



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

**Review of the Facility Providing Medium-Term Financial Assistance to
Member States under Article 119 of the Treaty**

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1. BACKGROUND

Under Article 119 of the Treaty, a Community facility exists for providing medium-term financial assistance to Member States, which have not adopted the euro and are experiencing, or are threatened with, difficulties in their balance of payments on current or capital accounts. The facility is governed by Council Regulation (EC) No 332/2002 of 18 February 2002 (hereafter referred to as “the Regulation”).¹ The Regulation stipulates that, every three years, the Council should examine the extent to which the facility still serves its purpose, in its principle, arrangements and the specified ceiling for outstanding loans under the facility. The Council examination should be made on the basis of a report from the Commission and after the Economic and Financial Committee (EFC) has delivered an opinion. As three years have elapsed since the adoption of the Regulation, the Commission has prepared this Communication as a report to the Council on the functioning of the facility.

2. MAIN FEATURES OF THE FACILITY

The facility is designed to allow substantial financial assistance to be granted in a timely manner. The beneficiary Member State should receive the assistance soon enough to allow economic policy measures to be taken so as to avoid an acute balance of payments crisis and to support efforts towards convergence. In this way, access to the facility – together with the economic conditions attached to any financial assistance - can serve to increase financial-market confidence in the ability of the beneficiary Member State to restore a sound balance of payments situation.²

The facility may be activated by the Council on the initiative of the Commission (pursuant to Article 119) in agreement with the Member State seeking Community financing or at the direct request of the Member State concerned. Once the facility has been activated, the Council examines the situation in the Member State seeking assistance and decides (a) whether to grant a loan or appropriate financing facility, its amount and its average duration; (b) the economic policy conditions attached to the medium-term financial assistance with a view to re-establishing a sustainable balance of payments situation; and (c) the techniques for disbursing the loan or financing facility, the release or drawings of which are, as a rule, by successive instalments. Council decisions to provide assistance via the facility are taken by qualified majority on a proposal from the Commission, which is made after consulting the EFC.

¹ Official Journal L 53, 23.2.2002, corrigendum: Official Journal L 349, 24.12.2002. The 2002 Regulation replaced Council Regulation (EC) No 1969/88.

² A Member State calling upon sources of financing outside the Community, which are subject to economic policy conditions, must first consult the Commission and the other Member States in order to examine the possibilities available under the Community medium-term financial assistance facility. Such consultations will be held within the Economic and Financial Committee .

At regular intervals, the Commission, in conjunction with the EFC, verifies that the economic policy of the Member State receiving assistance accords with the commitments laid down in the adjustment programme or any other conditions. The Member State makes all the necessary information available to the Commission and the release of further instalments depends on the findings of such verification. At the request of the beneficiary Member State, loans may carry the option of early repayment. In cases where restrictions on capital movements are introduced or reintroduced (Article 120 of the EC Treaty) during the period of the financial assistance, the conditions and arrangements governing financial assistance are re-examined.

3. FINANCING OF LOANS VIA THE FACILITY

The outstanding amount of loans to be granted to Member States under the facility for medium-term financial assistance is currently limited to €12 billion. The Commission is empowered to contract the corresponding borrowings up to this ceiling on the capital markets or with financial institutions on behalf of the European Community. Borrowing and lending operations are carried out in euros, use the same value date and must not involve the Community in the transformation of maturities, in any exchange or interest-rate risk or in any other commercial risk. The ECB makes the necessary arrangements for the administration of the loans.³ The Council also decides any full or partial financing of medium-term assistance by recourse to the Member States.

At the request of the debtor Member State and where circumstances permit an improvement in the interest rate on the loans, the Commission may refinance all or some of its initial borrowings or restructure the corresponding financial conditions. These operations may not have the effect of extending the average duration of the borrowing concerned or increasing the amount of capital outstanding. The cost incurred in concluding and carrying out each operation is borne by the beneficiary Member State. The EFC must be kept informed of these operations. Loans granted as medium-term financial assistance may be granted as consolidation of short-term monetary support made available by the European Central Bank (ECB) under the very short-term financing facility.

4. EVALUATION OF THE PRINCIPLE, AND CEILING FOR OUTSTANDING LOANS UNDER THE FACILITY

Since the adoption of the Regulation, the facility has not been activated.⁴ None of the eligible Member States has experienced or has been threatened with difficulties in their balance of payments within this period. In consequence, the adequacy of the facility in terms of its principle, arrangements and the ceiling on outstanding loans has not been tested in the context of a Member State(s) in actual need of Community financing.

³ Decision ECB/2003/14 of the European Central Bank of 7 November 2003 concerning the administration of the borrowing-and-lending operations concluded by the European Community under the medium-term financial assistance facility [Official Journal L 297 of 15.11.2003].

⁴ The most recent decision to activate the facility was taken by the Council under the previous Regulation in January 1993, when Italy received a loan of €8 billion in four instalments. Only the first two instalments of € 2 billion each were made, as the subsequent improvement in the Italian balance of payments situation made the disbursement of the remaining instalments unnecessary.

Although the need for medium-term financial assistance has not arisen since the Regulation was adopted, the principle and underlying rationale of the facility remains valid. The enlargement of the Union on 1 May 2004 has expanded the number of eligible Member States from three to thirteen. As long as these Member States have not adopted the euro, they are entitled to seek medium-term financial assistance from the Community in the event of problems in their balance of payments. The current ceiling of €12 billion on outstanding loans under the facility was decided by the Council in anticipation of future enlargements⁵. While the current ceiling implied a reduction from the ceiling of €16 billion provided by the 1988 Regulation, the Commission believes that it remains at a sufficiently high level to satisfy the simultaneous needs of several Member States. Accordingly, no change to the principle, arrangements for operating the facility or to the ceiling on outstanding loans is proposed at this stage.

5. UPDATE OF COMMUNITY'S EUROPEAN MEDIUM-TERM NOTE (EMTN) PROGRAMME

The Regulation governing the facility requires that appropriate procedures and instruments should be in place to enable the Community to provide medium-term financial assistance in a timely manner. In this context, it should be noted that the Commission has updated its framework agreement – European Medium-Term Note (EMTN) programme - on the issuance of bonds. The documentation associated with the updated framework has now been brought into line with current financial-market standards. In addition, the updated EMTN programme enables the Commission to issue directly up to €4 billion on behalf of the Community and/or Euratom, with maturities between three months to 30 years suited to the specific project to be financed.⁶ The size of the programme reflects a realistic assessment of near-term financing needs and could be rapidly increased at the Commission initiative, if needed.

The EMTN programme does not only serve the facility for medium-term financial assistance. EMTN issuance is also used to finance, on a back-to-back basis, loans, which (i) the EU grants as financial assistance to non-Member States in serious financial need; and (ii) Euratom may grant to Member States, certain central and eastern European countries and the CIS to help improve the safety of nuclear power stations. The new programme has already been used for transactions totalling € 1.66 billion, June 2005.

In the context of updating the EMTN programme, collective action clauses (CACs) have been introduced to the associated documentation, in conformity with the common understanding adopted by the EFC in September 2003. CACs are designed to improve the rights of bondholders by introducing provisions on collective representation, majority restructuring and

⁵ At the time of adoption of the Council Regulation (EC) No 332/2002 of 18 February 2002, the acceding countries included, the ten new Member States, Bulgaria and Romania.

⁶ The new programme replaces a programme, which was originally introduced in 1994 and updated in 1999 and was limited to € 2 billion. The programme will be implemented by Goldman Sachs and Deutsche Bank who will be responsible for placing the bonds with European and international investors.

enforcement in the event of default by the issuer. The inclusion of CACs in the EMTN documentation accords with the declaration of Member States and the Commission to lead by example in including CACs in their international debt issuance instruments so as to promote international efforts for orderly restructurings in the event of sovereign debt crises.⁷

6. CONCLUSION

This Communication is the first three-yearly report to the Council on the principle, arrangements and outstanding loan ceiling under the Community facility for medium-term financial assistance, as mandated by the relevant Council Regulation. As none of the eligible Member States has activated the facility in the review period, the principle, arrangements and ceiling for outstanding loans under the facility have not been tested. Nevertheless, the Commission believes that the facility continues to meet the potential needs of the eligible Member States and, accordingly, no change to the facility is proposed at this stage.

⁷ In the context of international efforts to promote orderly restructurings in the event of sovereign debt crises, the EU Member States agreed to lead by example in including collective action clauses (CACs) in their international debt issuance. More specifically, the ECOFIN President announced to the IMFC of April 2003 that “the EU will use contractual provisions based on the framework developed by the G-10, and where necessary in accordance with applicable law and adjusted to local legal practice, in their central government bonds issued under a foreign jurisdiction and/or governed by a foreign law by the end of this year. Thereafter, EU Member States will no longer issue such bonds without any CACs.” On the same occasion, the Commissioner for Economic and Monetary Affairs indicated that CACs would also be included in the documentation relating to the Communities’ issuance.