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REPORT FROM THE COMMISSION

TO THE EUROPEAN PARLIAMENT AND THE COUNCIL
on financial instruments, budgetary guarantees, financial assistance and contingent liabilities
Situation at 31 December 2020

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1. Introduction

This is the first report in accordance with the requirements of Article 250 of the Financial Regulation[1]. It has been prepared in conjunction with:

- Working Documents X and XI, accompanying the Draft Budget 2022, which provide detailed information on the EU financial instruments and budgetary guarantees[2]; and
- The Long-term forecast report on future inflows and outflows of the EU budget, which gives projections for the available financial capacity of the EU over 2021-2027 after planned budget expenditures are considered[3].

The objective of this document is to provide an overview of the contingent liabilities borne by the EU budget as of 31 December 2020 and of the panoply of measures and safeguards which the Commission has at its disposal to fully protect the EU budget from potential losses originating from those liabilities.

After a general introduction on the definition and sources of contingent liabilities, the report depicts the key features of the two categories of contingent liabilities (provisioned and un-provisioned) with particular regard to the analysis of the EU framework for the monitoring and management of the risks arising from contingent liabilities.

Finally, the report provides an assessment of the sustainability of the Union contingent liabilities in the long-term, based on qualitative and quantitative factors. The assessment is performed:

- Against the amount of existing provisions held in the guarantee funds set by the Commission for budgetary guarantees and financial assistance to third countries;
- Against the limits of the Own Resources ceiling and the available headroom for un-provisioned contingent liabilities stemming from financial assistance to Member States.

The main **conclusion** of the sustainability analysis is that the EU budget has in principle adequate resources to cope with the potential materialisation of contingent liabilities. In particular:

- **No under-provisioning issues are identified for contingent liabilities arising from budgetary guarantees and financial assistance to third countries;**
- **The EU financial capacity under the existing legal framework (i.e. Own Resources Decision[4] and Multiannual Financial Framework (MFF) 2021-2027 Regulation[5]) is sufficient to cover the existing obligations of the Union in relation to both spending programmes and financial markets (for debt issued under financial assistance programmes to Member States), even under extreme adverse circumstances**.

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[1] Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, OJ L 193, 30.7.2018, p. 1.

[2] Working Document X on the use made of financial instruments, pursuant to Article 41(4) of Financial Regulation; Working Document XI on the implementation of Budgetary Guarantees, the Common Provisioning Fund and the assessment of the sustainability of the contingent liabilities arising from budgetary guarantees and financial assistance pursuant to Article 41(5) of the Financial Regulation (COM(2021)300-June 2021).

[3] COM(2021) 343 final of 30.6.2021.

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

[5] Council Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027, OJ L 433I, 22.12.2020, p. 11-22.

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This report covers contingent liabilities incurred prior to the end of 2020, and assesses how they are catered for under the MFF 2021-2027. It therefore does not cover contingent liabilities arising from **NextGenerationEU** (NGEU)[6] which have only started to materialise during the course of 2021, and for which an additional financial capacity has been established through a temporary increase of the Own Resources ceiling.

2. What are contingent liabilities?

Contingent liabilities are potential financial liabilities of the EU, which stem from existing binding commitments or past events. Whether or not these contingent liabilities will lead to actual losses, will depend on future events not wholly under the control of the EU.

For the EU, there are three main sources of contingent liabilities[7]:

- **Budgetary guarantees**, which are guarantees provided to the European Investment Bank (EIB) Group or other implementing partners under the European Fund for Strategic Investments (EFSI)[8] mandate, the European Fund for Sustainable Development (EFSD)[9] mandate and the External Lending Mandate (ELM)[10]. Under all these instruments, the EU (partially) guarantees implementing partners for the losses emanating from their guaranteed financing and investment operations (i.e. debt or equity operations). Under the MFF 2021-2027, the InvestEU programme pools under the umbrella of a single EU guarantee the activities previously deployed under EFSI and several other financial instruments and has opened up access to a portion of the EU guarantee to pillar-assessed[11] implementing partners other than the EIB Group[12]. In a similar manner, the EFSD has been succeeded by the EFSD+, established by the Neighbourhood, Development and International Cooperation Instrument (NDICI) – Global Europe Regulation[13] and which now acts as the financing arm of a reinforced External Investment Plan.
- Loans and related borrowings to provide **financial assistance to third countries (**i.e. Macro Financial Assistance (MFA)[14] loans and Euratom loans to third countries[15]) that is

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

[7] A separate source of contingent liabilities are 'legal risks'. These are not covered by the present report.

[8] Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013, OJ L 169, 1.7.2015, p. 1.

[9] Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development (EFSD), the EFSD Guarantee and the EFSD Guarantee Fund, OJ L 249, 27.9.2017, p. 1.

[10] An overview of the relevant legislative acts and corresponding guarantee agreements between the Commission and the European Investment Bank is available in the Definitive Adoption (EU, Euratom) 2021/417 of the European Union's general budget for the financial year 2021 - Section III – Commission, Remarks for Item 14 20 03 02 of the statement of expenditure "External Action Guarantee for NDICI, EINS, IPA III and MFA", OJ L 93, 17.3.2021, pp. 959–965.

[11] See section 3.2.1 below for details on the Pillar Assessment process.

[12] Regulation (EU) 2021/523 of the European Parliament and of the Council establishing the InvestEU Programme and amending Regulation (EU) 2015/1017, OJ L 107, 26.3.2021, p. 30–89.

[13] Regulation (EU) 2021/947 of the European Parliament and of the Council of 9 June 2021 establishing the Neighbourhood, Development and International Cooperation Instrument – Global Europe, amending and repealing Decision No 466/2014/EU and repealing Regulation (EU) 2017/1601 and Council Regulation (EC, Euratom) No 480/2009, OJ L 209, 14.6.2021, p. 1–78.

[14] The legal basis for macro-financial assistance to non-EU countries other than developing countries is Article 212 of the Treaty on the Functioning of the European Union (TFEU). Article 213 TFEU may be used as a legal basis when the third country requires urgent financial assistance.

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in principle financed through 'back-to-back' borrowing operations. Concretely this means that each loan is funded through a corresponding EU bond, which fully matches the EU loan in terms of maturity, interest rate and repayment schedule. As a result, investors in EU bonds are only exposed to the EU credit risk and not to the credit risk of each single beneficiary country. For the EU, the liability is contingent since no outflow of EU resources is in principle required for settling the EU debt, the beneficiary country being contractually obliged to supply the revenue flow.

- Loans and related borrowings to provide **financial assistance to EU Member States**, i.e. Balance of Payments (BoP) loans[16], European Financial Stabilisation Mechanism (EFSM) loans[17], Euratom loans[18] and loans under the European instrument for temporary support to mitigate unemployment risks in an emergency (SURE)[19]. These loans are granted to EU Member States under the same back-to back technique as the financial assistance to third countries[20]. The revenue from repayments from the beneficiary Member States is channelled to service the EU debt. It does not count as own resources under the respective Own Resources ceiling.

Contingent liabilities arising from **budgetary guarantees** and from **financial assistance to third countries** are partially provisioned and the provision calculations are based on conservative assessments of the expected losses for each instrument plus an additional margin to cover a portion of the unexpected losses.

By contrast, contingent liabilities stemming from **financial assistance to EU Member States** are not provisioned. Borrowings of the EU constitute direct and unconditional obligations of the EU. Therefore, in case a beneficiary Member State would fail to honour its obligations towards the EU, the EU is entitled, as a last resort having exhausted all other possibilities to find solutions within the existing budgetary framework, to draw the necessary liquidity from the other Member States. Such calls for revenue would be made over and above the MFF ceilings, while respecting the Own Resources ceiling[21].

At the end of 2020, the EU budget included contingent liabilities amounting to over EUR 93 billion in relation to loans granted to Member States and third countries and approximately EUR 63 billion for the guarantees provided in the context of EFSI, EFSD,

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[15] Council Decision 94/179/Euratom of 21 March 1994 amending Decision 77/270/Euratom to authorize the Commission to contract Euratom borrowings in order to contribute to the financing required for improving the degree of safety and efficiency of nuclear power stations in certain non-member countries, OJ L 84 of 29.3.1994, p. 41–43.

[16] Council Regulation (EC) No 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments, OJ L 53, 23.2.2002, p. 1–3.

[17] Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, OJ L 118, 12.5.2010, p.1; Council Regulation (EU) 2015/1360 of 4 August 2015 amending Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism, OJ L 210, 7.8.2015, p. 1–2.

[18] Council Decision 77/270/Euratom of 29 March 1977 empowering the Commission to issue Euratom loans for the purpose of contributing to the financing of nuclear power stations (OJ L 88 of 6.4.1977, p. 9) as amended and supplemented.

[19] Council Regulation (EU) No 2020/672 of 19 May 2020 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak, OJ L 159, 20.5.2020, p. 1–7.

[20] In the future, the Commission will also borrow on the markets to finance the non-repayable support provided under NGEU. The repayment of these borrowing operations will be covered through the appropriations of the annual budgets, within the ceilings of the Multiannual Financial Frameworks, and therefore in principle will not represent a contingent liability for the EU. The borrowing-to-lend activities of NGEU will however give rise to new contingent liabilities.

[21] See Articles 2(3) and 3(1) of Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027.

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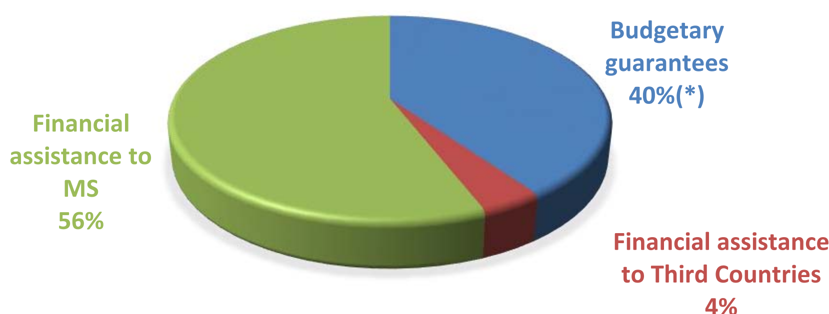
and ELM. The largest exposure for the EU budget originates from financial assistance programmes targeting Member States (See Figure 1 below).

Under the MFF 2021-2027 the use of budgetary guarantees is expected to further increase through, *inter alia*, the InvestEU programme which includes a EUR 26.2 billion guarantee to support investment operations in four policy windows (sustainable infrastructure, research, innovation and digitalisation, SMEs, and social investment and skills). By the end of 2021, the Union is expected to significantly increase its contingent liabilities also in relation to the borrowing undertaken to finance NGEU's Recovery and Resilience Facility loans to Member States. The results of those operations will be included in the next edition of the present report.

Figure 1: Breakdown of contingent liabilities by source at 31 December 2020



(*) Based on the total amount of "available guarantee signed with counterparts" (See table 1 below).

In accordance with EU accounting rules, **financial instruments** in the form of guarantees are classified as contingent liabilities[22], however, they are not a source of contingent liabilities from a budgetary perspective since they are always fully provisioned by the budget, i.e. the budget has foreseen commitments to meet the full amount of the contingent liability arising from the financial instrument. There is full assurance that the entirety of the commitment can be honoured in the extreme scenario that this would be warranted as it already forms part of the outstanding commitments of the Union.

The EU budget funds a large variety of financial instruments (equity, debt, loan guarantees, venture capital, capacity building and risk sharing facilities). These are classified in two main categories: those related to internal policy actions and those related to external policy actions (depending on whether the recipients are predominantly located in or outside the EU). Examples of financial instruments are the instruments established under Horizon 2020 to enhance access to finance to entities engaged in research and innovation[23], the

[22] See par. 4.1.3 of the Communication from the Commission to the European Parliament, the Council and the Court of Auditors -Annual Accounts of the European Union 2020, COM(2021) 381 final.

[23] Regulation (EU) No 1291/2013 of the European Parliament and of the Council of 11 December 2013 establishing Horizon 2020 - the Framework Programme for Research and Innovation (2014-2020), OJ L 347/104, 20.12.2013. The instruments are:
- The InnovFin Loan and Guarantee Service for R&I under which the Commission shares the financial risk related to a portfolio of new financing operations entered into by the EIB;
- The InnovFin SME Guarantee and the SME Initiative Uncapped Guarantee Instrument (SIUGI), managed by the EIF and providing guarantees and counter-guarantees to financial intermediaries for new portfolios of loans;
- The InnovFin Equity Facility for R&I providing for investments in venture capital funds which is managed by the EIF; and
- The EIC Fund (European Innovation Council Fund) which provides equity financing to accelerate innovation and market deployment actions.

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Connecting Europe Facility[24] debt instrument, which has been established to facilitate infrastructure projects (in the sectors of transport, telecommunications and energy), and the EU SME equity facilities that support the creation and financing of EU SMEs in their early and growth stages[25].

Working Document X accompanying the Draft 2022 budget provides a detailed description of all the thirty-six existing financial instruments.

3. Contingent liabilities arising from provisioned instruments: budgetary guarantees and financial assistance to third countries

3.1. Overview of the total EU risk exposure at the end of 2020

In 2020 the EU has extended budgetary support in the form of guarantees provided to the EIB Group on debt and equity operations covered by the EFSI and to the EIB Group and other nine financial institutions (including the European Bank for Reconstruction and Development and several national promotional banks) on operations covered by the EFSD. The EU has also guaranteed loans granted by the EIB to beneficiaries outside the EU under the ELM.

The **EFSI** was launched in 2015 to remedy the problem of prolonged subdued private investment following the financial crisis. It takes the form of a EUR 26 billion budgetary guarantee from the EU budget to the EIB Group. It is complemented by an allocation of the EIB's own resources of EUR 7.5 billion.

The guarantee under the **EFSD** was put in place to support investments and improve access to finance primarily in Africa and the Neighbourhood countries and to help those countries to meet the UN Sustainable Development Goals.

The basic rationale of the EU budgetary guarantee provided under the **ELM** is to enhance the ability of the EIB to undertake financing operations in riskier environments based outside the EU in areas such as local private sector development and development of socio-economic infrastructure.

Table 1 provides information on the total risk exposure for the EU budget originating from the three guarantees[26].

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[24] Regulation (EU) No 1316/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Connecting Europe Facility, amending Regulation (EU) No 913/2010 and repealing Regulations (EC) No 680/2007 and (EC) No 67/2010, OJ L 348, 20.12.2013, p. 129–171.

[25] These are equity instruments financed by different programmes, including COSME. For COSME see Regulation (EU) No 1287/2013 of the European Parliament and of the Council of 11 December 2013 establishing a Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014 - 2020) and repealing Decision No 1639/2006/EC, OJ L 347, 20.12.2013, p. 33-49.

[26] Disbursed amounts represent the amounts already given to final beneficiaries, while amounts related to operations signed by counterparts include the disbursed amounts plus agreements already signed with beneficiaries or financial intermediaries but not yet disbursed. Finally, the available guarantee signed with counterparts represents the total guarantee that is covered by the EU budget and therefore the maximum exposure potentially faced by the EU, including operations authorised for signature but not yet signed. Figures include amounts classified as "provisions/financial liabilities" in accordance with the applicable European Accounting Rules.

Table 1: Contingent liabilities arising from budgetary guarantees. Situation at 31 December 2020 (EUR million)

	Available guarantee signed with counterparts	**Available guarantee related to operations signed by counterparts**	**Available guarantee related to operations signed by counterparts and disbursed**
EFSI	25 833.27	24 121.52	18 880.06
EFSD	1 370.7	438. 56	34.52
ELM	35 574.71	32 732.34	20 252.21
Total	**62 778.68**	**57 292.42**	**39 166.78**

Financial support to third countries in the form of bilateral loans from the EU and funded back-to-back from the capital markets has been granted essentially in the context of the **Macro-Financial Assistance programme**, which targets countries outside the EU experiencing a balance of payment crisis. In 2020, a total of EUR 1 675 million in loans was disbursed[27].

The outstanding amounts at the end of 2020 are presented in table 2.

Table 2: Outstanding amounts in respect of loans to third countries as at 31 December 2020 (EUR million)

	Outstanding loans	**Accrued interests**	**Total**
MFA	5 786.80	26.17	5 812.97
Euratom	200	0.5	200.5
Total	**5 986.80**	**26.67**	**6 013.47**

3.2. The EU risk management system for provisioned contingent liabilities

Title X of the Financial Regulation provides the foundation of the EU framework for the management of contingent liabilities, as it includes a number of key provisions to ensure that the EU budget is adequately protected from the risks associated with those liabilities. To make sure that the EU is at any time able to honour fully, and in a timely manner, calls on the budgetary guarantees by implementing partners or to repay bonds where the loan beneficiary has defaulted, a number of risk management mechanisms and tools have been put in place. Some of those are horizontal and apply to all categories of contingent liabilities, others are more specific and relate either to budgetary guarantees or to financial assistance programmes.

[27] For details, see the Report from the Commission to the European Parliament and the Council on the implementation of macro-financial assistance to third countries in 2020, COM/2021/375 final.

3.2.1. Budgetary guarantees

The safeguards put in place to ensure that contingent liabilities arising from budgetary guarantees do not exceed the budgetary capacity to absorb them are described in the present section.

Measures to limit the amount of the contingent liabilities

First, the size of the EU guarantee is always capped in a clearly defined manner. The Financial Regulation states that the financial liability and the aggregate net payments from the budget cannot exceed the size of the budgetary guarantee, authorised by its basic act. The contingent liability generated by a budgetary guarantee can only exceed the financial assets provided to cover the EU financial liability if this is provided for in the underlying basic act and under the specific conditions it sets.

Secondly, the risk profile of the operations/financial products guaranteed by the EU is determined *ex ante*, i.e. at the time of the signature of the guarantee agreements. It shall be fully compatible with the provisioning rate as determined in the regulation governing the relevant guarantee and the risk appetite[28] that has been set for the programme. Where appropriate, the operations will strive for diversity (geographic scope, sectors, etc.) in order to avoid excessive risk concentrations.

Measures concerning the selection of implementing partners

Prior to becoming an implementing partner in the context of an existing guarantee programme, candidate institutions are subject to a 'Pillar Assessment', i.e. a thorough review of their internal processes and applicable procedures in order to assess their capacity to guarantee a level of protection of the EU financial interests equivalent to that required under the Financial Regulation[29].

Moreover, existing guarantee agreements include provisions to make sure that:

(i) Implementing partners contribute with their own resources to the operations covered by the budgetary guarantee, and;

(ii) Adequate mechanisms are in place to ensure that a portion of the risk of losses is borne by the implementing partners (risk sharing) or alternatively that other financial incentives[30] are introduced to secure sufficient alignment of interests.

Implementing partners are also requested to put in place adequate measures to prevent any potential conflict of interests with other activities they might carry out as part of their ordinary business.

Measures to ensure adequate ex-ante budgetary capacity to absorb guarantee calls

For budgetary guarantees, the Financial Regulation requires upfront provisioning based on a provisioning rate, which is determined in such a manner that it covers guarantee calls to the level of expected losses plus a 'safety' buffer to cope with a portion of unexpected losses[31].

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[28] The risk appetite is the maximum level of financial risk that the Commission is willing and able to incur in pursuing its activities in the context of its public mission and objectives and in compliance with the relevant legislation in place.

[29] See Commission Decision of 17.4.2019 on establishing new terms of reference for the pillar assessment methodology to be used under Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council, COM(2019)2882 Final, OJ C 191, 6.6.2019, p. 2–136.

[30] These can include, *inter alia,* a remuneration of the EU guarantee by the beneficiary implementing partner. This shall be consistent with the sharing of risk among financial participants and the policy objectives of the budgetary guarantee.

[31] The portion of unexpected losses is determined on the basis of the risk appetite of the specific programme.

The provisioning rate is set in the basic act and is expressed as a percentage of the total amount of the EU guarantee. The rate is subject to regular monitoring during the implementation of the programmes and is, if appropriate, reviewed to ensure continued alignment with the evolution of the risk profile of the outstanding liabilities.

The Commission has specific measures at its disposal to ensure a continued adequate level of provisioning. These are based on an early warning system that helps to avoid a potential exhaustion of the provisioning and that, if needed, can trigger a replenishment of the provisioning and/or an increase of the provisioning rate as provided for in the legal basis[32].

Replenishments, when and if required, are implemented through the normal annual budgetary procedure. Unlike the potential repayments in relation to financial assistance to Member States, the replenishments for budgetary guarantees count within the limits of the MFF ceilings for commitments and payments appropriations.

In order to mitigate the risk of the impact that guarantee calls from implementing partners could have on the EU budget, the EU has historically created dedicated guarantee funds funded by the EU budget. At 31 December 2020, the total amount of financial assets held in these three funds stood at:

- EUR 8.0 billion for the EFSI Guarantee Fund;
- EUR 2.8 billion for the Guarantee Fund for External Action (GFEA) which holds the provisions for the ELM, MFA and Euratom programmes;
- EUR 0.8 billion for the EFSD Guarantee Fund.

Since January 2021, the assets held in the three provisioning funds have been brought together in one Common Provisioning Fund (CPF)[33], which now holds the provisions to cover the potential financial liabilities arising from budgetary guarantees and financial assistance programmes to third countries in one investment portfolio (comprising separate compartments to respond to guarantee calls from the respective guarantee programmes).

Upon entry into force of the 2021-2027 MFF, the CPF received the assets of the EFSI Guarantee Fund, which was followed by the transfer of the net assets of the GFEA and of the EFSD Guarantee Fund in the summer of 2021, as established by the Regulation establishing the Neighbourhood, Development and International Cooperation Instrument (NDICI) – Global Europe programme. Going forward, also the provisions of the new instruments under the 2021-2027 MFF (i.e. the InvestEU and NDICI-Global Europe programmes) will be managed via the CPF.

Measures to deal with realised losses exceeding the available provisioning

If at any moment during the implementation of the programme, the provisioning should prove insufficient to cover the actual losses, the following measures can be activated:

[32] The triggering events are detailed by Article 211 of the Financial Regulation as follows:
- Where, as a result of calls on a budgetary guarantee, the level of provisioning for that budgetary guarantee falls below 50 % of the provisioning rate and again where it falls below 30 % of that provisioning rate, or where it could fall below any of those percentages within a year according to a risk assessment by the Commission;
- A country benefitting from financial assistance by the Union fails to pay on a maturity.

[33] Communication from the Commission to the European Parliament and the Council on the entry into operation of the Common Provisioning Fund, COM(2021) 88 final. See also Commission Decision of 25 March 2020 on the asset management guidelines of the common provisioning fund, 2020/C 131/03, OJ C 131, 22.4.2020, p. 3–11, and Communication from the Commission to the European Parliament and The Council on identity of the asset manager for the common provisioning fund in accordance with Article 212 of Financial Regulation 2018/1046, COM(2020) 130 final.

- Exceptional temporary transfers between provisioning compartments underpinning different budgetary guarantees in the CPF, i.e. to deal with a shortage of funds to pay guarantee calls under a budgetary guarantee, the assets provisioned under another budgetary guarantee can be temporarily made available;

- Exceptional additional expenditures to be approved through:
  - Redeployment of expenditure (commitment and payment appropriations) from other items within the EU budget; and/or
  - Amendment of the EU budget to allow for additional expenditure (within the limits of the MFF ceilings and flexibility mechanisms);
- Use of central treasury: in exceptional cases liquidity of the central treasury may be temporarily used to pay guarantee calls of a budgetary guarantee awaiting the approval of additional budgetary resources.

3.2.2. Financial assistance to third countries

Measures to limit the amount of the contingent liabilities

In a similar manner as for budgetary guarantees, the Financial Regulation limits the total exposure of the EU budget in relation to financial assistance programmes. The contingent liability shall only exceed the financial assets provided to cover the financial liability of the Union if provided for in the underlying basic act and under the conditions set out therein. Moreover the financial liability and aggregate net payments from the budget shall never exceed the maximum amount of funds that the Commission is empowered to borrow for funding the financial assistance and the relevant interest.

For each programme, the corresponding legislative act determines the overall granted amount, the number of instalments to be disbursed, and the maximum maturity of the loan package. Instalments usually depend on compliance with a number of policy conditions including, in some cases (e.g. MFA loans), a satisfactory track record of implementing International Monetary Fund (IMF) programme reforms.

Measures to ensure repayment of borrowings in case of loan default

Borrowings of the EU to grant financial assistance loans to third countries are direct and unconditional obligations of the EU. Borrowings to fund MFA and Euratom loans to third countries are covered by the GFEA which is provisioned by the EU budget so as to cover 9% of the guaranteed loans outstanding at year-end. The procedures to deal with insufficient provisioning to allow honouring EU obligations are similar to those detailed at the end of section 3.2.1 for budgetary guarantees as applied to the provisions set aside in the GFEA compartment for MFA, ELM and Euratom loans.

3.3. European Commission common framework for managing and monitoring provisioned contingent liabilities

Because of the increasing importance of budgetary guarantees and financial assistance programmes for the implementation of EU policies, the Commission has enhanced its risk management tools to deal with contingent liabilities with the establishment of a horizontal cross-Commission framework for the implementation and monitoring of these programmes. The objective of this framework is to develop, to the extent possible given the differences between programmes, common methodologies for the design, negotiation and implementation of budgetary guarantees and financial assistance and to allow close monitoring of the evolution of contingent liabilities. The ultimate objective is to fully protect the EU budget from the unforeseen materialisation of losses originating from the budgetary guarantees or provisioned loan programmes.

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The Steering Committee on contingent liabilities

At the heart of this framework is the Steering Committee on contingent liabilities[34], which focusses on cross-cutting issues, e.g. developing common tools for an effective risk management and reporting on the overall sustainability of contingent liabilities and coordinating a common approach to relevant horizontal provisions in guarantee agreements with implementing partners.

Monitoring

In order to allow the Commission to constantly monitor potential losses stemming from contingent liabilities, implementing partners and beneficiary countries are obliged to provide the Commission with regular reports with regard to the operational and financial situation of the guarantee programme or to the progress made with respect to the conditionality underlying the EU financial assistance. Financial information provided by the implementing partners shall be externally audited.

Reporting

Detailed reporting to the European Parliament, the Council and other stakeholders on the build-up and time-profile of contingent liabilities is an essential component of the EU approach to the management of contingent liabilities. The Financial Regulation foresees an integrated system of reporting on contingent liabilities with the objective of providing comprehensive and timely information on the different sources of contingent liabilities, both at individual and at consolidated level. The present report and the reports under Articles 41(4) and 41(5) of the Financial Regulation are the main building blocks of the reporting framework on contingent liabilities.

4. Contingent liabilities arising from financial assistance to Member States

4.1. Overview of total EU risk exposure at the end of 2020

In 2020 the Commission, acting on behalf of the EU, operated four programmes under which it may grant loans to Member States:

- The **BoP** assistance to help EU countries outside the euro area that experience or run the risk of experiencing balance of payments difficulties;
- The **EFSM** that was established in response to the financial crisis to provide financial support to EU Member States experiencing or threatened by severe financial difficulties caused by exceptional occurrences beyond their control;
- The **SURE** programme that was agreed in June 2020 to help finance sudden and severe increases of national public expenditure related to national short-time work schemes and similar measures in response to the COVID-19 crisis;
- The **Euratom loan facility** to help Member States finance investments in nuclear power stations and in industrial installations in the nuclear fuel cycle.

Outstanding amounts of loans under the four different programmes at the end of 2020 are presented in table 3.

[34] Commission decision of 24.7.2020 on establishing the Steering Committee on Contingent Liabilities arising from Budgetary Guarantees, C(2020) 5154 final.

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Table 3: Outstanding amounts in respect of loans to EU Member States as at 31 December 2020 (EUR million)

	Outstanding loans	Accrued interests	Total
BoP	200	1.15	201.15
Euratom	78.26	0.16	78.43
EFSM	46 800	596.02	47 396.02
SURE	39 500	3.48	39 503.48
Total	**86 578.26**	**600.81**	**87 179.08**

An adequate measure for the total annual risk to the EU budget emanating from the contingent liabilities arising from financial assistance to Member States is the annually maturing debt, i.e. the total amount of annual payments falling due for repayment by beneficiary Member States in a given year (capital and interest) under the different programmes (Table 4).

Table 4: Yearly repayment schedule of outstanding loans (capital + interest) under the existing programmes for the years 2021-2027 at 31 December 2020 (EUR million)

Year	Euratom	BoP	EFSM	SURE	All programmes
2021	29.05	5.75	10 849.88	23.92	**10 908.59**
2022	23.24	5.75	3 496.13	25	**3 550.11**
2023	13.22	5.75	4 221.88	25	**4 265.84**
2024	13.11	5.75	3 300	25	**3 343.86**
2025	0	205.75	3 051.25	8 025	**11 282**
2026	0	0	4 639.25	25	**4 664.25**
2027	0	0	3 519.25	25	**3 544.25**
Total	**78.61**	**228.75**	**33 077.63**	**8 173.92**	**41 558.90**

4.2. The EU risk management system for contingent liabilities arising from financial assistance to Member States

Measures to limit the amount of the contingent liabilities

As for financial assistance to third countries, the Financial Regulation limits the total EU exposure in relation to loans granted to Member States. The financial liability and aggregate net payments from the budget are capped at the maximum amount of funds that the Commission is empowered to borrow for funding the financial assistance (as authorised by the relevant basic act) plus the related interest.

Measures to ensure repayment of borrowings in case of loan default

In contrast to financial assistance to third countries, no provisioning is earmarked in the budget to cater for the unprecedented situation where an EU Member State defaults on its loans to the EU. In such an extreme eventuality where a beneficiary Member State fails to honour its obligations towards the Union, the Commission will, in line with the applicable Own Resources legislation, apply active cash management (i.e. drawing liquidity from the available treasury balance), and if necessary, activate other measures provided for by the financial arrangements applying to the loan. As a last resort, the Commission may call on all the Member States to provide provisionally the difference between the available assets and

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the cash requirements. If a Member State does not honour such a call on time, provisionally the Commission has the right to make additional calls to the other Member States. The provision of such cash resources will be compensated, without delay, in the framework of the EU budget.

The SURE instrument is a specific case since all Member States have agreed to provide irrevocable, unconditional and on-demand guarantees for 25% of the maximum amount of financial assistance[35]. Each Member State contributes to the overall amount of the guarantee proportionate to its relative share in the total gross national income of the EU (based on the 2020 EU Budget).

5. Assessing the sustainability of EU contingent liabilities

5.1. Assessment Framework

According to Article 210(3) Financial Regulation "*contingent liabilities arising from budgetary guarantees or financial assistance borne by the budget shall be deemed sustainable if their forecast multiannual evolution is compatible with the limits set by the regulation laying down the multiannual financial framework provided for in Article 312(2) TFEU and the ceiling on annual payment appropriations set out in Article 3(1) of Decision 2014/335/EU, Euratom*" (i.e. the MFF ceilings and the Own Resources ceiling).

In other words, the own resources that the EU is able to draw upon in a single year should suffice to finance the expenditures arising from the MFF as well as any materialising contingent liabilities. Each year, the Commission issues a long-term forecast for those expenditures and the own resources needed for their financing. The difference between the Own Resources ceiling and the own resources necessary to finance the EU budget, referred to as 'headroom', represents the EU financial capacity to cover additional outflows relating to the materialisation of contingent liabilities. To consider the contingent liabilities as sustainable, the following equation should be met.

$$Own\ Resources\ ceiling_N \geq \underset{to\ finance\ the\ EU\ \ budget_N}{Own\ Resources} + EU\ Maturing\ debt\ _N$$

Where:

$$\underset{to\ finance\ the\ EU\ \ budget_N}{Own\ Resources} = \underset{(incl. provisioning\ guarantees)_N}{Budget\ expenditure} - \underset{revenue_N}{Other}$$

Against this background, a distinction should be made between provisioned and un-provisioned contingent liabilities:

1) For partly provisioned contingent liabilities, annual losses have to be covered in the first place by the resources available in the respective compartment of the CPF. Only if losses would be higher than provided for, additional resources would be needed to replenish the respective CPF compartment in subsequent years, which could then have implications in terms of additional EU annual budget expenditure (subject to the MFF ceilings – see paragraph 3.2 above). Therefore, for provisioned instruments the annual assessment of the sustainability of their contingent liabilities shall, first and foremost, consist in verifying whether the provisioning is sufficient to cover the estimated life-time losses net of revenues with a sufficiently high confidence level.

[35] In addition to the guarantee provided by all Member States, there are a number of safeguards foreseen in the SURE Regulation to mitigate the risk sourced by SURE contingent liabilities. These include a concentration limit on the three largest loans of 60% of the maximum amount granted under SURE, a maximum annual exposure of 10% (i.e. payments due each year shall not exceed EUR 10 billion), and the possibility for the Commission to roll over its borrowings if necessary.

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2) For the contingent liabilities arising from borrowing and lending activities to Member States, no provisioning is set aside. If these contingent liabilities were to materialise, they may give rise to additional revenue calls from Member States. The related expenditure remains outside the limits of the MFF ceilings. However, on the revenue side compliance with the overall Own Resources ceiling for the year must be ensured.

5.2. Assessment of the sustainability of the provisioned contingent liabilities

As a preliminary remark, EU budgetary guarantees might differ substantially in terms of policy objectives and consequently the risk profile of the underlying operations, which in turn might lead to a different risk appetite applied to each of them. The risk appetite is usually expressed in terms of a lifetime Value at Risk (VaR)[36] at a certain (pre-defined) percentage of confidence level.

On the basis of the available data on life-time net estimated losses on 31 December 2020 concerning the budgetary guarantees in place at that date, it is possible to draw the following conclusions:

- The applicable provisioning rate of 35% of the total EFSI guarantee is sufficient to cover estimated losses from the operations guaranteed under the different EFSI windows with a confidence level of 95%, in line with the ex-ante risk appetite of the programme;
- With regard to the EFSD, the provisioning rate of 50% is consistent with the estimated losses with a target confidence level of 90%, in line with the ex-ante risk appetite of the programme;
- The provisions for the ELM held in the GFEA are sufficient to cover estimated losses with a confidence level of 86%[37].

With regard to the existing exposures arising from financial assistance to third countries, the adequacy of the 9% target provisioning rate is confirmed by the following factors[38]:

- The absence of payment defaults until the end of 2020;
- The 2020 impairment assessment carried out by the Commission which concluded that there is no need to book any accounting impairment for these loans[39];
- For MFA loans, their link to and contingency on an existing IMF programme, which underpins the financial viability of the third country and, thus, the eventual repayment of the Union funds.

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[36] The Value-at-Risk (VAR) can be defined as the portfolio loss level which, statistically, over a certain time horizon, will not be exceeded with a certain confidence level.

[37] Since the GFEA acts as a liquidity buffer, an ex-ante risk appetite in the form of a confidence level of the provisioning for the lifetime of the operations was not defined.

[38] The Commission is currently enhancing the credit risk modelling capacities to monitor its exposures in the context of financial assistance to third countries. The analysis of the sustainability of this category of contingent liabilities included in the present document has been carried out essentially through expert judgment based on a number of qualitative and quantitative factors.

[39] See note 2.4.3.1."Loans for financial assistance" to the 2020 Consolidated annual accounts of the European Union available at: https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/2020_eu_annual_accounts_web.pdf

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5.3. Assessment of the sustainability of the contingent liabilities in respect of the limits of the Own Resources ceiling

In order to assess the robustness of the capacity of the EU budget to cater for a situation where the exposure in respect of un-provisioned contingent liabilities also materialises, a stringent sensitivity analysis has been carried out.

In a first step a central scenario (baseline) is established, corresponding to the expected evolution of EU spending and financial capacity for the years up until 2027, in line with the long-term forecast report on budget expenditure and revenue need (Figure 2 below).

Excluding the current budgetary year, over the period 2022-2027 the headroom available for covering contingent liabilities (existing and new) is around **EUR 64 billion** per year with respect only to the permanent portion of the Own Resources ceiling of 1.40% gross national income (GNI).

The headroom for the remaining portion of the Own Resources ceiling of 0.6% GNI, which is temporary and exclusively available for NGEU liabilities, is not yet specifically analysed in this year's report as contingent liabilities linked to NGEU started to materialize after the end of 2020.

Once the central scenario is established, as a further step, an additional analysis corresponding to sensitivity tests to assess the existing contingent liabilities' sustainability under extreme scenarios for the years 2022-2027 was performed. These cover the following:

1) **Sensitivity test on the economy:** In the central scenario, the GNI follows the gross domestic product (GDP) projections for real growth and inflation as per the Commission's Spring 2021 economic forecast[40]. For the sensitivity test, the projected nominal growth rates are lower than the baseline by -0.5 percentage points for each year of the reported period[41]. With respect to the permanent Own Resources ceiling of 1.40% GNI, this reduces its nominal value and hence the headroom available by on average **EUR 2.9 billion** per year.

2) **Sensitivity test on the revenue side of the budget:** This extreme scenario assesses whether the available headroom is sufficiently large to legally allow for additional own resources to be collected should all the Member States benefitting from financial assistance simultaneously fail to honour their repayments falling due. The amounts at stake reflect the repayment schedules at end-2020 (See Table 4 above). The simulation is run excluding the option to redeploy resources within the budget and to temporary postpone other expenditure, which reinforces its remoteness. This would reduce the available headroom on average by **EUR 3.8 billion**.

3) **Shock on the expenditure side of the budget:** Under this scenario, the expenditure is projected at its theoretical maximum. It is important to underline that this does not reflect a bottom-up forecast and is unrelated to any actual expectations for the evolution of EU payments. Moreover, unlike a revenue shock, on the expenditure side the decision to initiate additional spending is subject to a proposal by the Commission and the approval of the European Parliament and the Council. Should such a decision be incompatible with the financial capacity of the Union in a given year, it is unrealistic to consider that it would be proposed. The average reduction of the headroom under this simulation would be around **EUR 12.6 billion** corresponding to the maximum possible ceilings for the MFF payments and individual special instruments.

[40] https://ec.europa.eu/info/sites/default/files/economy-finance/ip149_en.pdf

[41] Based on the approach of the Commission's Debt Sustainability: https://ec.europa.eu/info/sites/default/files/economy-finance/ip143_en.pdf

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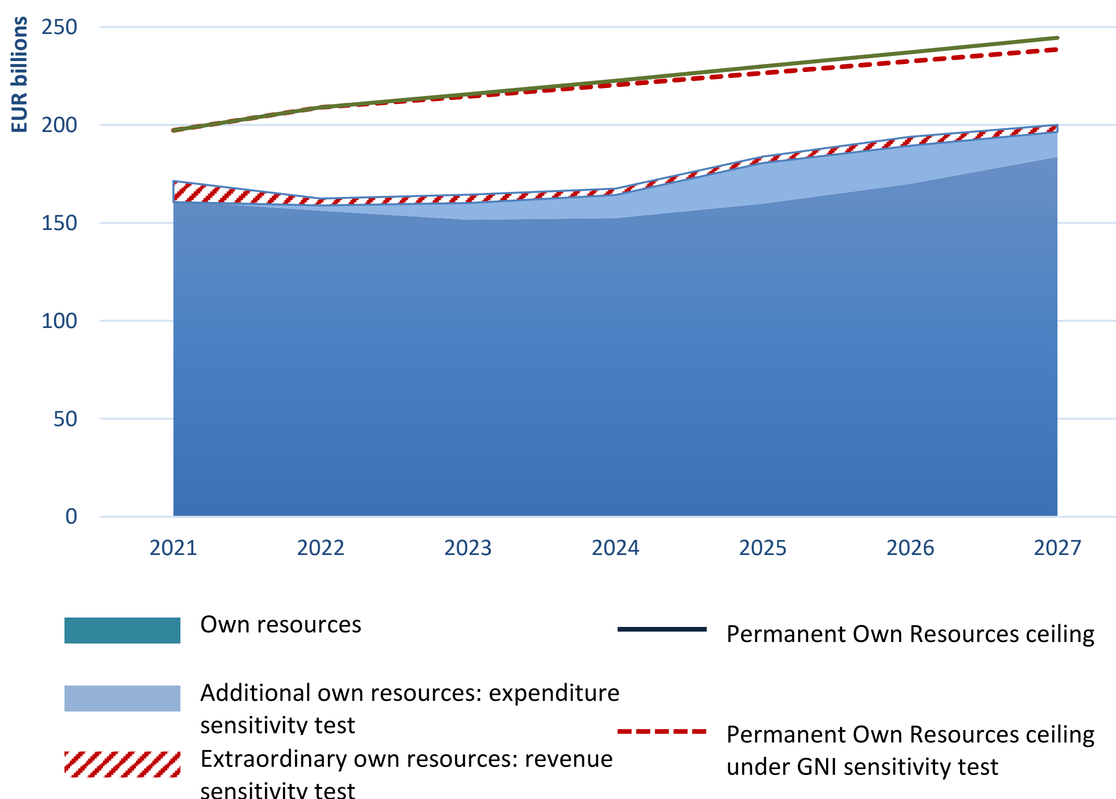
4) **A combined shock on the economic conditions, revenue and expenditure**: This should be seen as an extreme negative scenario as it cumulates several very remote scenarios, such as the simultaneous default of all the beneficiary Member States to honour their loans repayments at the same time. It would reduce the headroom by an annual average of **EUR 19 billion** down to a level of around **EUR 45 billion** per year over 2022-2027. This amount would remain as a safety buffer for the robustness of the EU financial capacity to cover its liabilities even in cases of more extreme and deep economic shocks, a potential legislative change triggering higher spending and for the possible issuance of new contingent liabilities.

The detailed results for the baseline and sensitivity test scenarios are provided in the Annex.

Figure 2: Own Resources ceiling and own resources' needs under a baseline and combined sensitivity test



6. Conclusions

At the end of 2020, the EU budget included contingent liabilities amounting to over EUR 93 billion in relation to loans granted to Member States and third countries and approximately EUR 63 billion for the guarantees provided in the context of EFSI, EFSD, and ELM.

The risks that these loans are not repaid by beneficiary countries or that guarantees are called upon are carefully managed through a comprehensive risk management framework including, for certain categories of contingent liabilities, the earmarking of budgetary resources as provisions to cover potential losses with a sufficiently conservative level of confidence.

Taking into account the multiple safeguards provided in the EU framework for the monitoring and management of the risks linked to the two main categories of contingent liabilities (provisioned and un-provisioned) and the sustainability assessment presented in this report, it is possible to draw the following conclusions:

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- Risks arising from provisioned instruments, i.e. budgetary guarantees and financial assistance to third countries, are carefully managed and adequately provisioned. This assessment takes into account the build-up of the risk positions in the past period, data on past defaults and on estimated losses as well as the measures in place to avoid that losses exceed predefined tolerance levels and the budgetary provisions available to cover expected losses.
- The EU financial capacity under the existing legal framework (i.e. Own Resources Decision and MFF Regulation) is sufficient to cater for the materialisation of losses that may arise in respect of un-provisioned loans over the period until end-2027. On average **EUR 64 billion, or 0.40% of the EU GNI**, over the period 2022-2027 is available for meeting extraordinary revenue calls to finance unforeseen expenditure of the MFF or to honour contingent liabilities (existing and potential new ones), should they materialise.
- The headroom is adequate even in an extreme negative scenario consisting of simultaneous adverse impacts on budget revenues, expenditures and on the economic growth. An average amount of **EUR 45 billion** or around **0.28% of the EU GNI** would remain available to substantiate the robustness of the EU financial system and credit rating, acting as a safety buffer in case of further negative economic shocks, new spending initiatives and contingent liabilities.

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Annex: Sustainability and headroom in respect of the permanent Own Resources ceiling*
(in EUR billion, current prices)

MFF		**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Baseline							
Own Resources ceiling 1.4% GNI	*a*	208,91	215,63	222,59	229,85	237,04	244,45
Own resources to finance the budget less NGEU	*b*	156,24	151,67	152,41	159,82	169,86	183,76
Headroom	*a-b*	52,67	63,96	70,18	70,03	67,18	60,69
Sensitivity tests							
1) Sensitivity test on the economy							
Own Resources ceiling 1.4% GNI	*a*	208,91	214,57	220,41	226,48	232,42	238,50
Own resources to finance the budget less NGEU	*b*	156,24	151,67	152,41	159,82	169,86	183,76
Headroom	*a-b*	52,67	62,90	67,99	66,66	62,55	54,74
2) Sensitivity test on the revenue							
Own Resources ceiling 1.4% GNI	*a*	208,91	215,63	222,59	229,85	237,04	244,45
Own resources to finance the budget (excl. NGEU)	*b*	156,24	151,67	152,41	159,82	169,86	183,76
Extraordinary own resources to cover CLs**	*c*	3,53	4,24	3,32	3,26	4,64	3,57
Headroom	*a-b-c*	49,14	59,72	66,86	66,77	62,54	57,12
3) Sensitivity test on expenditure							
Own Resources ceiling 1.4% GNI	*a*	208,91	215,63	222,59	229,85	237,04	244,45
Own resources to finance the budget less NGEU	*b*	156,24	151,67	152,41	159,82	169,86	183,76
Additional own resources (up to MFF ceiling maximum, and special instruments' maximum)***	*b**	2,65	8,40	11,76	20,78	19,47	12,69
Headroom	*a-(b+b*)*	50,01	55,56	58,42	49,25	47,71	48,00
4) Combined adverse/unfavourable shock							
Own Resources ceiling 1.4% GNI	*a*	208,91	214,57	220,41	226,48	232,42	238,50
Own resources to finance the budget (baseline)	*b*	156,24	151,67	152,41	159,82	169,86	183,76
Additional own resources (up to MFF ceiling maximum, and special instruments' maximum)	*b**	2,65	8,40	11,76	20,78	19,47	12,69
Extraordinary own resources to cover CLs	*c*	3,53	4,24	3,32	3,26	4,64	3,57
Headroom	*a-(b+b*)-c*	46,48	50,26	52,91	42,62	38,45	38,48

** The sustainability in respect of the 0.6% GNI portion of the Own Resources ceiling will be covered in the next edition of this report, once NextGenerationEU liabilities start phasing in.*

*** The risk-assessment linked to the SURE instrument takes into account the specific counter-guarantee provided by all the Member States for 25% of the maximum amount of the financial assistance. In practice, all the annual payments in relation to the SURE loans can be excluded from the annual risk for the years covered in the period under examination, since the amounts falling due are fully covered by the Member States' guarantees.*

**** The expenditure is projected at the theoretical maximum for: 1) the MFF payment ceiling over 2022-2027[42], 2) future adjustments up to their potential maximum in any single year[43], and 3) the annual ceilings of the thematic special instruments (European Globalisation Adjustment Fund, Solidarity and Emergency Aid Reserve, Brexit Adjustment Reserve), and the Flexibility Instrument.*

[42] As established in the most recent technical adjustment of the MFF: COM(2021) 365 final of 7.6.2021

[43] In relation to the mechanism of Article 5 and Article 11(1)(b) of the MFF Regulation (up to the ceilings set in Article 11(3) of the same Regulation and only considering the possible upwards adjustments).