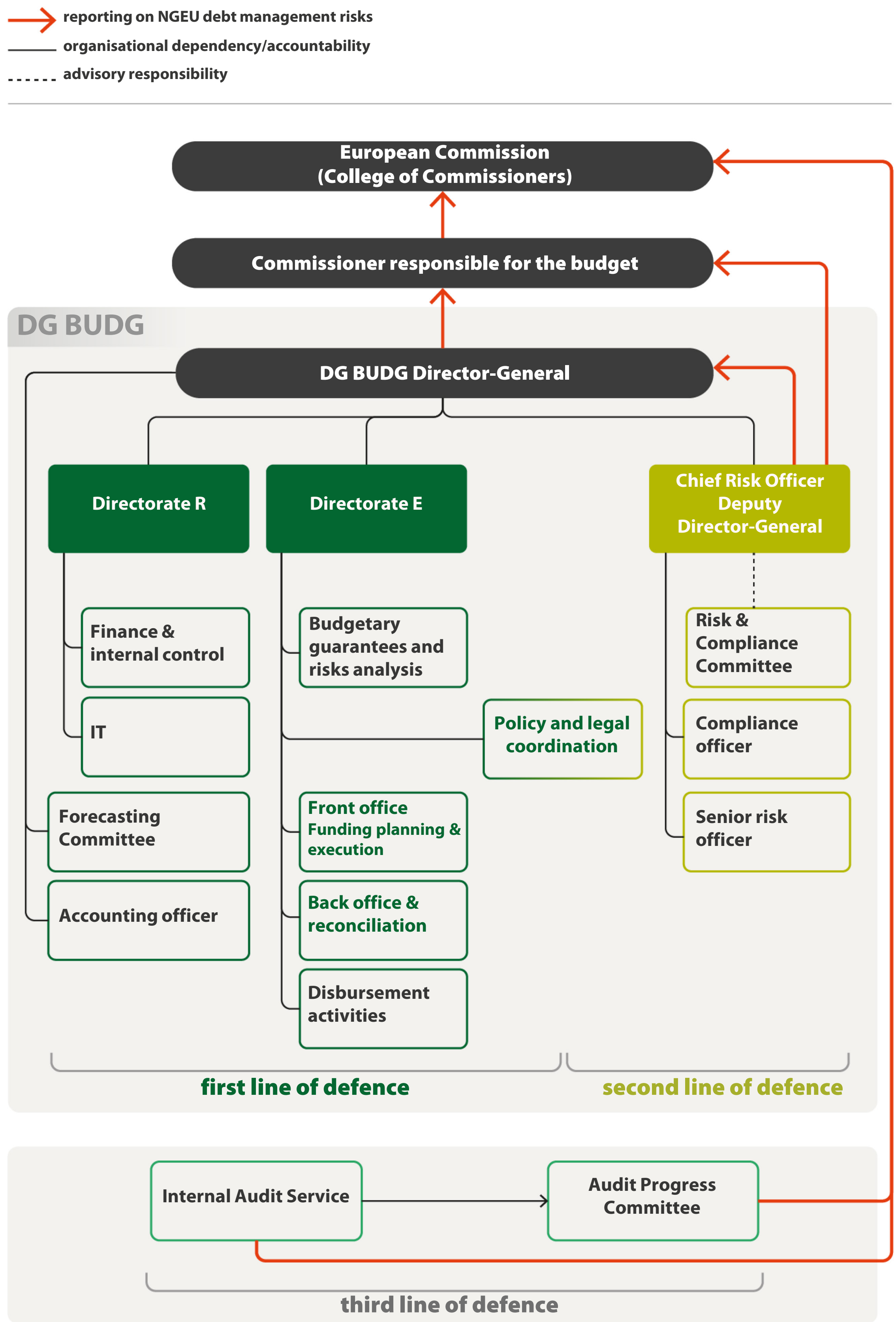
28 The governance set-up for NGEU debt management operations mirrors the "three lines of defence" model, which originates in the COSO framework. It enhances an effective risk management system, where the first line of defence owns and manages the risks and the second line of defence oversees these risks. For the Commission:

- DG BUDG (the front and back office for NGEU debt management) performs the first-line controls embedded in the debt management operations;
- the CRO, located within DG BUDG and supported by the Risk and Compliance Committee, is responsible for second-line controls, compliance checks and risk oversight; and
- the Internal Audit Service provides an independent assurance on the adequacy of the control systems, as the third line of defence.

Figure 10 illustrates this governance set-up for NGEU debt management.

[11] Article 16 of Commission Implementing Decision C(2021) 2502.

Figure 10 – Governance set-up and reporting lines for NGEU debt management



Source: ECA, based on the HLRCP.

29 The Commission mandated[12] that the CRO should conduct their activities independently, and in line with the High-Level Risk and Compliance Policy (HLRCP). The HLRCP defined the reporting lines, overall responsibilities, objectives and scope of work of the CRO. We found that the distinction between the roles of the Deputy Director-General and the CRO is not clear, and the CRO's responsibilities in their capacity as Deputy Director-General are not well defined. As the CRO is also a Deputy Director-General of DG BUDG, they may also be assigned additional tasks which may conflict with their mandate or increase their workload. This may impede the effectiveness of the CRO in their role.

30 We found that in line with the requirements of the HLRCP, the Commission had adopted written procedures and manuals establishing key risk indicators and internal controls related to the specific risks. ***Annex II*** contains a list of the relevant risks. This action allowed the risk management framework to be deployed in good time in the first year of NGEU debt management.

31 We consider that the role of the CRO became central to the implementation of an organisational change, in which risk awareness was embedded in the new debt management structure at the Commission. The establishment of the new risk and compliance framework for NGEU triggered the setting-up of a new high-level policy, procedures and tools, complemented by training and information sessions, all organised by the CRO's team. The CRO's analyses, opinions and recommendations, concerning issues such as borrowing plans, improved the management of risks associated with NGEU borrowing activities. These activities also partially compensated the risk analyses expected from the middle office.

32 The staffing of the CRO team, which has had 2.5 full-time equivalent (FTE) staff members on 30 June 2022, may pose a risk to business continuity, particularly when team members are unexpectedly absent (***Annex I*** provides details on staff numbers and responsibilities). We also found that the workload of the CRO team requires the use of resources from the first line of defence, which weakens the independent oversight of risks by the second line of defence.

33 Up to December 2022, the CRO's responsibilities did not include analysis and reporting on risks associated with back-to-back borrowing programmes, liabilities from which amounted to €148 billion in June 2022. In December 2022, the Commission

[12] Commission Implementing Decision C(2021) 2502.

extended the CRO’s mandate beyond the NGEU programme to cover all borrowing under the diversified funding strategy and back-to-back funding[13].

Management of staff dealing with NGEU debt

34 In 2021, the Commission established Directorate E within DG BUDG. The directorate is responsible for asset, debt and financial risk management. In a relatively short period of six months, the Commission assembled a core team to start borrowing activities on a large scale.

35 The Commission quickly had to fill many highly specialised new posts in the debt management team. Most of the required skills and experience were not already available internally. We found that 46 % of debt management team members in DG BUDG were on temporary contracts of various descriptions (see ***Table 4***). Significant numbers of staff came from member state authorities and the European Stability Mechanism. The high proportion of external and temporary staff raises the risk that future staff turnover may compromise the quality and efficiency of NGEU debt management, and result in the loss of institutional knowledge.

Table 4 – Staff involved in NGEU debt management activities in DG BUDG at the end of June 2022

Employment type	Number of staff (FTE)	Proportion (%)
Officials	17.5	54 %
Seconded national experts	8.0	25 %
Temporary staff	5.0	15 %
Contract agents	2.0	6 %
Overall staff number	**32.5**	

Source: ECA, based on DG BUDG data for FTE staff members for the NGEU, Directorate E units E.1, E.2, E.3, E.4, and the CRO team, 30.6.2022.

36 In 2022, DG BUDG identified a number of recruitment-related risks, though it did not formally classify them as critical. These risks related to 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 in the NGEU debt management team, mainly based in

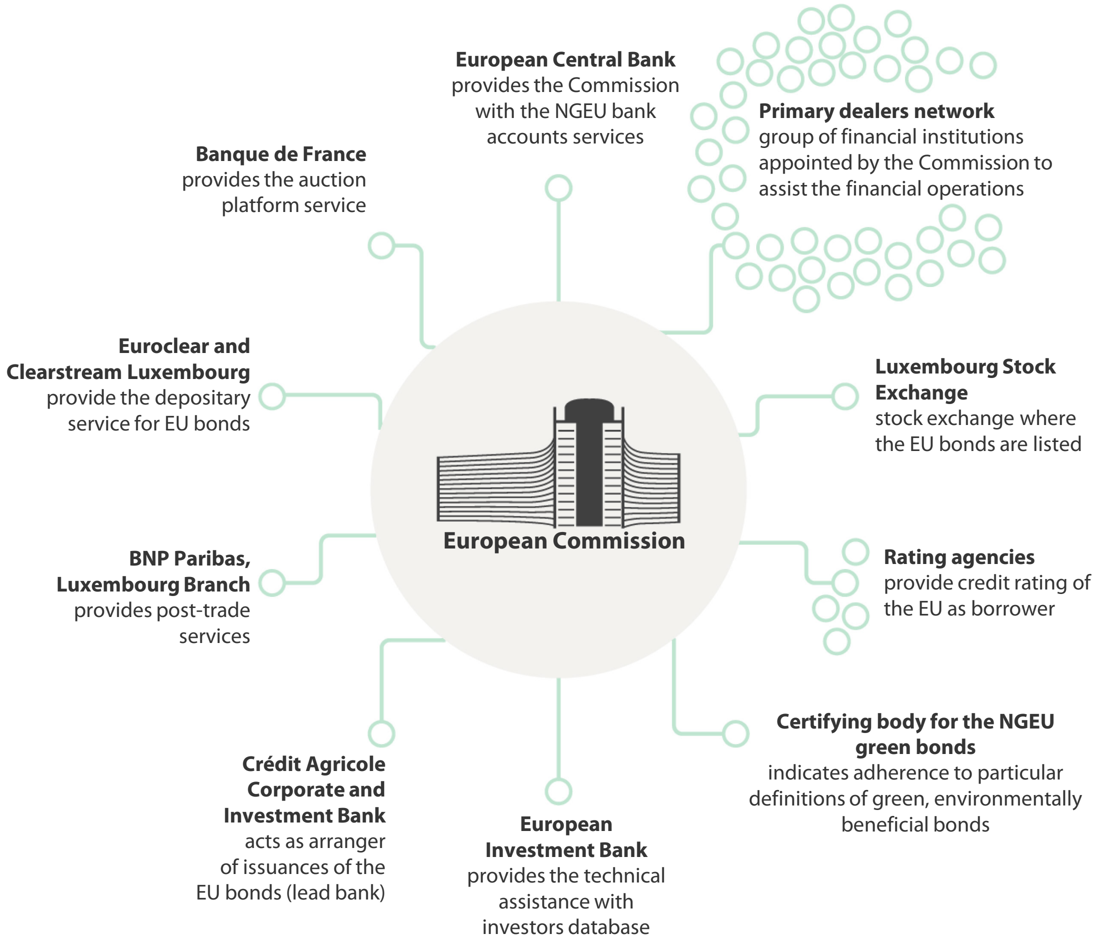
[13] Article 2 of Commission Implementing Decision (EU, Euratom) 2022/2544 on the governance arrangements for diversified funding strategy.

Luxembourg, to assistants and specialists from the financial sector. The Commission has not yet addressed these risks.

The Commission used sound criteria to select key external service providers

37 The implementation of the NGEU funding strategy required a number of new external service providers to be engaged. For example, the Commission needed a safe and reliable bank account service in order to hold and disburse the amounts being borrowed on an unprecedented scale. The NGEU funding strategy required the use of an auction system as a new tool for issuing EU bonds, and as the only method of issuing EU bills. Given the high number and volume of borrowing transactions under the NGEU funding strategy, the Commission also established a primary dealer network (PDN). *Figure 11* provides a short description of all service providers engaged by the Commission for NGEU debt management.

Figure 11 – External service providers for NGEU debt management



Source: ECA, based on the Commission and prospectus for EU bonds.

38 We analysed whether the Commission had selected the external service providers necessary for NGEU debt management on the basis of transparent and robust criteria. Taking into consideration their strategic importance, we analysed the contracts signed by the Commission with the European Central Bank (ECB), Banque de France and the establishment of the PDN.

NGEU ECB bank account

39 The ECB provides the NGEU programme with bank account services for cash holdings and disbursements. The Commission's agreement with the ECB practically eliminates the credit risk associated with the NGEU bank account. The Commission identified the ECB as the only service provider that could reliably process the large payments associated with NGEU.

Auction system for NGEU bonds and bills

40 The Commission uses the auction system provided by the Banque de France. It was selected based on robust criteria, including technical requirements, availability, and security of the auction system. The analysis of requirements covered five different offers and included consultation with market participants. In April 2021, the Commission concluded that the functionality of the auction system fully corresponded to the Commission's requirements. It also satisfied the need for it to be operational by 1 September 2021.

Primary dealer network

41 The Commission has set up a PDN to facilitate the execution of syndicated transactions, auctions and private placements[14]. The PDN ensures that EU debt is spread across a wide investor base. At the end of June 2022, the PDN comprised 43 primary dealers (PDs). Only PDs can participate in auctions, syndications, and private placements. See ***Figure 12***.

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[14] European Commission website: How EU issuance works.

Figure 12 – Primary dealer network

KEY FACTS

43 institutions
in the PDN

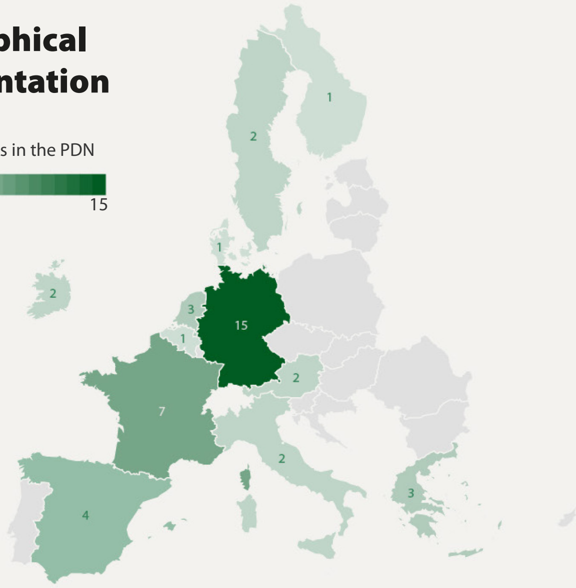
Eligibility criteria

- → Established legal entities having its head office in the EU or in an EEA country
- → Credit institution supervised by an EU competent authority or an investment firm, authorised in the EU to carry out the activity of underwriting and/or placing of financial instruments
- → Primary dealer for another European issuer

Geographical representation

Number of banks in the PDN

0 1 15



Duties

purchase a minimum weighted average of 0.05 % of volumes auctioned by the Union on a semi-annual basis

promote the liquidity of Union debt securities, contributing to price discovery and efficiency of the secondary market

report on the execution of the PD activities, any non-compliance with the eligibility criterion or rating upgrades or downgrades

Fees

for syndications are calculated as a share of the volume of securities sold which changes with the maturity of the bonds

Maturity in years →	1 - 4	4 - 6	6 - 9	9 -14	14 - 19	19 - 28	28 -
Syndication fee →	0.05 %	0.07 %	0.09 %	0.10 %	0.12 %	0.15 %	0.17 %

Source: ECA, based on Commission data.

42 The Commission accepted all applications to participate in the PDN. We noted that of the 43 PDs that existed at the end of 2021, the Commission found that 10 were in breach of EU antitrust law, which resulted in their initial suspension by the Commission from participating in the PDN. Consequently, they were required to submit information on measures addressing their breaches of antitrust law. The Commission admitted all of these 10 PDs to the PDN after analysing the information they had submitted.

43 In order to assess the application of eligibility criteria and the transparency and scope of the selection process, we checked a random sample of 10 PDs' applications out of 43 submitted to the Commission. Overall, the Commission had documented the selection of the PDs in a clear and transparent manner, and the selected institutions were eligible to participate in the PDN. Of the 10 PDs in the sample, four had been suspended for the breach of EU antitrust law. We found that the Commission collected sufficient evidence to warrant the suspension being lifted, and their participation in the PDN being allowed.

44 PDs give their consent to audits and verifications associated with the data sent to the Commission in the framework of their reporting obligations[15]. The Commission has not yet used its right to use a third party to carry out an audit in this regard.

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

45 In this section, we assessed whether the Commission had developed and applied appropriate debt management procedures in order to borrow the required funds on time and in line with regulatory requirements. Debt management operations fall under the scope of budgetary implementation[16], and must respect the principle of sound financial management. We therefore also analysed whether the Commission had avoided unnecessary costs which could arise from excessive cash balances on the NGEU ECB bank account.

[15] Article 14 of Commission Decision (EU, Euratom) 2021/625 on the establishment of PDN.

[16] Recital 5 of the Commission Decision C(2021) 2501 on specific internal rules on the implementation of borrowing, debt management and lending operations.

The Commission communicated its borrowing needs well, and complied with key regulatory requirements for NGEU debt

46 The NGEU funding strategy outlined that clear and open communication to investors and peer issuers is critical to the success of the NGEU funding programme. The Commission must comply with the targets communicated to the market, and legal and procedural requirements applicable to NGEU debt. Therefore, we examined the following elements:

- Commission analyses of borrowing needs related to the funding of NGEU;
- Commission communications with capital markets and stakeholders in respect of EU debt issuances;
- fulfilment by the Commission of the key legal and procedural requirements for debt management operations.

Analysis of borrowing needs

47 DG BUDG prepares systemic and detailed analyses of borrowing needs before it performs NGEU borrowing transactions. The Commission uses a dedicated IT tool to communicate short- and long-term funding needs. The Forecasting Committee, created within DG BUDG in May 2021, prepares monthly reports on NGEU disbursement needs. These reports, which cover a rolling two-month period, provide a basis for the monthly borrowing schedules.

48 Our analysis of two reports on NGEU disbursement needs adopted in August and December 2021 found that the vast majority of actual disbursements were as initially projected. The only notable change to the forecasts included in these reports was one of €5.96 billion for one member state. We note that the forecast was updated based on new data.

49 We found that 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. In 2021, for example, actual needs for NGEU funds were much lower than expected when the semi-annual funding plan was issued. We found that the Commission's response to changes in borrowing needs at the end of 2021 was appropriate. See ***Box 1***.

Box 1

Adaptation of NGEU borrowing to changing funding needs in 2021

On 28 October 2021, DG BUDG issued an NGEU disbursement needs report for November and December 2021, which showed that disbursement needs were €18 billion lower than initially planned for November and December.

On 29 October 2021, the Commission prepared a scenario analysis for the remaining transactions at year-end. The Commission decided to decrease the planned amount of long-term borrowing but to keep the set timeline of the short-term auctions.

On the same date, DG BUDG changed the monthly borrowing schedule for November and December 2021, and the Commission issued an update of the funding target.

Communication of funding plans

50 One key condition for borrowing sufficient funds on time is the clear and timely communication of funding plans to investors and other borrowers. This enables investors to prepare the relevant funds to buy NGEU bonds or bills. The exchange of information on funding plans between borrowers helps them to coordinate their issuances of debt instruments. For example, concentrating borrowings with similar maturities in the same period may increase borrowing costs and jeopardise the execution of borrowing transactions.

51 In the own resources decision[17], the Council asked the Commission to establish a structured dialogue with national debt management offices and treasuries in respect of debt issuance and repayment schedules. The Commission did so, notably through the EFC Sub-Committee on EU Sovereign Debt Markets ("the sub-committee").

52 In the replies to our survey, the member states' debt management offices outlined that the current exchange of information between the Commission and member states was generally adequate in respect of debt issuance and repayment schedules. Respondents suggested a number of possible changes, including the Commission sharing more information on the debt maturities being considered for auctions and syndications, and submitting an ex ante funding plan to the sub-committee. The Commission considers that it needs to retain certain flexibility in order

[17] Article 9(5) of Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

to tap into market demand. Therefore, it is not able to set the debt maturities for auctions far in advance. The Commission also argues that submitting the funding plan to the sub-committee before it is released to the market is not possible, as the funding plan contains non-public market-sensitive information.

53 The Commission sets its annual borrowing limits in its borrowing decisions[18]. After these decisions are adopted, the Commission also publishes semi-annual funding plans[19] providing stakeholders with more precise information on the expected amount of long-term funding operations and the frequency of issuances of NGEU bonds and bills.

54 Details of the annual borrowing limits for 2021 and 2022 and semi-annual plans concerning long-term funding until June 2022 are set out in ***Table 5***.

Table 5 – Limits and borrowing plans for long-term funding

2021		2022	
Annual limit	Funding plan June-December	Annual limit	Funding plan January-June
€125 billion	€80 billion*	**€140 billion**	€50 billion

Note: * Before amendment in October 2021.

Source: ECA, based on Commission's annual borrowing decisions for 2021 and 2022 and semi-annual funding plans until June 2022.

Compliance of the NGEU debt management with key regulatory requirements

55 Several regulatory provisions reduce the flexibility of NGEU debt management to some extent. They express the risk appetite, need for stability of the EU budget and financial market, and temporary character of this borrowing programme. ***Table 6*** includes information on the key limits that the Commission had to take into consideration when planning and implementing the borrowing transactions.

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[18] European Commission website: EU funding strategy, Legal Documents.

[19] European Commission website: Funding plans.

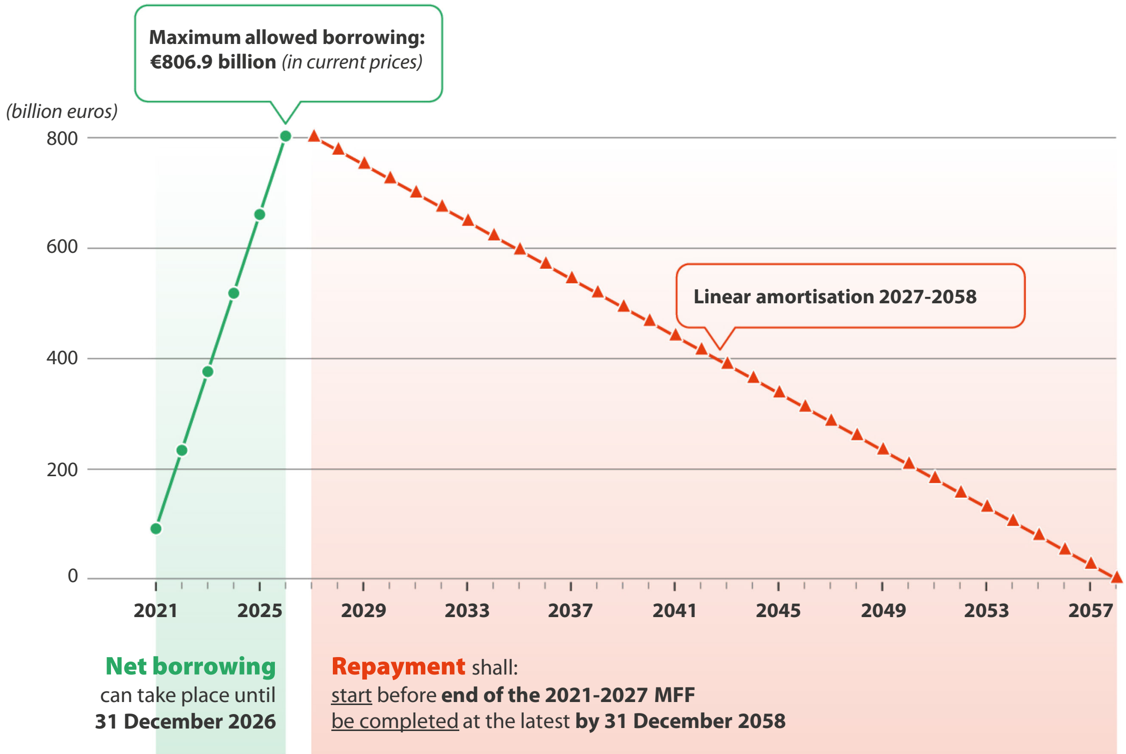
Table 6 – Key limits for NGEU debt management

Source	Limit	Timeframe
Article 5 of the Council Decision on the EU own resources	**€807 billion in current prices** (€750 billion in 2018 prices) – ceiling for total NGEU debt	2021-2058
	Euro currency – the only currency allowed for NGEU borrowing transactions	
	31 December 2026 – deadline for net new issuance of NGEU debt (after 2026, the Commission can still borrow funds to roll over the maturing securities)	
	31 December 2058 – deadline for repayment of all NGEU liabilities	
	The repayment of NGEU debt must be **steady and predictable**	
	€29.25 billion (in 2018 prices) – annual limit for repayment of NGEU debt raised to fund subsidies from the EU budget	
Annual borrowing decisions 2021 and 2022	**€125 billion (in current prices)** – ceiling on long-term funding	2021
	€140 billion (in current prices) – ceiling on long-term funding	2022
	€60 billion (in current prices) – ceiling on outstanding amount of short-term funding	2021 and 2022
	€20 billion (in current prices) – ceiling on maximum amount per single issuance of long-term funding	
	17 years – maximum average maturity of long-term funding	

Source: ECA, based on Council and Commission decisions.

56 *Figure 13* shows a theoretical example of an increase and decline of NGEU debt in compliance with the regulatory limits. In practice, the borrowing and repayment of NGEU debt does not have to follow such a strict linear pattern.

Figure 13 – Simulation of outstanding NGEU debt per year



Source: ECA, based on Commission information.

57 We found that 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.

58 We also examined documentation associated with 10 borrowing transactions, amounting to €55.5 billion, out of 65 borrowing transactions implemented by the Commission until 30 June 2022. Our selection focused on the biggest amounts and included all types of NGEU borrowing instruments. See ***Annex III***. We examined the application of internal procedure manuals for all types of borrowing transactions. We also examined the alignment of the transactions with borrowing instructions. We found that the Commission appropriately applied internal procedures concerning planning, execution and reporting on analysed syndications, auctions and money market transactions. All 10 analysed transactions were aligned with the appropriate semi-annual funding plans and detailed borrowing instructions prepared by the Commission.

Borrowing costs mirror the market conditions and the objective of providing sufficient funding on time

59 The main aim of the NGEU funding strategy is to provide sufficient funds for NGEU programmes in good time. We analysed whether the evolution of the cost of NGEU funding reflected market conditions, and whether it had been obtained at a cost close to the costs enjoyed by EU member states with a similar credit rating. We also assessed whether the Commission had avoided excessive or insufficient cash balances in the NGEU ECB bank account to prevent unnecessary costs, while meeting funding obligations as they became due.

Performance of NGEU borrowing transactions in terms of funding cost

60 Most rating agencies, including Fitch, Moody's, Scope and DBRS EU, assign the highest ratings to EU debt: AAA, Aaa, AAA and AAA (outlook stable) respectively. Since May 2022, S&P Global Ratings has classified EU debt as AA+ (outlook stable)[20]. Although the credit rating is not the only factor influencing the funding costs, the Commission can borrow funds on capital markets at a lower cost than most EU member states.

61 Since early 2022, rising market yields and price volatility have affected all bonds and securities in the EU, including the bonds of major EU sovereign issuers and NGEU. These developments resulted from the heightened uncertainties associated with geopolitical conflicts. Another factor is the tightening of monetary policy by central banks in advanced economies, which gradually began to reverse quantitative-easing policies and raise short-term policy rates in response to inflationary pressures intensifying worldwide.

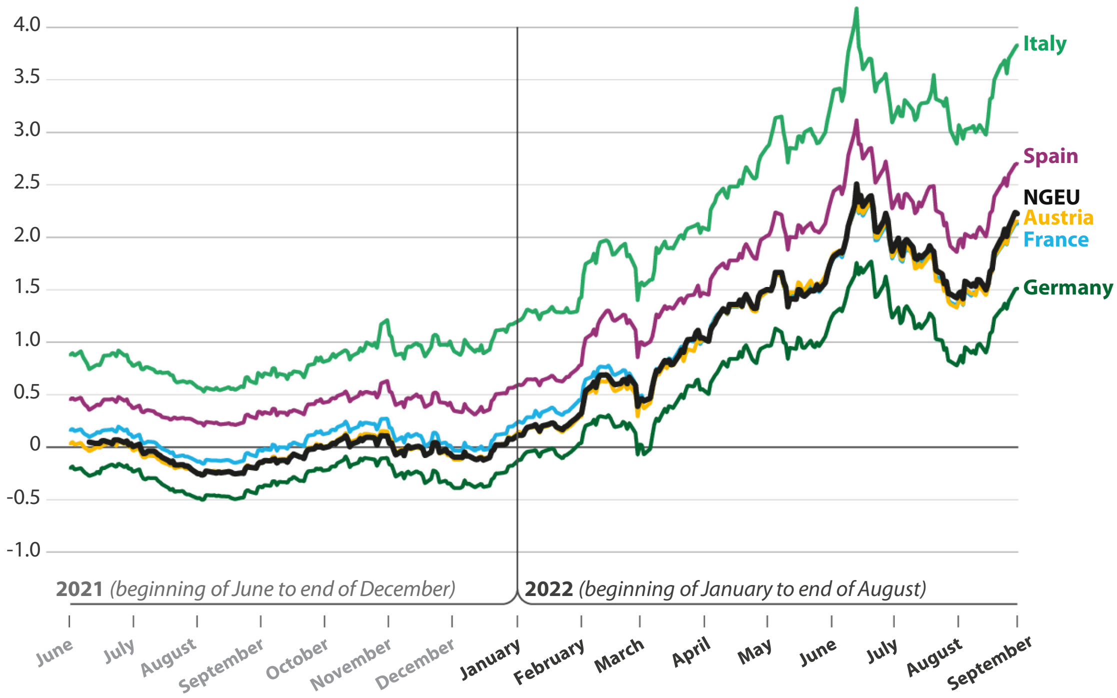
62 NGEU bond yields at issuance were higher in 2022 than in 2021. For NGEU bond syndications undertaken between June and December 2021, the weighted market yield at issuance was 0.16 %. For syndications carried out between January and June 2022, the corresponding figure was 1.36 %, which is 1.2 percentage points higher than in 2021.

63 Since the launch of the NGEU funding programme, the market yields of NGEU bonds – implicit in their prices – have been consistently close to yields of sovereign debt issued by France and Austria (see ***Figure 14*** for a comparison of yields for 10-year bonds). The evolution of market yields of NGEU bonds was comparable to the yields of

[20] European Commission website: EU credit strength.

member states' bonds with similar credit ratings. We observed that the average spread between market yields of 10-year benchmark bonds issued by Germany and NGEU was 0.24 percentage points (i.e. 24 basis points) in June-December 2021 and 0.45 percentage points (i.e. 45 basis points) in January-June 2022.

Figure 14 – Market yields for 10-year bonds for major EU issuers



Source: ECA, based on data provided by external expert.

64 The NGEU bonds' yields at issuance reflected the position of the Commission as a new large-scale borrower. Furthermore, the yields also reflect the Commission's aim to ensure a strong level of participation by investors in borrowing transactions and availability of funds when needed.

Liquidity management

65 Our analysis of borrowing transactions and cash management confirms that the applied procedures ensure flexibility in the use of different borrowing methods and the choice of the optimal time for borrowing. These methods include syndications of bonds, auctions of bonds and bills, and money market operations. 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.

66 Effective liquidity management can be affected, for example, by a delay in receiving a payment request from a member state, or by difficulties with the Commission's assessment of certain milestones and targets that are conditions for receiving RRF payments[21]. By 30 June 2022, 21 member states had received grants and loans under the RRF, including pre-financing; the six countries that had yet to do so were Bulgaria, Ireland, Hungary, the Netherlands, Poland, and Sweden[22].

67 We found that until the end of June 2022, the average payment period for all RRF grants and loans was around five business days after all requirements had been met and confirmed by the Commission. This was significantly lower than the thresholds outlined in the applicable Regulations (two months for pre-financing payments[23] and 30 calendar days for milestones and target-based payments[24]). Our analysis confirms that the Commission executed the RRF disbursements in a timely manner.

68 The Commission's internal guidance emphasises that the overarching objective of liquidity management is to ensure that amounts held in the NGEU bank account are sufficient to meet all upcoming disbursement needs and maintain a defined safety buffer while avoiding any excess balances. To achieve this objective, the Commission implemented a liquidity management policy, respecting the limits set out in ***Table 7***.

Table 7 – Liquidity Management Limits

Limits	Values	Details
Free cash balance	≥ 0	On each business day, there must be a free cash balance on the NGEU ECB account equal to or exceeding the prudential cash holding, i.e. payments from the account due for the next 10 business days.
Minimum free cash balance	€0.1 billion	The Commission has also set a soft buffer of €0.1 billion above the prudential cash holding, which must be available on each business day to cover unexpected expenses.
Upper bound (ceiling) on average liquidity	€30 billion	This parameter relates to the six-month period of each funding plan. It takes into account the past and expected average liquidity available in the NGEU ECB account over this six-month period.

Source: ECA, based on the Commission's Forecasting and Liquidity Management Manual.

[21] Special report 21/2022: "The Commission's assessment of national recovery and resilience plans", paragraph 82.

[22] Semi-annual report on the execution of the NGEU funding operations 1 January 2022-30 June 2022, COM(2022) 335, p. 3.

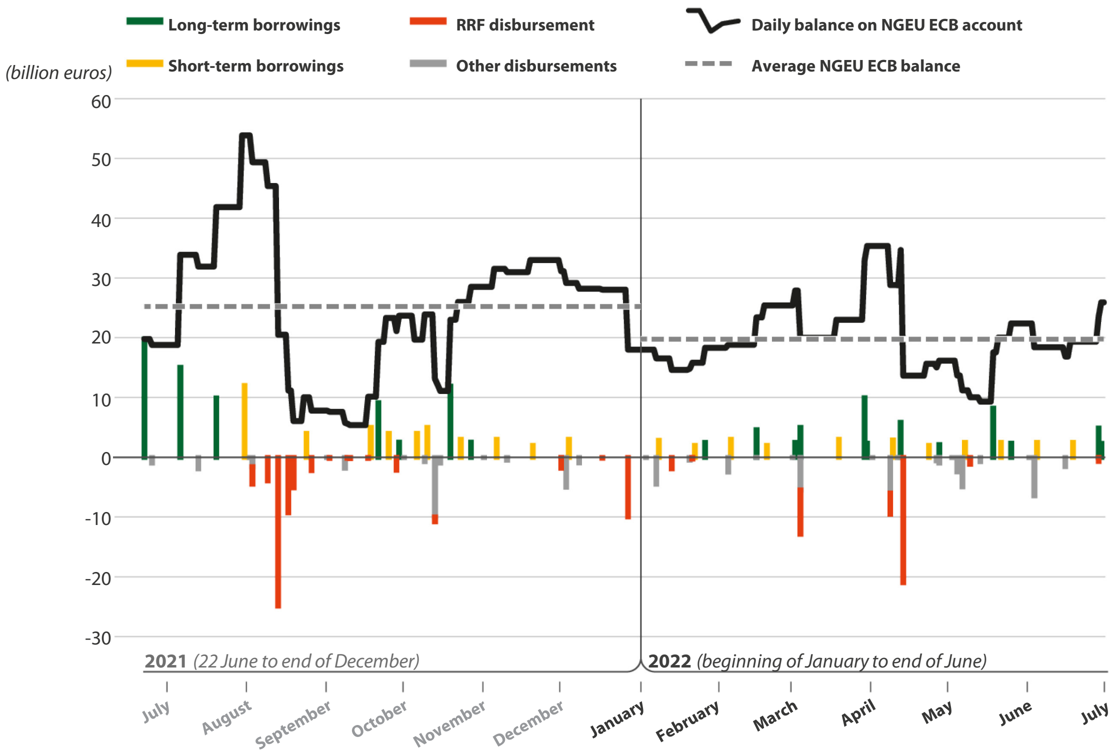
[23] Article 13(1) of Regulation (EU) 2021/241 establishing the RRF.

[24] Article 24.7 of Regulation (EU) 2021/241 establishing the RRF, in conjunction with Articles 116(1) and 116(2) of Regulation (EU, Euratom) 2018/1046 on the financial rules applicable to the general budget of the Union.

69 The Commission prepares weekly reports on the liquidity of the NGEU ECB account, which highlight any potential limit breaches. If such breaches occur, the Commission can delay planned disbursements for NGEU programmes, or it can decrease the planned volumes of upcoming borrowing transactions.

70 We reviewed the liquidity monitoring reports for all weeks from June 2021 to June 2022. We found that in the analysed period, the Commission had respected all three liquidity management limits. In accordance with the daily NGEU ECB account balances, the actual average cash balance amounted to €25 billion in 2021 and €20 billion in the first half of 2022. See ***Figure 15***. We observed that the liquidity management limits remained unchanged in this period.

Figure 15 – Daily and average cash balances, proceeds and disbursement of funds in the NGEU ECB account



Source: ECA, based on the NGEU ECB bank account statements and Commission documents.

71 In the period from June to August 2021, the cash balance of the NGEU ECB account was unusually volatile. This was a result of RRF pre-financing disbursements being paid as a large lump sum. From June 2021 until June 2022, cash balances on the NGEU ECB account that exceeded €20 billion were subject to negative deposit rates. In 2021, for example, this rate was -0.50 %, and led to deposit rate costs of €21.1 million being charged by the ECB.

72 According to the Commission's cost allocation method[25], the cost of liquidity management is the difference between the interest from the NGEU ECB bank account and the yield paid from the short-term instruments used to finance liquidity reserves. Our analysis of liquidity management in 2021 found that short-term debt instruments, which are used to finance liquidity reserves, had a negative yield and, instead of interest costs, they generated revenue for the EU. Consequently, the cost of liquidity management turned out to be negative; in other words, it resulted in a surplus for the Commission. The Commission distributed the liquidity management surplus between the EU budget (€11 million) and the member states (€3.6 million), proportionally to the use of all borrowed amounts for grants and loans.

The Commission's measurement and reporting on NGEU debt management performance was limited

73 In this section, we focus on setting the objectives and reporting on the performance of NGEU debt management. We also checked how the Commission documents the trade-offs between costs and risk in the analysed borrowing transactions, which is an important element for measuring performance.

Debt management objectives are not clearly set out, which limits reporting on performance

74 Under the internationally recognised best practice of the IMF[26] and the World Bank[27], a public debt management strategy is a plan that operationalises debt management objectives. Article 5(3) of the Own Resources Decision[28] requires the Commission to inform the European Parliament and the Council regularly and comprehensively about all aspects of its debt management strategy. We examined whether the Commission had clearly set out its debt management objectives in the

[25] Commission Implementing Decision (EU) 2021/1095 on allocation of costs of borrowing and debt management under NGEU.

[26] International Monetary Fund Policy Paper, Revised Guidelines for Public Debt Management, 2014.

[27] The World Bank, Government Debt Management: Designing Debt Management Strategies, 2017.

[28] Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

debt management strategy, and whether it had issued regular reports on their implementation to the EU budgetary authority.

Debt management objectives and reporting on their implementation

75 The Commission's debt management strategy does not clearly outline its debt management objectives and how it will meet them, though this is an internationally recognised best practice. The NGEU funding strategy focuses on funding methods and instruments to raise up to €150-200 billion per year for NGEU loans and grants until the end of 2026.

76 The Commission considers that it takes into account widely recognised key objectives of debt management when implementing NGEU borrowing transactions. These objectives concern the timely borrowing of required funds and the minimisation of borrowing costs with a prudent degree of long-term risk. According to the Commission, additional important NGEU debt management objectives include maintaining a broad investor base, promoting the use of green bonds, maintaining high creditor ratings, minimising counterparty risk, and having adequate processes in place to cover unexpected events such as market turmoil.

77 None of these objectives are explicitly set out in the NGEU funding strategy; however, 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. We consider that such non-specific references are not sufficient to make the Commission accountable for meeting these objectives.

78 The Commission prepares various reports that include an overview and cover different types of borrowing programmes, liabilities and treasury management (see ***Annex IV***). However, these documents do not contain comprehensive information about the achievement of debt management objectives related to the funding of NGEU. For example, the semi-annual reporting on NGEU borrowing transactions documents borrowing costs and the size and composition of the investor base, but it does not contain sufficient information on performance, in particular in terms of:

- minimising borrowing costs over the medium to long term, combined with the maintenance of prudential risk characteristics in debt management;
- preventing the concentration of EU borrowing transactions among a narrow group of primary dealers or final investors.

79 In its report of October 2021 on the revision of the Financial Regulation, the European Parliament called for the reporting requirements relating to the Commission's debt management strategy to be revised. The request referred to the increased complexity and risk of borrowing as well as lending operations for the EU budget. On 16 May 2022, the Commission proposed a recast of the Financial Regulation, Article 52(1)(d)(iii) of which includes a requirement for the draft budget to contain "a comprehensive overview of borrowing and lending operations". The proposal does not provide a clear requirement for the Commission to report on the achievement of debt management objectives. We have also commented on this issue in our opinion concerning the Commission's proposal for amendment of Article 52 of Financial Regulation[29].

80 Article 12 of the Commission's implementing decision of December 2022 establishing the arrangements for the diversified funding strategy[30] contains a requirement to report "twice per year on all aspects of its borrowing and debt management strategy". The scope of the reporting setup in this article does not include a clear requirement to inform the EU budgetary authority about achieving debt management objectives.

Reporting on NGEU green bonds

81 Under the NGEU funding strategy, green bonds issued under NGEU will further expand the investor base and strengthen the EU's world leadership in green finance on the euro-denominated market. The Commission aims to finance 30 % of NGEU through green bonds. The proceeds from these bonds will provide funding to the member states' contributions to the green transition in the framework of climate-related milestones and targets in their recovery and resilience plans.

82 According to the Commission, the NGEU green bond framework[31] will be aligned with the upcoming EU green bond standard[32] wherever possible. The key requirement

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[29] Opinion 06/2022 concerning the proposal for a Regulation on the financial rules applicable to the general budget of the Union, pp. 11-12.

[30] Commission Implementing Decision (EU, Euratom) 2022/2544.

[31] Communication from the Commission to the European Parliament and the Council on a new funding strategy to finance NextGenerationEU, COM(2021) 250, p. 9.

[32] European Commission website: EU Green Bond Standard proposal.

of this standard is that bonds will be allocated fully to expenditure that is aligned with the EU's sustainability classification system – the "EU Taxonomy"[33].

83 The Commission stated that it checks whether the proceeds of the NGEU green bonds are directed towards the green transition. To this end, member states agreed to report on the actual amount of expenditure related to reforms and investments with a positive climate marker when they make requests for RRF payments. The reliability and accuracy of this reporting depend mainly on the member state authorities and their control systems. Currently, the documents underlying the expenditure financed by NGEU green bonds are not subject to checks by the Commission.

84 We noted that in certain cases (for example, the energy renovation of buildings), RRF reforms and investments are required to satisfy some of the technical screening criteria of the EU Taxonomy in order to be allocated a 100 % climate marker. However, to calculate the contribution to the green transition, the Commission also considered some activities that do not meet any EU Taxonomy criteria[34]. This means that 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.

85 At the end of March 2022, the Commission launched the NGEU green bond dashboard. This dashboard includes updated information on the allocation of NGEU green bond proceeds across member states, expenditure categories and RRF intervention fields. In December 2022, the Commission published its first annual NGEU green bond allocation report. This report contains details of the degree of alignment with the EU Taxonomy for those RRF reforms and investments which were included in the NGEU green-bond-eligible pool of expenditure. None of these 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.

The Commission's analyses underlying decisions on the pricing and maturity of bonds were not consistently documented

86 Debt management requires an evaluation of the trade-off between cost and risk, since lower cost typically is associated with higher risk. Trade-off choices therefore

[33] European Commission website: EU taxonomy for sustainable activities.

[34] Special report 22/2021: "Sustainable finance: More consistent EU action needed to redirect finance towards sustainable investment", paragraphs 80 and 90.

have a direct impact on performance in terms of borrowing costs. We examined whether the Commission's decisions on the pricing of syndicated bonds were supported by sound documentation of the trade-offs associated with costs and risks. They concern in particular liquidity, market, funding, credit, counterparty and operational risks associated with debt management (see ***Annex II***). Such documentation provides accountability and allows the rationale of the pricing decisions having long-term consequences to be followed.

87 The financial markets, including the secondary market of EU bonds and activities of peer and sovereign issuers of debt, are subject to monitoring and weekly documentation by DG BUDG. For information about the pricing of the bonds and the best available borrowing opportunities in terms of time, volume and maturity, the Commission used the feedback and recommendations provided by the members of the PDN. According to the Commission, this information was also complemented by the Commission's own market research.

88 The Commission orally agrees with PDs on the price of the bonds issued by syndications during the pricing calls. These prices are subject to a judgement decision resulting from the analysis of the situation on the capital market, acceptable trade-offs and negotiation between the Commission and its PDs. For the syndicated transactions included in our sample (see paragraph ***58***), we found that the Commission 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.

Conclusions and recommendations

89 Overall, we conclude that the Commission has quickly put in place a debt management system which has provided the funds required for NextGenerationEU (NGEU) in good time. In this context, we consider 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, we found that NGEU's rapidly built debt management capacities do not comply with established best practice in all respects. We also conclude that the Commission did not pay enough attention to setting clear debt management objectives and measuring and reporting on performance in debt management.

90 Within a few months, the Commission set up new organisational arrangements and established an adequate network of external service providers to start NGEU's borrowing activities. Since it was necessary to build up capacity at speed, with few available staff members, no discrete middle-office function was established. The role of the middle office usually includes the monitoring of front-office performance against strategic targets and benchmarks. Currently, some of the middle-office functions, including developing a debt management strategy, are performed by the front office itself. Consequently, the front-office debt managers' performance is not continuously monitored. While the Chief Risk Officer (CRO) could challenge and monitor the performance of the front office, the CRO team has limited capacity for such work. See paragraphs ***22***-***26***, ***31***-***32*** and ***37***-***44***.

Recommendation 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.

Target implementation date: mid-2024

91 The Commission has established a risk management framework for NGEU debt management activities. It includes the newly created role of CRO. We consider that the

CRO team has performed important risk assessment work in the period under review. However, the positioning of the CRO as a Deputy Director-General of DG BUDG has weaknesses. It may require the CRO to deal with risk-related tasks as well as operational management activities within DG BUDG, which may affect the effectiveness of their oversight of risk. There is no clear description of the Deputy Director-General's responsibilities. Altogether, this situation brings with it the risk that the CRO may not be able to enforce properly their obligations regarding the assessment and reporting on risks. See paragraphs ***27***-***32***.

92 In December 2022, the Commission extended the CRO's mandate to cover all borrowing programmes implemented under the diversified funding strategy and under back-to-back funding. The information on risk exposure associated with EU debt provided to the decision-making bodies will therefore be more comprehensive. See paragraph ***33***.

Recommendation 2 – Reinforce the role of the CRO

To ensure that the CRO fulfils their mandate independently, effectively and efficiently, the Commission should:

(a) prepare a charter explaining which operational management tasks fall under the responsibility of the CRO in their capacity as a Deputy Director-General;

(b) reinforce the capacity of the CRO's team so that it is commensurate with its assigned tasks, particularly by establishing back-ups.

Target implementation date: end of 2023

93 Despite challenging circumstances, the Commission established a core team with the necessary skills and experience. The Commission relies heavily on temporary staff to manage its debt operations. This can put business continuity at risk; in the long term, it may jeopardise the quality and efficiency of debt management activities. See paragraphs ***34***-***36***.

Recommendation 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.

Target implementation date: end of 2023

94 The Commission has structured its communications to markets and stakeholders in such a way that they provide a good level of predictability about the NGEU funding programme and confidence in EU debt among market participants. We found that the Commission had adapted its funding plans and borrowing transactions to changes in the actual borrowing needs of NGEU. See paragraphs ***46***-***54***.

95 During the period covered by our audit, the NGEU debt portfolio satisfied regulatory requirements concerning borrowing ceilings, the currency of borrowing transactions, and maximum average maturity. The evolution of market yields of NGEU bonds was comparable to the yields of member states' bonds with similar credit ratings. The Commission had also been efficient in managing the liquidity of the NGEU bank account at the European Central Bank (ECB). Over the audited period, the average cash balances decreased on the NGEU ECB bank account and liquidity limits remained unchanged. See paragraphs ***55***-***72***.

96 The Commission is legally required to inform the EU budgetary authority regularly and comprehensively about all aspects of its debt management strategy. However, we found that the NGEU funding strategy does not clearly set out its debt management objectives or the associated indicators. Neither the relevant legislation nor the strategy provides a clear requirement for the Commission to report on the performance of its debt management activities. The Commission also does not report on the proportion of NGEU green bond proceeds actually spent in accordance with the EU's sustainability classification system, the EU Taxonomy. With this approach, the Commission is mainly accountable for providing a sufficient amount of funds on time to finance NGEU. Accountability for the other objectives of NGEU debt management remains unclear. See paragraphs ***75***-***85***.

Recommendation 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:

(a) 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;

(b) publish regular information on the proportion of NGEU green bond proceeds actually spent in accordance with the EU Taxonomy.

Target implementation date: end of 2023

97 The Commission agrees orally with primary dealers on the price of the bonds issued by syndications during pricing calls. These prices are the result of judgement decisions based on an analysis of the situation on the capital markets, acceptable trade-offs, and negotiations between the Commission and its primary dealers. The Commission does not consistently document its analyses underlying individual decisions on the pricing and maturity of syndicated bonds. See paragraphs ***86***-***88***.

Recommendation 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.

Target implementation date: September 2023

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 11 May 2023.

For the Court of Auditors

Tony Murphy
President

Annexes

Annex I – Key roles and responsibilities concerning debt management at the Commission

Front office (combining some functions of middle office)	**Unit BUDG E.3 — Borrowing & Lending Operations** → organises debt issuance and lending of proceeds for the EU's financial assistance programmes; → develops and implements a debt management strategy including operations issuance, loan administration and review of repayment schedules; → manages communication with stakeholders e.g. credit rating agencies, investment banks, peer institutions and national debt management offices. **Staff capacity: 15 FTE**
Back office	**Unit BUDG E.2 — Accounting & Reporting Back Office** → provides the accounting for loans and borrowings and for the various asset portfolios; → conducts the tasks relating to settlement, payment processing, reconciliation of transactions and financial reporting. **Staff capacity: 8.7 FTE**
Legal service	**Unit BUDG E.4 — Policy & Legal Coordination** → provides the legal support for the front, back office and CRO team. **Staff capacity: 4.1 FTE**
CRO and team	**CRO team** → prepares the HLRCP, addressing the principal risks to the financial interest of the EU arising from the implementation of NGEU operations, and oversees its implementation; → establishes and maintains standards for risk identification, assessment and quantification and develops guidelines, internal risk policies and procedures; → reports regularly on material risks and on the compliance with rules and procedures (to the Member of the College responsible for the Budget, to the Risk and Compliance Committee, to the Director-General of DG BUDG and to the Accounting Officer; → provides regular information on risks and limits to persons who are responsible for the operational execution of the diversified funding strategy; → reports on the implementation of the HLRCP to the Commission once per year. **Staff capacity: 2.5 FTE**

Source: ECA, based on Commission data.

Annex II – Types of risk in NGEU debt management

Risk	Description
Liquidity risk	The risk that the Commission is unable to mobilise the financing when needed and on advantageous financial terms.
Budgetary sustainability risk	The risk that the total amount of interest and principal payments in a specific year exceeds the available appropriations in the European Union Recovery Instrument (EURI) budget line of the Commission's section of the adopted annual budget. It is also the risk that liabilities of the NGEU operations, including the contingent liabilities resulting from loans to member states, exceed the EU's financial capacity.
Market risk	The interest rate risk that applies to future funding activities to raise new debt or to roll over maturing debt under the diversified funding strategy.
Credit risk	The risk of loss arising from exposures with counterparties and issuers/borrowers facing issues to meet their obligations. It comprises of:
(a) Lending risk	The potential for a liquidity shortfall arising from a member state receiving RRF loans and failing to meet its initial financial obligations towards the EU.
(b) Counterparty risk	The risk of one or more parties in a financial transaction defaulting on or failing to meet their obligations.
(c) Settlement risk	A particular form of counterparty risk. The potential for loss arising from the failure of one or more counterparties to settle an exchange for value transaction.
(d) Concentration risk	The risk of accumulation of funding exposure on limited categories of investors or counterparties.
Operational risk	The risk of direct or indirect loss, resulting from inadequate or failed internal processes, people and systems, or from external events.
Reputational risk	The risk of loss or damage arising from a deterioration of good name or standing of the European Commission.
Green bond programme implementation risk	The risk that arises from the potential failure of the EU to ensure alignment of the use of proceeds with the EU Green Bond Framework and report to the investors on the achieved impact.

Source: ECA, based on the HLRCP.

Annex III – NGEU borrowing transactions selected for analysis

Number	Date	Type	Tenor	Yield	Face value
EU000A3KT6B1	13/07/2021	Bond syndication	20 years	0.47 %	€10 billion
EU000A3K4C42	12/10/2021	Green bond syndication	15 years	0.45 %	€12 billion
EU000A3KWCF4	25/10/2021	Bond auction (tap)	7 years	-0.12 %	€2.5 billion
EU000A3K4C42	24/01/2022	Green bond auction	15 years	0.37 %	€2.5 billion
EU000A3K4C18	22/09/2021	Bill auction	6 months	-0.74 %	€2 billion
EU000A3K4C26	06/10/2021	Bill auction	3 months	-0.79 %	€3 billion
Not published	30/07/2021	Credit line	75 days	-0.48 %	€9 billion
EU000A3K4DD8	22/03/2022	Bond syndication	10 years	1.02 %	€10 billion
EU000A3KWCF4	28/03/2022	Bond auction	7 years	0.80 %	€2.5 billion
EU000A3K4C75	16/03/2022	Bill auction	3 months	-0.67 %	€2 billion
Total					**€55.5 billion**

Source: ECA, based on Commission information.

Annex IV – Commission's reports concerning the EU liabilities resulting from the borrowing transactions until 30 June 2022

No	Title of the report or document (website link to the most recent one)	Legal requirement
1.	Semi-annual reports on the execution of the NextGenerationEU funding operations	Article 12 of Commission Implementing Decision C(2021) 2502 Article 5(3) of Decision (EU, Euratom) 2020/2053
2.	NextGenerationEU Quarterly Update – Note on the outstanding claims under loan agreements and liabilities under borrowings (Not published, sent by e-mail for every quarter by DG BUDG to the European Parliament and the Council)	The "quarterly update complements the reporting under the obligations set in the different relevant legal texts (e.g. Decision (EU, Euratom) 2020/2053, Regulation (EU, Euratom) 2018/1046 (Financial Regulation), Commission Implementing Decision C(2021) 2502)."
3.	Budgetary transparency report	In accordance with points 16 and 17 of Interinstitutional Agreement
4.	Report from the Commission to the European Parliament and the Council on financial instruments, budgetary guarantees, financial assistance and contingent liabilities	Article 250 of Regulation (EU, Euratom) 2018/1046 (Financial Regulation)
5.	Report from the Commission to the European Parliament and the Council on the long-term forecast of future inflows and outflows of the EU budget (2021-2027)	Article 247(1)(c) of Regulation (EU, Euratom) 2018/1046 (Financial Regulation)
6.	Separate financial statements at the end of the year for NGEU, SURE, EFSM and MFA	Article 80 of Regulation (EU, Euratom) 2018/1046 (Financial Regulation)
7.	NextGenerationEU funding plan	Article 5(3) of Decision (EU, Euratom) 2020/2053 and Article 4 of Commission Implementing Decision C(2021) 2502
8.	Draft budget and working documents I, V, and XI	Article 41 of Regulation (EU, Euratom) 2018/1046 (Financial Regulation) and points 41, 44, 46, 47, and 48 of Annex I to Interinstitutional Agreement
9.	Consolidated annual accounts of the EU	Article 246 and 247(1)a of Regulation (EU, Euratom) 2018/1046 (Financial Regulation)

Source: ECA.

Abbreviations

CRO: Chief Risk Officer

DG BUDG: Directorate-General for Budget

ECB: European Central Bank

EFSM: European Financial Stabilisation Mechanism

FTE: Full-time equivalent

HLRCP: High Level Risk and Compliance Policy

IMF: International Monetary Fund

INTOSAI: International Organization of Supreme Audit Institutions

MFA: Macro-Financial Assistance

NGEU: NextGenerationEU

PD: Primary dealer

PDN: Primary dealer network

RRF: Recovery and Resilience Facility

SURE: Support to Mitigate Unemployment Risks in Emergency

UNCTAD: United Nations Conference on Trade and Development

Glossary

Auction: Competitive process in which EU bonds and bills are sold to the highest bidders among the primary dealers approved by the Commission.

Bill: Short-term debt security that is sold at a discount compared to the value at which it will be redeemed, rather than paying a fixed annual interest rate.

Bond: Medium- to long-term debt security with a fixed annual interest rate.

Capital market: Market on which financial assets are traded.

Contingent liability: Potential payment obligation that may be incurred depending on the outcome of a future event.

Credit rating: Objective assessment of a borrower’s creditworthiness, either in general or with respect to a particular debt or financial obligation.

Debt management: Action taken to issue debt or optimise the amount and timing of outstanding debt repayments and to mitigate the risk of default.

Green bond: Debt instrument for financing or re-financing investments, projects, expenditure or assets that address climate and environmental issues.

Maturity: Date on which a bond or bill will be repaid.

Own resources: The funds used to finance the EU budget, the vast majority coming from member state contributions.

Primary dealer: Financial institution approved by the Commission to market and trade EU debt instruments through a process known as syndication.

Secondary market: Market on which investors trade financial assets directly with each other rather than with the issuer.

Tenor: Time remaining until maturity of a bond or bill.

Replies of the Commission

https://www.eca.europa.eu/en/publications/sr-2023-16

Timeline

https://www.eca.europa.eu/en/publications/sr-2023-16

Audit team

The ECA's special reports set out the results of its audits of EU policies and programmes, or of management-related topics from specific budgetary areas. The ECA selects and designs these audit tasks to be of maximum impact by considering the risks to performance or compliance, the level of income or spending involved, forthcoming developments and political and public interest.

This performance audit was carried out by Audit Chamber V Financing and administering the Union, headed by ECA Member Jan Gregor. The audit was led by ECA Member Jorg Kristijan Petrovič, supported by Martin Puc, Head of Private Office and Mirko Iaconisi, Private Office Attaché; Colm Friel, Principal Manager; Tomasz Plebanowicz, Head of Task; Daria Bochnar and David Macken, Auditors. Jesús Nieto Muñoz and Alexandra Mazilu provided graphical support. Richard Moore provided linguistic support.

From left to right: Jesús Nieto Muñoz, Mirko Iaconisi, Daria Bochnar, Jorg Kristijan Petrovič, Martin Puc, Tomasz Plebanowicz, Colm Friel, David Macken.

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The NextGenerationEU programme provides grants and loans to member states to support their economic recovery following the COVID-19 pandemic. The Commission will fund the programme by issuing up to €807 billion in EU bonds on the capital markets. We analysed whether the Commission had developed effective systems to manage the debt raised to finance NextGenerationEU. We found that the Commission had established the funding strategy and the organisational arrangements quickly, which had allowed the required funds to be made available in a timely manner. However, the rapidly built debt management capacities need adjustment to be in line with established best practice. The Commission did not concentrate enough on setting strategic objectives and measuring and reporting on performance in debt management. We make various recommendations to address these issues.

ECA special report pursuant to Article 287(4), second subparagraph, TFEU.

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