COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 20.7.2007
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2007/0150(CNS)

Proposal for a

COUNCIL DECISION

amending Decision 2003/77/EC laying down multiannual financial guidelines for managing the assets of the ECSC in liquidation and, on completion of the liquidation, the Assets of the Research Fund for Coal and Steel

(presented by the Commission)

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

∉ Grounds for and objectives of the proposal

Article 2 of Council Decision 2003/77/EC (the "Financial Guidelines") states "that the Commission shall reassess the operation and effectiveness of the financial guidelines and shall propose any appropriate amendments" every five years and, for the first time, before 31 December 2007. The amendments proposed are the result of the first such review in the light of the experience gained in the first five years of operation and of recent market developments.

The objective is to further enhance the efficiency of the Financial Guidelines by adapting them to market developments and by clarifying certain concepts.

∉ General context

Following the expiry of the ECSC Treaty on 23 July 2002, management of the assets of the ECSC in liquidation ("ECSC i.L.") and, upon completion of the liquidation, the Assets of the Research Fund for Coal and Steel were entrusted to the Commission.

From the asset allocation and investment limits set by the Council Decision 2003/77/EC, and in particular to provide "the highest return available, consistent with maintaining a high degree of security and stability over the long-term" (point 3 of the Financial Guidelines), the Commission derived a target structure for the investments of the ECSC i.L. portfolio. This target structure aims to distribute the investments equally out to 10 years within certain tolerances. The only exception is the allocation for one year or less, which is doubled to provide a liquidity cushion. The structure was fully implemented at the end of 2006.

This structure has permitted ECSC i.L. to have sufficient liquidity to meet all budgetary payment requests in a timely manner without unwanted and comparably expensive liquidation of investment positions.

The investment categories permitted have been clearly set out in point 4. Investment funds have been considered in several cases, but so far there has been no economic case for investing in such funds given our conservative risk criteria, maturity restriction and the financial efficiency of direct investments in bonds. The Commission requires that all investment classes of a fund need to respect the investment criteria of the Financial Guidelines.

A stable return, which compares favourably with a market benchmark, has been achieved with very low risk.

Quarterly reports have been sent to the Member States and have not elicited comments or questions.

However, the experience gained in applying the Financial Guidelines and recent market developments necessitate certain minor amendments to the Financial Guidelines. These are to a large extent of a technical nature.

- **Existing provisions in the area of the proposal**

2003/77/EC

- **Consistency with the other policies and objectives of the Union**

Not applicable.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Not applicable.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

Not applicable.

The proposal concerns modifications of a technical nature to an existing Council Decision.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

The Financial Guidelines laid down for the management of the assets of the ECSC i.L. and, upon completion of the liquidation, the Assets of the Research Fund for Coal and Steel have been reviewed in accordance with Article 2 of Council Decision 2003/77/EC.

Following this review, a number of minor changes to the Financial Guidelines are proposed. The changes reflect the experience gained in the first five years of operation, developments in the financial markets in which ECSC i.L. operates and finally the change to internationally accepted accounting rules for the Commission as a whole.

There are clarifications of several definitions, namely the maturity concept of a bond, which is refined to cover the definition used by asset-backed securities (ABS), the definition of government issued or government guaranteed securities and the definition of "debt" issued by banks. The rules for sale and repurchase operations are brought up to market standards. In addition, certain rating-related provisions are clarified and the maximum maturity permitted is extended to take account of the changing issuance pattern of the Member States.

Already in the past, the financial statements of the ECSC i.L. were prepared on an accrual basis. Now, the provisions on accounting have been updated to reflect the change to internationally accepted accounting rules for the whole Commission.

- **Legal basis**

Protocol annexed to the Treaty establishing the European Community on the financial consequences of the expiry of the ECSC Treaty and on the Research Fund for Coal and Steel.

Council Decision 2003/76/EC.

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

Not applicable.

- **Choice of instruments**

Proposed instruments: other.

Other means would not be adequate for the following reason(s).

A decision is required to modify the original decision.

4) BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

5) ADDITIONAL INFORMATION

- **Detailed explanation of the proposal**

Point 3 of the Annex to Council Decision 2003/77/EC

Many Member States auction what the financial market considers as "ten-year benchmark bonds" with a maturity up to 10 years and six months, allowing them to increase the bond's size, and thus its liquidity, with additional issuance over the following months. In order to be able to purchase such bonds at issue, when it is typically most advantageous, it is proposed to increase the maximum maturity permitted in point 3 (a)(iii) from 10 years to 10 1/2 years from the payment date of the bond.

In addition, it proposed to clarify that asset backed securities ("ABS"), which is an increasingly important issue class, can be invested in based on the "expected maturity". ABS are securities backed by assets such as mortgages or other types of receivables. They are typically subdivided into tranches with different ratings and different expected maturity dates, whereas the legal maturity date is dictated by the receivables underlying the structure and is typically much longer. However, for all but the lowest rated tranches the expected maturity date corresponds to the maturity date in the normal sense of the word and is treated as such by market participants. It is therefore proposed to use the expected maturity as the determinant for whether ABS with a rating of AAA or its equivalent, considered the only suitable investments for the ECSC i.L., qualify for investment and apply the same maturity restrictions as proposed for other bonds, i.e. 10 years and six months.

In the case of the repurchase and reverse repurchase operations described in point 3(b), it is proposed to drop the requirement for no on-selling, as this could be interpreted as requiring the return of physically the same bond(s), not appropriate for dematerialised securities. It is most important to ensure that the securities returned are legally and economically equivalent. Therefore a sentence is included stipulating that ECSC i.L. should be able to obtain equivalent securities, a market-standard definition of which is added.

Point 4

It is proposed to clarify which type of issuers may be considered as sovereign risk due to a high degree of government ownership, government guarantee or government control despite not being issued by the central administration itself. The interpretation follows that of market participants and market regulators and is, in addition, subject to minimum rating requirements for both point 4(a)(i) and point 4(a)(ii).

It is proposed to clarify explicitly that the debt instruments referred to in point 4(a)(iii) include bonds.

It is proposed to clarify that the maximum limit of 20 % of an issue size specified in point 4(b) is to be applied and checked only at the time of purchase.

It is proposed to add a sentence to clarify that the Commission should endeavour to replace investments which are downgraded below the minimum levels required provided that satisfactory financial terms can be obtained.

Furthermore, a sentence has been added to clarify that if a bond is rated higher than the issuer, as is possible for secured bonds, or the issuer has no rating, as is possible for secured bonds and ABS, the rating of the bond is applicable.

Point 6

The Financial Regulation applicable to the general budget of the European Communities, Council Regulation (EC, Euratom) No. 1605/2002, provides that starting from budget year 2005 the accounting shall be accrual based (Articles 125 and 181[1]). In addition, Article 133 of the Financial Regulation provides that the accounting rules and methods and the harmonised chart of accounts to be applied by all institutions shall be guided by the internationally accepted accounting standards for the public sector but may depart from these where justified by the specific nature of the Communities' activities.

[1] Before the revision of Article 181 of the Financial Regulation adopted by Council Regulation (EC, Euratom) No 1995/2006 of 13 December 2006 (OJ L 390, 30.12.06, p.1)

According to Article 3 of Council Decision 2003/76/EC, the ECSC i.L. shall draw up each year a profit-and-loss account, balance sheet and financial report to show, separately from the other financial operations of the remaining Communities, the liquidation operations and the investment transactions. These financial statements are consolidated by the Commission annually in accordance with Article 275 of the EC Treaty and the Financial Regulation. As the internationally accepted accounting standards have changed, the reference to Council Directives 78/660/EEC and 86/635/EEC has become obsolete. To take account of the specific nature of its operation, the ECSC i.L. draws up its financial report following recommendations for financial institutions. Consequently, the ECSC i.L. establishes an income statement, a balance sheet, a statement of changes in equity, a cash flow statement, and notes to the financial statements.

Point 7

It is proposed to send reports on a six-monthly basis henceforth. As previous reports did not result in any comments or questions, it is considered that a six-monthly reporting rhythm would be more efficient both for the Member States, allowing them to give enhanced attention to a less frequent report, and for the Commission by reducing its administrative costs.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to the Protocol annexed to the Treaty establishing the European Community on the financial consequences of the expiry of the ECSC Treaty and on the Research Fund for Coal and Steel,

Having regard to Council Decision 2003/76/EC of 1 February 2003 establishing the measures necessary for the implementation of the Protocol, annexed to the Treaty establishing the European Community, on the financial consequences of the expiry of the ECSC Treaty and on the Research Fund for Coal and Steel[2], and in particular Article 2(2) thereof,

Having regard to the proposal from the Commission[3],

Having regard to the opinion of the European Parliament[4],

Whereas:

(1) For the purposes of the Protocol annexed to the Treaty establishing the European Community on the financial consequences of the expiry of the ECSC Treaty and on the Research Fund for Coal and Steel, the Commission manages the assets of the ECSC in liquidation and, on completion of the liquidation, the Assets of the Research Fund for Coal and Steel.

(2) In accordance with Article 2 of Council Decision 2003/77/EC of 1 February 2003 laying down multiannual financial guidelines for managing the assets of the ECSC in liquidation and, on completion of the liquidation, the Assets of the Research Fund for Coal and Steel , the Commission has reassessed the operation and effectiveness of the financial guidelines.

(3) The experience gained in the first five years of implementation and developments in financial market practice show a need to adapt these guidelines.

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2 OJ L 29, 5.2.2003, p. 22.
3 OJ C , , p. .
4 OJ C , , p. .

(4) The guidelines should reflect standard market practice and definitions as regards, *inter alia*, the maturity concepts used, equivalent securities in the case of repurchase agreements and applicable ratings.

(5) Subject to rating requirements, certain public entities should be assimilated to Member States or other sovereigns in the context of the investment limits.

(6) The guidelines should take into account the changes in the accounting rules of the Commission.

(7) For reasons of efficiency and in order to reduce administrative costs, the frequency of reporting should be adapted.

(8) Decision 2003/77/EC should therefore be amended accordingly,

HAS ADOPTED THIS DECISION:

Article 1

The Annex to Decision 2003/77/EC is amended as follows.

(1) Point 3 is amended as follows:

(a) Point (a)(iii) is replaced by the following :

"fixed and floating rate bonds with a maturity or, in the case of asset-backed securities, an expected maturity not exceeding a remaining life of 10 years and six months from the payment date, provided that they are issued by any of the categories of authorised issuers;"

(b) Point (b) (i) is replaced by the following :

"(i) repurchase and reverse repurchase agreements, provided the counterparts are authorised for such transactions, and provided that the Commission remains in a position to repurchase equivalent securities that it may have sold at the contractual deadline. Equivalent securities are securities (i) issued by the same issuer, (ii) which form part of the same issue, and (iii) are of an identical type, nominal value, description and amount as the securities lent out except where subject to a corporate action or redenomination;"

(2) Point 4 is amended as follows:

(a) Point (a)(i) to (iii) is replaced by the following:

"(a) The investment shall be limited to the following amounts:

(i) for bonds issued or guaranteed by Member States or institutions of the Union, EUR 250 million per Member State or institution; bonds issued or guaranteed by regional or local authorities or government-owned and/or government-controlled public enterprises or institutions can be included under the limit of the respective Member State, provided that they have a credit rating of not less than 'AA' or its equivalent;

(ii) for bonds issued or guaranteed by other sovereign borrowers, their regional or local authorities or government-owned and/or government-controlled public enterprises or institutions, or by supranational borrowers, with a credit rating of not less than 'AA' or its equivalent, EUR 100 million per issuer or guarantor;

(iii) for deposits with and/or debt instruments, including bonds, of an authorised bank, the lower of either EUR 100 million per bank or 5 % of the bank's own funds;"

(b) Point (b) is replaced by the following :

"The investment in any single bond issue, subject to the limits given in point (a), shall not be more than 20 % of the total amount of such issue at the time of purchase."

(c) In point (d) the following second paragraph is added :

"Once the Commission has become aware of a downgrade below the minimum rating requirements, it shall endeavour to replace the corresponding investments, subject to acceptable financial terms."

(d) The following point (e) is added:

"If the rating of a bond is higher than the rating of the issuer or the issuer has no rating, the rating of the bond is applicable."

(3) Point 6 is replaced by the following:

"6. ACCOUNTING

The management of the funds shall be accounted for in the annual accounts for the ECSC in liquidation and, on completion of the liquidation, the Assets of the Research Fund for Coal and Steel. These shall be based upon and presented in accordance with the EC Accounting Rules as adopted by the Commission's Accounting Officer, taking into account the specific nature of the ECSC in liquidation and, upon completion of the liquidation, the Assets of the Research Fund for Coal and Steel. The accounts will be approved by the Commission and examined by the Court of Auditors. The Commission shall engage external firms to carry out an annual audit of its accounts."

(4) In point 7, the second paragraph is replaced by the following :

"A detailed report on management operations carried out under these guidelines shall be drawn up every six months and sent to the Member States."

Article 2

This Decision shall take effect on the day following that of its publication in the *Official Journal of the European Union*.

Article 3

This Decision is addressed to the Member States.

Done at Brussels,

For the Council
The President