



# High Level Risk and Compliance Policy

July 2023

Budget

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# 1. Introduction

## 1.1. PURPOSE, REVIEW, AND APPROVAL

The High Level Risk and Compliance Policy (HLRCP or 'the Policy') comprises an appropriate risk management and compliance framework for the identification of the risks to the financial interests of the Union arising from the implementation of the EU borrowing, debt management and related lending operations ('financial operations') and for the effective management and mitigation of the identified risks. This Policy sets the Commission's strategic risk objectives and risk appetite applicable and ensures the probity, integrity and transparency of the operations.

This Policy forms an integral part of DG BUDG's overall internal control system and is in line with the Commission's general Internal Control Framework as defined in Communication C(2017) 2373 final, on the revision of the Internal Control Framework.<sup>1</sup> This Policy will feed into the Annual Activity Report produced by the Director-General of DG BUDG in her capacity as Authorising Officer by Delegation.<sup>2</sup> This Policy is prepared by the Chief Risk Officer (CRO) for the EU borrowing, debt management and lending financial operations.

The CRO, supported by the Risk and Compliance Committee (RCC), reviews this Policy at least annually, or whenever there are changes in conditions in relation to the financial operations, which could have a material impact on the financial interests of the Union. The CRO consults the RCC on any amendments of this Policy before submitting it to the Member of the College responsible for the Budget for approval. The CRO monitors the implementation of this Policy.

## 1.2. LEGAL FRAMEWORK

The key legal acts ('legal framework'), which support and inform the risk framework, are enumerated under Annex I of this Policy.

## 1.3. INTERNAL DOCUMENTS

The following internal documents complement the legal framework and support or inform the risk framework:

### **(a) Manuals and methodologies adopted by the Authorising officer by Delegation, such as:**

- Manual of Issuance of Bonds and Bills via Auctions
- Manual of Issuance of Bonds via Syndication
- Manual on Issuance via private placements for back-to-back lending
- Manual on Liquidity and Disbursement Management
- Green Bond Manual
- Manual on the allocation, invoicing, and payment processes of costs under NGEU

### **(b) Rules relevant for the Risk and Compliance Committee**

- Rules of Procedure of the RCC

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<sup>1</sup> [Internal Control Framework](#).

<sup>2</sup> The AAR includes a declaration of assurance in which the Director-General provides assurance as regards the true and fair view given by the report and as regards the legality and regularity and the sound financial management of all financial transactions under their responsibility, as well as for the non-omission of significant information.

**(c) Internal policies and guidelines, which form part of the risk framework and are part of this Policy, such as:**

- Market and Funding Liquidity Risk Policy
- Operational Risk Management Policy

## **1.4. SCOPE OF THE POLICY**

The scope of this Policy is determined by Article 1 of Decision (EU, Euratom) 2022/2544. It establishes the arrangements for the implementation of the Diversified Funding Strategy ('DFS') for borrowing and debt management operations within the scope of Article 220a of the Financial Regulation<sup>3</sup>, as well as to the related lending operations. Risk management and compliance arrangements also apply to any borrowing and lending operations under the back-to-back method. This Section provides an overview of the financial operations and elaborates on the core activities stemming from these operations, which give rise to the risks addressed by this Policy.

### **1.4.1. Borrowing operations**

The European Commission, on behalf of the Union, is borrowing on the financial markets from banks, financial and other institutions through issuance of debt securities and through secured and unsecured money market operations. The Commission adopted a Diversified Funding Strategy as its unified funding method to raise funding by deploying a wide range of instruments and maturities. The back-to-back funding approach might also apply, by way of exception, to new financial assistance programmes and shall apply to [any] Euratom programmes.

**Diversified Funding Strategy:** Under the DFS, the Commission collects all proceeds in a central funding pool and internally allocates them to fund policy programmes for financial assistance<sup>4</sup> in the form of repayable support (loans) and non-repayable support.<sup>5</sup>

In implementing the diversified funding strategy<sup>6</sup>, the Commission services shall apply the following principles, as appropriate, in full respect of the principle of sound financial management:

- a) borrowing operations and debt management operations may be conducted on the primary market, on the secondary market and on money markets;
- b) borrowing operations shall be organised through a set of individual borrowings of different maturities, ranging from short-term to long-term funding;
- c) borrowing operations may be organised through a mix of syndicated transactions and auctions, and private placements, in both cases relying on the services of credit institutions and investment firms who are members of the primary dealers network established under Commission Decision (EU, Euratom) 2021/625;
- d) the resulting debt may be rolled-over as a part of maturity management;
- e) cash flow mismatches and liquidity risk shall be managed through measures of short-term liquidity management of amounts held on a dedicated account using secured and unsecured money market transactions.

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<sup>3</sup> Consolidated text: 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

<sup>4</sup> Cf. Article 220a of the Financial Regulation.

<sup>5</sup> As foreseen under the Recovery and Resilience Facility.

<sup>6</sup> Cf. Article 7 of Decision (EU, Euratom) 2022/2544.

**Back-to-back funding method:** Under the back-to-back approach, the Commission issues bonds and transfers the proceeds directly to the beneficiary country on the same terms that it received (in terms of interest payments and redemption). Back-to-back funding approach is used exceptionally, on a case-by-case basis.

### 1.4.2. Debt management operations

Debt management operations are used to optimise the structure of outstanding debt, to mitigate interest rate, liquidity, and other financial risks and provide support to secondary market liquidity<sup>7</sup>.

The debt management operations that may consist of bond buy-backs, bond exchanges and can also include holdings of own bonds on own accounts. They further may include the use of derivatives such as swaps to manage interest rate or other financial risks, or may imply entering into secured or unsecured money market transactions. In particular, swaps may only be used for the hedging of interest rate risks borne by countries benefitting from loans. The costs for managing risks with derivatives shall be borne by the beneficiary of the risk management operation.

### 1.4.3. EU programmes for financial assistance

The following programmes for financial assistance are funded through the diversified funding strategy:

- 1. NextGenerationEU** ('NGEU') is the European Union's temporary recovery instrument, amounting to EUR 806.9 billion (in current prices)[1] to support the economic recovery from the coronavirus pandemic. Through the NGEU Recovery and Resilience Facility ('RRF'), the EU provides to the beneficiary Member States Non-Repayable financial support ('NRS') in the form of grants of up to EUR 338 billion in current prices and Repayable Support ('RS') in the form of loans of up to EUR 385.9 billion in current prices. The remaining part (EUR 83.1 billion) is provided through other Union spending programmes in the form of non-repayable financial support to various categories of beneficiaries and as provisioning to the Invest EU budgetary guarantee. The EU intends to issue up to 30% of the NGEU debt in green bonds to finance eligible green expenditures.
- 2. Macro Financial Assistance + (MFA+)** is the provision of financial support by the Union to Ukraine in the form of a loan of EUR 18 billion as well as non-repayable support and interest rate subsidy.<sup>8</sup>
- 3. Macro Financial Assistance** is the financial assistance that may be provided by the Union in the coming years to third countries (countries, that are not members of the Union) in the forms of loans as authorized by the relevant legal act.

**Contingent liabilities.** The support under the programmes for financial assistance gives rise to contingent liabilities<sup>9</sup>. For the purposes of this policy, these are potential financial liabilities for the Union, which stem from existing binding commitments or past events, and arising from:

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<sup>7</sup> Cf. Article 2(2) of Decision (EU, Euratom) 2022/2544.

<sup>8</sup> Regulation (EU) 2022/2463 of the European Parliament and of the Council of 14 December 2022 establishing an instrument for providing support to Ukraine for 2023 (macro-financial assistance +), OJ L 322, 16.12.2022, p. 1–14.

<sup>9</sup> COM(2022)560 final

**Financial assistance to third countries** - Loans to third countries that have been traditionally financed with borrowing by the Union on the capital market through 'back-to-back' funding approach until the adoption of the diversified funding strategy as a unified funding method, and

- **Financial assistance to EU Member States** - Loans to EU Member States under NGEU, which are financed with borrowings through the diversified funding strategy.

#### 1.4.4. Lending operations

Lending operations are the provision of repayable support in the form of loans to Member States and third countries (beneficiary countries) under various EU programmes for financial assistance.<sup>10</sup> The loans' repayment schedules are specified under the loan agreements with the beneficiaries.

#### 1.4.5. EU budgetary ceilings

Borrowing by the Union is a direct and unconditional obligation of the EU. The European Parliament, Council and the Commission are legally bound by the Treaty on the Functioning of the EU (Article 323) to ensure that the EU is in the position to fulfil its financial obligations towards third parties.

In the EU budget, ceilings exist both for:

- **Revenue** – the own resources ceiling establishes the maximum amount of own resources the Union can request from Member States to finance its expenditures for the period 2021-2027;
- **Expenditure** – the long-term budget ceilings establish the maximum amounts that the Union can either commit or pay during the same period.

The revenue ceilings are defined in the Own Resources Decision, the legal text that sets the revenue which finances the EU budget. The own resources ceilings are expressed as a percentage of the EU's estimated Gross National Income (GNI) – the sum of all the Member States' GNI – because the nominal amount varies annually according to the evolution of the EU GNI.

The **headroom** is the difference between the own resources ceiling for payment appropriations and the long-term budget (MFF) ceiling for payment appropriations. The headroom of the EU budget functions as a guarantee for the Union to cover all of its financial obligations under any circumstance, even in case of adverse economic developments. Borrowing operations and related debt management operations are organised to ensure that the Union's financial capacity – i.e., the headroom – is sufficient to meet the liabilities arising from these operations.

For the sole purpose of guaranteeing the borrowings of the Union under NGEU only, the own resources ceiling was increased by 0.6% of EU GNI on a temporary basis (**Additional Own Resources Ceiling**). The increase will expire when all funds borrowed under NGEU have been repaid and all contingent liabilities related to the loans under NGEU have been repaid, which should be by 31 December 2058 at the latest.

The headroom provides a guarantee for contingent liabilities arising from financial assistance to Member States and for financial assistance to Ukraine under the MFA+ instrument<sup>11</sup>. Therefore, if a beneficiary country failed to honour its obligations towards the EU, the EU would in the first place recourse to its budget which would provide for the necessary resources.

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<sup>10</sup> Article 220 of the Financial Regulation.

<sup>11</sup> Council Regulation (EU, Euratom) 2022/2496 of 15 December 2022 amending Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027.

Availability of budgetary appropriations gives the Union an unconditional claim towards the Member States to request payments of own resources in case of need. For the exceptional case that budgetary appropriations were not available in the annual budget, the Union is– as a last resort and only after having exhausted all other possibilities to find solutions within the existing budgetary framework – to call on the (other) Member States for own resources to temporarily cover the amount in question. The corresponding revenue would be over and above the MFF ceilings, while respecting the own resources ceiling<sup>12</sup>.

For contingent liabilities that are backed by the Common Provisioning Fund (CPF) and fall under the scope of this policy, the CPF holds the provisions protecting the EU budget against losses which may arise. Availabilities under the relevant expenditure ceiling allow for the necessary replenishment of the CPF in case of need.

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<sup>12</sup> 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.

## 2. Risk framework

The risk framework comprises the high-level principles on risk culture, risk objectives, risk appetite and risk management as set out below.

### 2.1. RISK CULTURE

Risk culture is the combined set of values, attitudes, competencies and behaviours that should be followed when determining the commitment to, and style of, risk management in relation to the operations. The main components are:

- Responsible staff clearly understand their responsibilities with respect to risk management in relation to the operations.
- Procedures draw clear lines of authority, segregated powers and duties, and appropriate checks and balances across the organisation.
- Risk management activities are carried out by a sufficient number of qualified staff with the necessary experience, technical capabilities, and adequate access to resources.
- Management adheres to, and emphasises that, the highest ethical standards are expected at all levels, and sends a consistent message to the whole organisation that is fully supportive of the risk management framework through its actions and words.

A strong risk culture shall comprise:

- Training and development: ensuring that all staff have an adequate understanding of the risks they are responsible/accountable for in their day-to-day roles, and the controls, policies and tools that are available to them to manage these.
- Communication: raising awareness of the importance of risk management via consistent messaging across multiple mediums reinforcing a strong risk culture.

### 2.2. RISK MANAGEMENT OBJECTIVES

The risk management objectives in relation to the financial operations are:

- 1. EU's Credit Rating:** Protect the reputational solidity of the EU as an issuer and [support maintain its high credit rating.
- 2. Market Funding Access:** Assure continuous market access by pursuing appropriate policies and maintain, to the best extent possible, an institutionally and geographically broad investors base;
- 3. Liquidity:** Maintain a sufficient level of liquidity to honor payments under EU programs for financial assistance and EU debt repayments and avoid liquidity shortfalls.
- 4. EU Budget sustainability:** Ensure that annually maturing EU debt – both principal and interest – is managed in line with the relevant headroom and is fully covered by the available own resources. For the contingent liabilities that are backed by the CPF, ensure that expected losses are compatible with existing provisions and availabilities.
- 5. Solid processes and coordination:** Maintain adequate processes and effective coordination among the responsible Authorizing Officers by Delegation to avoid unexpected changes in the loans' repayment schedules and minimize the risks related to mismatch between disbursement forecast, loan repayment schedules and borrowing operations.

- 6. Business Continuity and Resilience:** Have processes in place to ensure business continuity whenever unexpected event or shock occurs.
- 7. Green bonds:** ensure alignment of the use of proceeds with the EU Green Bond Framework and report to the investors on the achieved impact.

### **2.3. RISK APPETITE STATEMENT**

The Commission recognises that in the conduct of its borrowing, debt management and lending operations it will have to accept a certain degree of risk to fulfil its policy and risk objectives. The Commission monitors and manages the accepted risks in its financial operations prudently to ensure that they remain within the boundaries of the legal and policy frameworks.

In pursuit of its strategic and policy objectives, the Commission is exposed to different risks, such as credit risk from lending operations, funding risk, market risk, liquidity risk and others. The risk capacity is the maximum level of risk the Commission can support up to the level where it remains aligned with the following high level risk appetite statements:

- Ensure that the EU budget sustainability is protected
- Retain the EU long-term high credit rating from all the major rating agencies
- Protect the reputational solidity of the EU as issuer

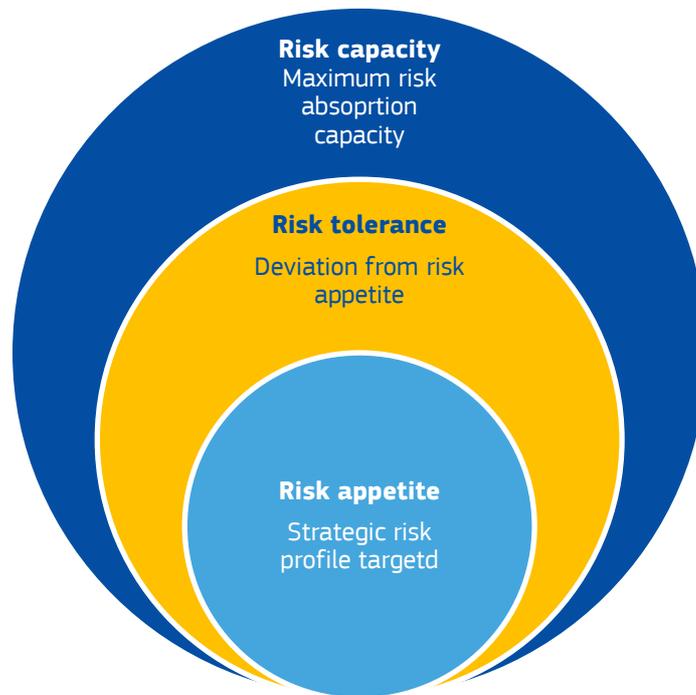
The risk appetite is the level of risk that the Commission is prepared to accept in order to achieve its objectives. The risk appetite per type of risk is defined in the relevant legal acts, such as those establishing the Recovery and Resilience Facility under NGEU, the EU programmes for financial assistance to third countries, the Own Resources Decision, the risk management framework, internal policies and manuals and other documents that complement the relevant legal acts and the HLRCP.

The risk tolerance defines the acceptable deviation from the level of risk that the institution should not exceed. Quantifiable tolerance levels for specific type of risk and metrics allow measuring and reporting the risk exposure when implementing the financial operations. The risk tolerance can vary from zero to full acceptance, depending on the legal framework, policy mandate (e.g., NGEU, financial assistance to third-country) and the availability and strength of the risk mitigation measures applied to the different identified risks.

The Commission shall limit, to the best extent possible, all the risks it is exposed to through the implementation of safeguards, adequate processes and internal controls and mitigation measures, in order to avoid the exposures to uncovered risks, beyond the risk appetite and tolerance level, and to ensure that the Commission will be able to operate under normal and stressed market circumstances. In taking any decision, the Commission carefully weighs the risks to its creditworthiness and reputation as an issuer on the financial markets.

Details on the risk appetite and risk tolerance levels for each type of identified risk will be presented in a separate Risk Appetite Statement document.

The first and second line of defence monitor the tolerance levels against the risk appetite and foresees corrective action should levels be breached.



## 2.4. RISK MANAGEMENT PROCESSES

The risk management framework is implemented to ensure that the risks arising from the financial operations remain within the defined risk appetite. The risk management process sets out for each risk: methodologies for measuring risk exposure, risk mitigation measures, and monitoring and reporting requirements. Risk mitigation measures, of which risk limits, are established to ensure that the risk profile remains within the risk appetite.

The CRO provides regular risk reports to the Member of the College responsible for the Budget, to the RCC, to the Director-General of DG BUDG and to the Accounting Officer. The report provides insight into risk exposures, highlighting any emerging risks and breaches of limits as well as mitigation plans. The CRO reports annually to the Commission on the implementation of this Policy.

The CRO annually conducts a review of the risk management framework to assess current state of risk management and to identify measures for improvement. Responsible staff at all levels shall continuously seek ways to improve the efficiency and quality of risk management at DG BUDG.

## 3. Compliance framework

The compliance framework comprises of: (i) compliance culture; (ii) principles and objectives; and (iii) appropriate internal governance and structured procedures that DG BUDG relies on to manage compliance-related risks.

The framework builds on the existing ethics and compliance requirements for the European Commission staff, namely pertinent rules in the Staff Regulations<sup>13</sup> and the Code of Good Administrative Behaviour<sup>14</sup>, and augments them with specific compliance requirements stemming from the legal framework applicable to the financial operations. Furthermore, the compliance framework draws on principles established as best practices in the COSO Compliance Risk Management<sup>15</sup> and the BCBS<sup>16</sup> principles on compliance risk and the compliance function, in particular the principles on compliance culture, objective setting, the performance component for compliance risk, and risk review and revision, with a view to effectively manage compliance related risks.

### 3.1. COMPLIANCE CULTURE

A strong compliance culture requires that responsible staff understand the compliance risks related to their respective duties and tasks. It begins with each responsible staff member and their commitment to the integrity and ethics espoused by the Commission and DG BUDG. Furthermore, responsible staff should be empowered to proactively ensure that DG BUDG remains compliant with the legal framework, internal rules, and relevant procedures applicable to financial operations. In addition, leadership from management is fundamental in promoting awareness and equipping staff members to carry out their duties and tasks in alignment with sound risk management principles and practices.

Achieving a strong compliance culture comprises several activities, including:

- continuous and clear advocating of the benefits of a strong compliance culture ('tone from the top');
- appropriate reinforcing of the 'tone from the top' at all hierarchical levels of DG BUDG;
- ensuring suitable training programmes, that foster staff compliance, such training covering both general training for responsible staff as a whole and specialist training for functions dealing with elevated compliance-related risks;
- setting clear expectations for compliance;
- introducing and maintaining effective governance for oversight and challenge of compliance-related risks;
- developing and maintaining risk management tools.

### 3.2. COMPLIANCE PRINCIPLES

The compliance framework is based on the following set of principles:

- 1) Integrity and ethics while conducting operations.** Responsible staff involved in operations shall be deeply committed to preserving the integrity and ethical conduct and pay particular attention to the implementation of and adherence to the Policy on an on-going basis.
- 2) Strict compliance with legal requirements.** Strict compliance with the legal framework and relevant procedures applicable to the operations is required of the responsible staff.

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<sup>13</sup> <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A01962R0031-20160101>

<sup>14</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02000Q3614-20111116>

<sup>15</sup> Committee of Sponsoring Organizations of the Treadway Commission

<sup>16</sup> Basel Committee on Banking Supervision

- 3) Management commitment to compliance.** Management adheres to the compliance framework and sets an example of compliance ('tone from the top'), ethical behaviour and integrity, while taking all appropriate measures to ensure that the responsible staff conduct their compliance-related duties in an appropriate manner.
- 4) Responsible staff members adherence to the compliance framework.** Responsible staff members adhere to the compliance framework, independently of their position within DG BUDG's organisational structure.
- 5) Effective assessment and monitoring of compliance-related risks.** The effectiveness and integrity of the compliance process should be ensured by appropriate and detailed assessment and monitoring of the adherence to the compliance framework and to the legal requirements and standards applicable to the financial operations.
- 6) Robust enforcement of compliance.** Compliance enforcement should be ensured by deployment of an appropriate and effective enforcement regime as a means to encourage compliance, such as compliance audits, administrative checks, whistleblowing procedures.

### 3.3. COMPLIANCE OBJECTIVES

The overarching objective of compliance with the legal framework applicable to the operations is pursued by the compliance officer through the following compliance risk management objectives:

- Ensuring compliance with the requirements necessary to implement the borrowing operations through the diversified funding strategy and back-to-back finding approach;
- Monitoring of checks and verifications of the members of the Primary Dealer Network compliance with regulatory requirements by deploying KYC questionnaires;
- Promoting a culture of frank and open disclosure of compliance breaches without fear of retaliation or unfair treatment;
- Overseeing the appropriateness of procedures that are meant to ensure the existence of an audit trail documenting the execution of the financial operations;
- Proposing enhancements to the professional secrecy and treatment of internal or market sensitive information requirements for responsible staff by developing and implementing appropriate guidelines;
- Keeping staff up to date and raising awareness on the applicable rules, procedures and other standards through training;
- Ensuring sufficient oversight of the financial operations;
- Putting in place measures and controls intended to protect financial operations and responsible staff from deliberate or inadvertent breaches and consequent penalties;
- Addressing promptly instances of non-compliance or other circumstances that present an unacceptable exposure to legal risk and/or reputational damage;
- Ensuring consistency of the compliance framework with current compliance-related risks and generally accepted compliance management practices and standards through periodical and ad hoc review.

## **4. Governance**

The HLRCP supplements the governance framework set out in the Decision (EU, Euratom) 2022/2544, which outlines the main roles and responsibilities related to the risk management and compliance framework of the financial operations. It establishes the roles of the CRO and of the Compliance Officer, and the RCC.

### **4.1. MEMBER OF THE COLLEGE RESPONSIBLE FOR THE BUDGET**

The Member of the College responsible for the Budget approves the HLRCP upon proposal of the CRO and following CRO's consultation by the RCC. He/she is accountable to the College for the adequacy of the risk management framework.

### **4.2. CHIEF RISK OFFICER**

The role of Chief Risk Officer is to ensure that the systems and processes used to implement the borrowing, debt management and lending operations are designed and implemented in a manner that ensures to the greatest extent possible the protection of the financial interests of the Union and the sound financial management of the financial operations.

The CRO prepares this Policy to ensure that risks related to the financial operations are appropriately identified, managed and controlled, and checks that the Policy is implemented in a comprehensive and consistent manner.

The CRO, supported by the RCC, deploys the risk management framework through internal risk policies and procedures.

The CRO reports to the Member of the College responsible for the Budget with respect to the responsibilities set out in Chapter 4 of Decision (EU, Euratom) 2022/2544 and chairs the RCC. The CRO exercises its role independently and enjoys autonomy in carrying out the assigned tasks and responsibilities.

### **4.3. RISK AND COMPLIANCE COMMITTEE**

The RCC is an internal committee of the Commission. Its role is to support the CRO in the conduct of his/her responsibilities. The RCC adopts positions on matters related to the risk management framework for the financial operations.

Members of the RCC are the CRO, the Accounting Officer of the Commission, the Compliance officer, two staff members from Directorates-General whose functions entail knowledge of risk management and of financial markets supervision, and two staff members of DG BUDG designated by the Director-General of DG BUDG. The CRO invites two external experts with extensive experience in the field of risk management and capital market operations to provide expert opinions and participate in deliberations, including the review of the High Level Risk and Compliance Policy. These two experts are not assigned voting rights in the RCC.

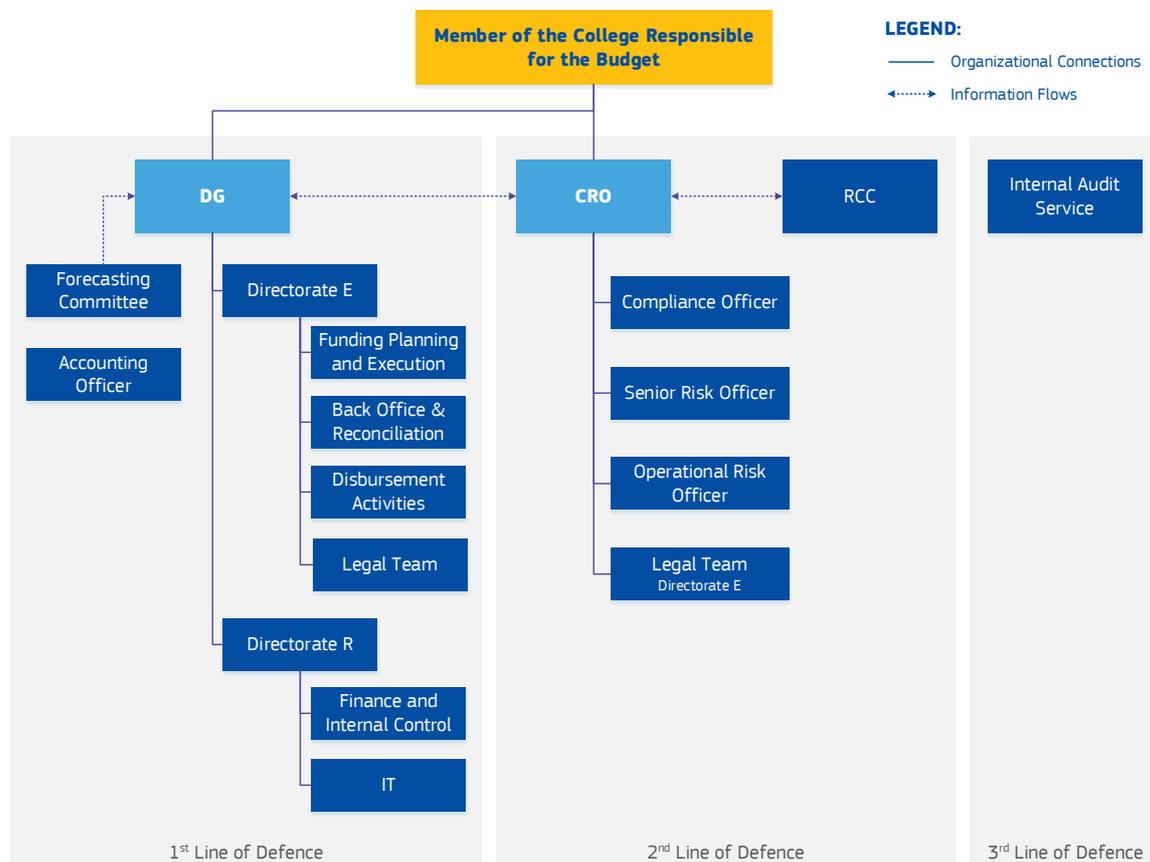
### **4.4. COMPLIANCE OFFICER**

The Compliance Officer provides support to the CRO to ensure that the financial operations comply with this Policy and that compliance risks related to financial operations are identified, understood, managed, and reported to the CRO. The Compliance Officer reports directly to the CRO on matters regarding conformity with rules and procedures and fulfil its tasks outlined in the Compliance Charter.

The Compliance Officer relies on the legal advice and support to be provided by the legal team in DG BUDG.

## 4.5. THREE LINES OF DEFENCE

In relation to the borrowing and debt management operations, the ‘three lines of defence’ model for risk management is deployed to: (i) ensure the appropriate segregation of powers and duties; (ii) clearly define lines of authority; and (iii) ensure distinct roles and responsibilities for the management and control of risk.



### 4.5.1. First line of defence – Authorising officers with direct responsibility for management and control of risk

The Director-General of DG BUDG and the staff responsible for the borrowing and debt management operations ensure that all risks (financial as well as non-financial risks) undertaken in their respective operations carried out by DG BUDG are identified, quantified where possible, classified, monitored and mitigated. During their day-to-day operations, the first line of defence shall adequately manage and implement internal controls and:

- develop, implement and apply adequate procedures, internal policies, guidelines, manuals and controls to ensure proper risk mitigation by the first line of defence;
- apply the ‘four eyes’ principle in critical areas, which means that at least two or more people are involved independently in completing a task;
- report on a regular basis to the second line of defence on their activities related to the borrowing and debt management operations, as further specified in the internal risk policies and procedures;
- immediately report any breach of a risk limit as defined in Section 5 and in line with the applicable procedures and rules.

For the lending operations, the first line of defence is the responsible Authorising Officers by Delegation (AOD) in the Directorate Generals (DGs) and the responsible staff reporting to that person. The responsible DGs apply appropriate procedures for the origination of the loans and the fulfilment and monitoring of the loan conditions. An Early Warning System, as described in section 5.2.1 in this document, will be set up to promptly inform DG BUDG, and the CRO, about any change to the loans' debt service and repayment schedules that could affect the debt management operations.

Responsible DGs and members of staff shall comply with the rules defined in the Staff Regulations and the Code of Good Administrative Behaviour. All members of staff are considered part of the 'first line of defence' for reputational, compliance and operational risks and, where relevant, financial risks.

#### **4.5.2. Second line of defence – Independent assessment and oversight by the CRO**

The CRO, supported by the RCC and by the staff reporting to the CRO, exercises central oversight of risk management related to the financial operations. The CRO ensures that the risks assumed by the first line of defence are appropriately managed and controlled by robust processes, which are in line with this Policy. The CRO shall signal any shortcomings in the implementation of this Policy and/or emergence of material risks to the Director-General of DG BUDG and, where relevant, the responsible DGs on matters of their competence.

The CRO enjoys autonomy in carrying out its tasks and functions as a second line of defence, which are independent from the first line of defence. The CRO reports directly to the Member of the College responsible for Budget with respect to those tasks and responsibilities.

The main tasks of the CRO are listed below:

##### **Main tasks related to the overall risk framework :**

- a.** Prepares the HLRCP and oversees its implementation;
- b.** Provides the overarching framework for the risk management guidelines applicable to the borrowing, debt management and lending operations, i.e.:
  - (i)** establishes and maintains guidelines for risk identification, assessment and quantification;
  - (ii)** develops guidelines, internal risk policies and procedures, to be respected by staff responsible for the financial operations, to ensure risk-taking remains within the stated risk appetite and monitors compliance.
- c.** Identifies potential breaches of this Policy or of other risk-related guidelines, policies and limits, and recommends possible steps to be taken in case of breaches or non-compliance;
- d.** Reviews internal rules and guidance documents issued by the Director-General of DG BUDG for the implementation of Decision (EU, Euratom) 2022/2544 for consistency with this Policy, and requests their amendment, if needed;
- e.** Reviews, as part of DG BUDG response to interservice consultation, legislative proposals related to borrowing and lending programmes;
- f.** Identifies emerging risk exposures and reviews associated management/mitigating actions proposed by the first line of defence. Monitors the execution of such actions by the first line of defence and determines when such actions may be considered complete/sufficient;
- g.** Reports regularly on material risks and on the compliance with rules and procedures (among others for the operational implementation and execution of the diversified funding strategy conformity and for the prevention of money laundering and terrorist financing) to the Member of the College responsible for the Budget, to the RCC, to the Director-General of DG BUDG and to the Accounting Officer.

- h. Provide regular information on risks and limits to persons who are responsible for the operational execution of the financial operations;
- i. Reports annually on the implementation of this Policy to the College of Commissioners

**Main tasks related to the borrowing and debt management operations:**

- a. Issues an opinion on the draft funding plan and its subsequent amendments as well as monthly issuance schedules.
- b. Issues an opinion on the proposed financing decision by the first line of defence concerning the amount of the interests payments for the following year to be included as expenditure in the Commission's annual budget;
- c. Monitors the identified risks as defined in section 5 and proposes, when necessary, mitigation measures to maintain the level of risk within the defined risk appetite and risk tolerance level.

**The RCC supports the CRO in the conducting its duties and assumes the following main tasks:**

- a. It is consulted on the High Level Risk and Compliance Policy and its subsequent amendments.
- b. It supports the CRO in issuing an opinion on the draft funding plan, reviewing internal rules and guidance documents issued by the Director-General of DG BUDG for the implementation of the financial operations to ensure consistency with the HLRCP and overseeing continued compliance with robust processes for risk identification, quantification and monitoring.
- c. It supports the CRO in assessing emerging risk exposures in connection with financial operations. The CRO informs the RCC when the limits set to reduce risks are exceeded or other cases of non-compliance with this Policy.
- d. It reviews any management/mitigating actions, as presented to the RCC by the CRO, for the management of excesses/breaches or emerging risk.
- e. It participates in evaluating, monitoring and approving practices regarding the implementation of this Policy.

The RCC, where possible, adopts positions based on a simple majority of its voting members. In the event of a tied vote, the vote of the CRO is decisive.

**4.5.3. Third line of defence – Internal Audit**

The Commission's Internal Audit Service (IAS) provides independent advice, opinions and recommendations on the quality and functioning of internal control systems inside the Commission, EU agencies and other autonomous bodies. The IAS reports to the Commission's Audit Progress Committee (APC) of which the Member of the College responsible for DG BUDG, is a permanent member. The choice of the audit topics is made by the Internal Auditor based upon a detailed risk assessment. Audit reports are issued to the individual services covered by the engagements. The audited services produce action plans describing how the audit recommendations will be implemented. The implementation of the recommendations is monitored by the IAS through follow-up audits.

The IAS provides every DG annually with a limited conclusion on the state of internal control in the DG as a contribution to the statement of assurance of the AODs in the annual activity report of the DG.

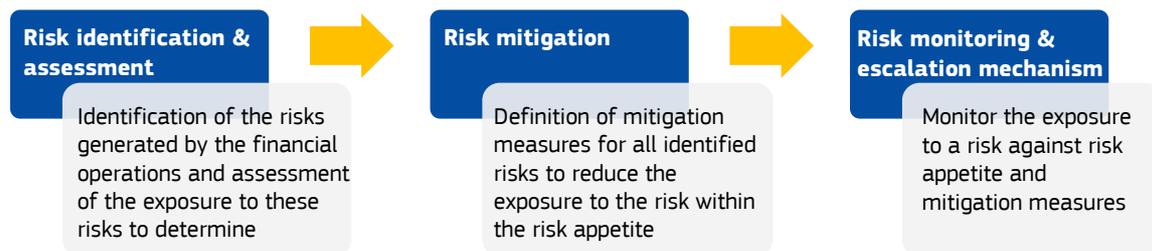
# 5. Risk management

## 5.1. RISK MANAGEMENT PROCESS

The management of the different types of risk follows a three-steps process:

- Step 1: Risk identification and assessment
- Step 2: Risk mitigation measures
- Step 3: Risk monitoring and escalation mechanism

**Figure 1. Risk management process**



### 5.1.1. Risk identification & assessment

Risk identification is the process of identifying the type of risks to which the Commission is exposed in implementing the financial operations. The exposure to each identified risk and its materiality is assessed in financial and or non-financial terms, depending on the type of risk.

The risk mapping in Table 2 matches the different identified risks with the financial operations set out in Section 1. Potential additional activities, such as the use of derivatives, will be considered in this Policy once internally developed and or authorised.

**Table 2. Risk mapping**

Type of risk		Borrowing operations	Lending operations	Debt management operations
Credit risk	Settlement risk	X	X	X
	Credit risk from lending operations		X	
	Counterparty risk	X		X
Market risk		X		X
Liquidity risk		X	X	X
Operational risk		X	X	X
Reputational risk		X	X	X
Compliance risk		X	X	X
Legal risk		X	X	X

### 5.1.2. Mitigation measures

For each type of risk, main mitigation measures are identified to ensure consistency with the risk appetite such as risk limits, evaluation procedures, key risk controls and key risk indicators. A robust legal framework key for the mitigation measures.

**Key risk indicators (KRIs)** are used to assess risks generated by the financial operations, which may result in a financial and/or reputational loss and/or trigger the inability of the Commission to fulfil its mandates. KRIs can include best practices and or regulatory indicators as well as internally developed indicators. KRIs can form the basis to decide on the need for risk mitigation measures.

**Risk limits** are set against different types of risks, such as counterparty risk, liquidity risk, concentration risk, etc., to ensure that the risks remain within the defined risk appetite. Risk limits shall be set based on quantitative criteria, or, where that is not possible, on qualitative criteria. Risk limits shall be reviewed periodically and on an ad hoc basis where situations arise which provide reasons for such a review. A risk limit can be a hard limit or a soft limit. For hard limits, breaches are not allowed. Risk limits must allow for efficient execution of the financial operations.

**Evaluation procedures** allow for a proper assessment and monitoring of risks related to selection of third-party service providers and counterparties, etc. (for example primary dealers selection process, monitoring of the creditworthiness of beneficiaries of repayable support).

**Key risk controls (KRCs)** are controls performed by the first line of defence and/or the second line of defence during the execution of an operation. They are intended to ensure the proper execution of key steps/milestones of the process, which could generate different type of risks (e.g. operational risk, settlement risk, etc.). KRCs require clear mapping of processes, controls and documentation.

**Legal acts and contracts** are key elements to mitigate the risks through the appropriate provisions.

If both the first and second line of defence have defined equivalent risk mitigation measures for an identified risk, the most conservative approach shall prevail.

### 5.1.3. Risk monitoring & escalation mechanism

**Monitoring** is implemented through a set of robust processes, procedures, guidelines, tools, hard and soft limits, KRI, risk dashboards and reports that ensure the permanent monitoring and reporting of exposures to identified risks and for taking timely measures to manage and mitigate excessive risk exposures.

All risk limits set by the first and second line of defence <sup>17</sup> shall be regularly monitored by the CRO to identify breaches or potential breaches. KRCs and KRIs are monitored in accordance with the approved guidelines and procedures and are included in the regular risk reports.

**The escalation mechanism** is the process to manage and report on limit breaches and KRIs. If a limit is breached or in case of elevated risk of limit breach, the first line of defence should promptly report to the CRO on the root cause(s) and should propose a mitigation plan, if necessary. If the CRO and/or the first line of defence is (are) of the opinion that the proposed mitigation plan might generate a material risk for the Commission, then the CRO shall report the limit breach and the proposed mitigation plan to the Commissioner responsible for the Budget. All limit breaches are also reported to the Director-General of DG BUDG, and the RCC. The latter shall be consulted about limit breaches on an ad hoc basis, as appropriate.

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<sup>17</sup> E.g. funding limits.

Following the breach of a limit, a review of the operational procedure(s) might be required by the CRO to minimise further the risk of reoccurrence.

## 5.2. FUNDING LIQUIDITY RISK

### 5.2.1. Liquidity risk

**Definition:** The liquidity risk is the risk that the Commission is unable to mobilise the financing as and when needed and on advantageous financial terms. This risk can lead to an inability of the Commission to honour payment commitments due to a shortfall in the proceeds from funding operations and/or unexpected delay in the loans' debt service and repayment schedules. In the borrowing and lending context, the materialisation of liquidity risk can lead to inability of the Commission to fulfil:

- its disbursement obligations in connection with the non-repayable support and loans to the Member States and third-country beneficiaries under EU programmes for financial assistance; or
- its interest and principal repayment obligations on outstanding debt when due.

The accumulation of funding exposure on limited number of investors or counterparties could also trigger funding liquidity risk. This risk could crystallise in the form of not being able to raise funds when needed or being faced with higher costs due to the non-availability of some funding sources upon which the EU has become overly reliant.

#### Management/mitigation:

- **Forecasting Tool and Forecasting Committee:** The projected disbursement needs for the repayable and non-repayable support under the respective EU programmes for financial assistance are communicated to DG BUDG by the responsible authorising services via the forecasting tool. The relevant DGs can introduce the estimated payment needs on a weekly basis, used for short-term forecasting or on a semester basis, used for the long-term forecasting. Based on the data available in the forecasting tool, a Forecasting Committee created within DG BUDG prepares monthly reports for the Director-General of DG BUDG, indicating the disbursement needs. On the basis of that report and taking into account the liquidity situation, the Director-General of DG BUDG takes a decision on the amounts to be borrowed on the market.
- **Early warning system (EWS):** To avoid any liquidity shortfall that might arise from the loans' repayment schedules, an EWS should be established to monitor the risk and repayment capacity of the beneficiaries of repayable support. This would consist of collaborative monitoring between the responsible DGs and DG BUDG, ensuring transversal and efficient monitoring of the loans' cash flows. The EWS would generate alerts on potential risks related to the scheduled repayments of loans and minimize the impact of non-payment by ensuring the availability of sufficient liquid assets to meet the EU obligations towards bond holders in the event of non-repayment.
- **Diversified funding strategy:** The diversified funding strategy for borrowing and debt management operations is implemented in the context of six-month funding plans<sup>18</sup>, complemented by monthly reviews of the planning. This provides flexibility and opportunity to adapt in a timely manner the volume and structure of the funding operations to actual needs. The adequate level of the funding to be raised needs to be assessed in light of the associated costs. Furthermore, the diversified funding strategy

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<sup>18</sup> Section 1.4.2.1. and 1.4.2.2. pages 6 and 7 of this Policy.

comprises the tools and flexibility to address any possible liquidity shortfall quickly and in sufficient amounts. In particular, the EU-bills issued via a monthly auction schedule provides the possibility to mobilise additional liquidity as and when needed. Moreover, the Commission has the possibility to enter into money market transactions in case of need.

- **Liquidity buffer:** As a critical part of the risk management approach for a diversified funding strategy, the Commission maintains a secure and purpose-specific prudential cash holding for payments (liquidity buffer). Ongoing and rigorous liquidity planning ensures that the prudential cash holdings are sufficient to avoid liquidity shortfalls while avoiding unnecessary and expensive excess cash balances.
- **Investors base:** One of the prime objectives of the diversified funding strategy is to broaden and deepen the Union's investor base through a large set of funding instruments, a regular market presence and a proactive investor relations framework. The diversification of the investors' base – in terms of geographical or institutional profile is an important mitigation measure. Rotation of the selected primary dealers should facilitate the diversification of the investors.

**Monitoring and reporting:** Liquidity risk is continuously monitored, by the first line of defence and the second line of defence, which performs an independent assessment. The liquidity situation is monitored on a daily basis with a short-term (next 10 business days) and a long-term perspective.

The investors' base and its diversification is monitored through adequate key risk controls and KRIs to ensure that the operations are in line with the risk appetite and risk objectives. In addition, the responsible staff involved with operations seeks to ensure broad diversification of its investor base and should monitor and report on the allocations of funds by investor type, country and geography.

### 5.2.2. Budgetary sustainability risk

**Definition:** In the context of borrowing and debt management operations, the budgetary sustainability risk refers to:

- i. With regard to NGEU, the risk that the total amount of interest and principal payments due by the EU budget in a specific year exceeds the available appropriations in the EURI budget line of the Commission's section of the adopted annual budget.
- ii. With regard to NGEU, the total cost of funding and cost of liquidity management and forecasted net repayments of principal for the current MFF exceed the appropriations in the financial programming of the MFF EURI line;
- iii. With regard to NGEU, the risk that liabilities of the NGEU operations, including the contingent liabilities resulting from loans to Member States, exceed the additional headroom of 0.6% of EU GNI, which may exclusively be used for NGEU liabilities.
- iv. With regard to other lending operations backed by the headroom, the risk that liabilities, including the contingent liabilities resulting from loans to Member States and, where applicable, third-country beneficiaries, exceed the headroom under the permanent Own Resources ceiling of 1.4% of EU GNI.
- v. With regard to the lending operations related to financial assistance provided to third countries backed by the Common Provisioning Fund, the risk that provisioning is not sufficient to cover the estimated life-time losses net of revenues with a sufficiently high confidence level.

Failure to ensure adherence to the financial capacity of the Union may endanger the Union's credit rating, which would likely have direct implications for its standing in the markets and its funding conditions and the credibility of the EU budget as a whole.

**Management/mitigation:** The liabilities resulting from the borrowing operations are structured in a way that the annual redemptions and interest payments related to funding instruments stay well below the limits set by the Own Resources ceilings. The sustainability of the Union's borrowing is assessed using a comprehensive methodology, which includes long-term macroeconomic and budgetary sensitivity analyses.

Regular updates on interest rate developments and budgetary impacts are analysed carefully by the first and second line of defence. Budgetary implications are considered in the context of the annual budget process, where the Commission's proposal for the annual budget reflects the expected financing costs for the relevant year.

Contingent liabilities arising from financial assistance to third countries (except those covered by the headroom) and from budgetary guarantees 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.

Regular assessment of the credit risk of the contingent liabilities against the available provisions and the headroom is carried out to ensure that there is sufficient coverage of expected losses.

**Monitoring and reporting:** Budgetary sustainability risk is continuously monitored by the first line of defence and second line of defence and any relevant developments assessed and reported.

### 5.3. MARKET RISK

**Definition:** in the context of the borrowing operations, the market risk is 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. Under the strategy, the funding pool uses instruments with different maturities to allow for an effective management of the liquidity risk at advantageous funding costs for the EU budget, the Member States and third-country beneficiaries of repayable loan. The roll-over risk occurs due to a maturity mismatch between the repayments from the EU budget and the beneficiaries of repayable support on the one side and the maturities of funding instruments on the other. Such a mismatch may require that borrowings to be rolled over in the future at an unknown interest rate.

In addition, market developments could cause significant volumes of issuance to take place at rates that exceed the conservative levels, used to estimate the budgetary resources for interest payments. Therefore, the amounts earmarked in the budget might not be sufficient to cover the interest payments (which is also a form of budgetary sustainability risk described in the previous heading 5.2.2).

**Management/mitigation measures:** The management of the interest rate risk and rollover risk is addressed through:

- (i) Regular assessment of the future cost of funding and the funding plans of the diversified funding strategy under different interest rate scenarios;
- (ii) Careful planning of the maturity profile of the borrowings, including limit to the maximum of maturing debt per calendar year, in order to limit the rollover risk and high concentration of maturities;
- (iii) Continuous assessment of the available budget for interest rate payments against different possible interest rate evolutions. This will provide a basis for anticipating potential budgetary challenges and their implication on the design of the funding plans.

Considering the constraints affecting the design of the funding plans (e.g. annual redemptions in line with financial capacity, investor demand versus tenors, etc.), possibilities to mitigate the interest rate risk, rollover risk and market execution risk are currently limited to the above measures. The availability of mitigation actions (to anticipate or postpone an issuance, and/or change a maturity) maybe limited by operational imperatives.

In the event that the market risk cannot be eliminated and leads to budgetary shortfalls cannot be eliminated, the risk and the supporting analysis should be communicated in a timely manner to the appropriate bodies so that suitable solutions can be found in good time and integrated in the planning of upcoming annual budget and in line with amount planned in the Multi-Annual Financial Framework.

**Monitoring and reporting:** Interest rates, rollover risk and market execution risk are continuously monitored in line with the respective guidelines and limits, the risk appetite and the risk objectives. These risks are the key components of the decision making related to the approval of the funding plan and the risk reports. Evolutions in the cost of funding of borrowing operations, including the results of the different interest rate scenarios, are monitored by the CRO and regularly discussed with the first line of defence.

## 5.4. CREDIT RISK

Credit risk can materialise in different ways, of which settlement risk, issuer risk, credit risk from lending operations, counterparty risk and concentration risk. It is mainly the risk of loss arising from exposures with counterparties and borrowers facing issues to meet their obligations.

### 5.4.1. Credit risk from lending operations to third countries

**Definition:** The credit risk from lending operations to third countries is the risk of loss arising in case a beneficiary of repayable support fails to meet its obligations due to the Union.<sup>19</sup>

**Management/mitigation measures:** The lending operations to third countries are authorised in the legal acts establishing the various EU programmes of financial assistance. General rules are set out in Article 220 of the Financial Regulation.

Should the credit risk from lending operations materialise, the EU budget is protected through different mechanisms. The ultimate layer of protection is provided by the Own Resources decision and the Making Available Regulation<sup>20</sup>, which ensure that the EU will always meet its obligations. Article 323 of the Treaty of the Functioning of the European Union provides the ultimate legal guarantee as it obliges the EU institutions to ensure that the financial means are made available for the Union to fulfil its legal obligations towards third parties. As an ultimate safeguard, the Commission can under Article 14(3) MAR call on cash resources from the Member States even if no budgetary appropriations are provided in the annual budget.

**Monitoring and reporting:** Credit risks are assessed and monitored as part of financial risks under Article 211 of the Financial Regulation. Under Article 250 of the Financial Regulation the Commission reports annually to the European Parliament and the Council on the contingent liabilities *inter alia* from financial assistance.

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<sup>19</sup> This is to be considered in conjunction with longer-term sustainability analysis of the headroom and related sensitivity tests as outlined in Section 3.2.2.

<sup>20</sup> Council Regulation (EU, Euratom) No 609/2014 of 26 May 2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements (Recast)

### 5.4.2. Counterparty risk

**Definition:** Counterparty risk is the risk of one or more parties in a financial transaction defaulting on or failing to meet their obligations.

**Management/mitigation measures:** Once an issuance in an auction has been settled, the paying agent receives the proceeds and transfers them to the Commission, which faces an intraday counterparty risk. To mitigate the risk, the first line of defence carefully monitors the cash flows to ensure that the proceeds will be received on the expected date and the DG BUDG will not be exposed to an open overnight position. In case of choice of a new paying agent, the CRO will be duly involved to ensure alignment with the risk framework.

**Monitoring and reporting:** Counterparty risk related to the paying agent is monitored in line with the relevant procedures.

### 5.4.3. Settlement risk

**Definition:** Settlement risk is a particular form of counterparty risk. It is the potential for loss arising from the failure of one or more counterparties to settle an exchange-for-value transaction, which occurs when the settlement of various legs of a transaction happens at different times. The borrowing operations are settled via a 'delivery versus payment' procedure, both for the auctions and for syndications.

**Management/mitigation:** The Commission does not deliver securities in advance to the counterparties. In case of a failed settlement, the potential liquidity risk is mitigated via an adequate liquidity buffer and/or specific arrangements.

**Monitoring and reporting:** Settlement risk is monitored with respect to the relevant internal procedure, which defines adequate risk controls.

## 5.5. OPERATIONAL RISK

**Definition:** Operational risk is the risk of direct or indirect loss, resulting from inadequate or failed internal processes, people and systems or from external events<sup>21</sup>. Although the underlying nature or cause of operational risk is usually not financial, operational risk may still lead to financial losses. For example, the use of financial models or tools for cost allocation or calculation of cost of funding exposes DG BUDG to model risk, which for the purposes of operations are considered as part of operational risk.

**Management/mitigation:** In relation to operations, DG BUDG adopts procedures with clearly drawn lines of authority, segregated powers and duties, and appropriate checks and balances across the organisation. In addition, DG BUDG applies, across critical operations and processes, the 'four eyes' principle requiring more than one person to be involved in order for a task to be completed. DG BUDG strives to automate the processes to the highest extent possible in order to reduce sources of human error.

Furthermore, DG BUDG ensures that all activities are carried out by sufficient number of qualified staff with the necessary experience, technical capabilities and adequate access to resources. For operations, DG BUDG in relation to operations makes sure that the staff adheres to high ethical standard and all other rules. Finally, business continuity arrangements are to be put in place.

In case of complex models with high operational risk, the Model risk can be mitigated through an independent external validation to ensure that the model is operating correctly and to confirm

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<sup>21</sup> As defined by the Basel Committee on Banking Supervision.

that checks and controls are integrated to limit any risk of operational error or other unidentified risks.

**Monitoring and reporting:** Operational risk is continuously monitored, in close liaison with the responsible services, during operations and any relevant developments are reported. Material risks, events and associated losses are registered and reported to the CRO. Material events are followed up to determine their causes and to agree on mitigating actions.

## 5.6. REPUTATIONAL RISK

**Definition:** Reputational risk is the risk of loss and/or damage arising from a deterioration of good name or standing of the Union or the European Commission, which could lead to a reduction in its access to the financial markets, lowering of its credit rating, loss of political capital, inability to attract suitably qualified staff and other similar consequences. In the context of the borrowing operations, reputational risk is the risk that an event or action directly or indirectly under the control of the Commission can reflect negatively on the standing of the Union as an issuer in the market and/or its integrity while performing other financial operations (debt management and lending operations).

**Management/mitigation:** The financial operations are implemented within a governance framework that ensures a high degree of scrutiny and control in the decision-making processes. Overall, the Commission mitigates its reputational risk by undertaking borrowing and lending operations in accordance with the highest professional standards, by having a centralised and coordinated external communication, by managing its risks prudently and by closely monitoring its high credit standing.

**Monitoring and reporting:** In their personal conduct, each member of staff involved in the operations needs to exercise their responsibilities in a manner that avoids, to the greatest extent possible, giving rise to reputational risk for the Commission. Any misconduct or other behaviour that give rise to a reputational risk event, should be promptly reported to the CRO.

### 5.6.1. Green Bond programme implementation risk

**Definition:** The risk arises from the potential failure of the EU to ensure alignment of the use of proceeds with the EU Green Bond Framework<sup>22</sup> and report to the investors on the achieved impact. Such failure will compromise the credibility of the EU as an issuer of green bonds. This risk could particularly materialize in case of over-issuances of green bonds, which exceeds the reported eligible expenditures by the Member States. Regular and accurate reporting by the Member States is key for the Commission to be able to properly plan the issuances of EU green bonds and report on the use of proceeds to the investors. Green bonds are issued based on anticipated actual expenditures by the Member States. Proceeds from green bond issuance can only be considered allocated once Member States have reported corresponding amounts of expenditure on measures, eligible for green bond financing. There is a need to manage the risk of over-issuance in case the anticipated eligible expenditures do not ultimately materialise, which could give rise to reputational and legal risks.

**Management/mitigation:** The first line of defence will ensure credible and timely allocation and impact reporting for the use of proceeds from the green bonds through appropriate internal and monitoring procedures. These procedures are reviewed every year.

DG BUDG deploys a risk management tool for the purpose of determining the appropriate level of green bond issuance in each period to mitigate the risk of over-issuance and has set a risk appetite for the maximum amount of unallocated proceeds from green bonds for any given year. In addition, the Commission will keep a safety buffer of eligible green bond expenditures to minimize the risk of green bonds over-issuance. If an eligible expenditure does not fully

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<sup>22</sup> [nextgenerationeu\\_green\\_bond\\_framework.pdf \(europa.eu\)](#)

materialise or cannot be implemented as expected, it will be substituted by another eligible investment from the safety buffer. This mechanism will act as a safeguard to ensure that all green bond issuances are eventually covered by eligible green expenditures.

**Monitoring and reporting:** To ensure that the use of proceeds from green bonds is aligned with the Green Bond Framework, the first line of defence will monitor and update the pool of eligible green expenditures regularly with the new available information as reported by the Member States.

This information is audited at the level of the Member State. Updates to the pool of eligible green expenditures will be communicated in the context of the monthly Forecasting Committee to enable calibration of green bond issuances. Both allocation reporting and impact reporting are subject to external validation.

## 5.7. COMPLIANCE RISK

**Definition:** Compliance risk is the risk of loss and/or financial or non-financial damage caused by non-compliance with the applicable legal provisions, as well as internal policies, procedures and measures.

**Management/mitigation:** The complexity of the legal framework and rules defined for the financial operations is relatively high, and the novelty of the operations, systems and procedures further increases the compliance risk. To mitigate these risks, the appropriate internal procedures are set up, followed, and reviewed as specified by the Compliance Charter and case specific guidelines (e.g., Guidelines on Anti-Money Laundering and Countering Terrorism Financing). A dedicated Compliance Officer role is established in order to monitor, manage and mitigate the compliance risks related to the financial operations.

**Monitoring and reporting:** The general monitoring and reporting set-up, presented under the settlement risk, is also valid for the compliance risk.

## 5.8. LEGAL RISK

**Definition:** Legal risk is the risk of loss due to inadequate or inefficient documentation, legal capacity, enforceability of applicable laws, and litigation risk stemming from borrowing operations counterparties.

**Management/mitigation:** The volumes, frequency and complexity of the borrowing operations require constant legal checks. An *ex ante* and *ex post* review of agreements and legal undertakings entered into are implemented, in order to ensure that strong legal protections for the institution are in place.

**Monitoring and reporting:** The Compliance Officer is responsible for overseeing the implementation of these mitigating measures. The general monitoring and reporting set-up, presented under the settlement risk, is also valid for the legal risk.

## ANNEX I: LEGAL FRAMEWORK

The key legal documents, which support or inform the risk framework, are:

- 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<sup>23</sup>
- Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility<sup>24</sup>
- Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027<sup>25</sup>
- Regulation (EU) 2022/2463 of the European Parliament and of the Council of 14 December 2022 establishing an instrument for providing support to Ukraine for 2023 (macro-financial assistance +)<sup>26</sup>
- Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union<sup>27</sup>
- Commission Decision (EU, Euratom) 2021/625 of 14 April 2021 on the establishment of the primary dealer network and the definition of eligibility criteria for lead and co-lead mandates for syndicated transactions for the purposes of the borrowing activities by the Commission on behalf of the Union and of the European Atomic Energy Community<sup>28</sup>
- Commission Decision C(2022) 9304 final of 15 December 2022 on the internal rules for the implementation of the Commission section of the general budget of the European Union
- Commission Implementing Decision (EU, Euratom) 2022/2544 of 19 December 2022 establishing the arrangements for the administration and implementation of the EU borrowing and debt management operations under the diversified funding strategy and related lending operations<sup>29</sup>
- Commission Implementing Decision (EU, Euratom) 2022/2545 of 19 December 2022 on establishing the framework for allocating costs related to borrowing and debt management operations under the diversified funding strategy<sup>30</sup>

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<sup>23</sup> OJ L 193, 30.7.2018, p. 1

<sup>24</sup> OJ L 57, 18.2.2021, p. 17

<sup>25</sup> OJ L 4331, 22.12.2020, p. 11

<sup>26</sup> OJ L 322, 16.12.2022, p. 1–14

<sup>27</sup> OJ L 424, 15.12.2020, p. 1

<sup>28</sup> OJ L 131, 16.4.2021, p. 170

<sup>29</sup> OJ L 328, 22.12.2022, p. 109

<sup>30</sup> OJ L 328, 22.12.2022, p. 123–135