Counter Balance
Challenging Public Investment Banks

September 2016



The dark side of EIB funds:

How the EU's bank supports non-transparent investment funds based in tax havens

CONTENT OVERVIEW:

Introduction:
The EU's bank support for investment funds: why and how? 4

EIB investments ending up in tax havens 7

The black hole of transparency 9

Strong potential for conflicts of interest 12

Ways forward for the EIB to clean up its act 14

ANNEX 1: Methodology 16

ANNEX 2: EIB-supported investment funds (2011–2015) 17

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Counter Balance – Challenging public investment banks is a European coalition of development and environmental non-governmental organisations with extensive experience working on development finance and the international financial institutions as well as campaigning to prevent negative impacts resulting from major infrastructure projects.

Counter Balance's mission is to make European public finance a key driver of the transition towards socially and environmentally sustainable and equitable societies.

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This publication has been produced with the financial assistance of the European Union and of the Think Tank Fund of the Open Societies Institute. The content of this publication is the sole responsibility of Counter Balance and can under no circumstances be regarded as reflecting the position of the European Union.

Text closed on 10 July 2016

EXECUTIVE SUMMARY:

The role of the European Investment Bank (EIB) in development finance has rapidly expanded in recent years, as demonstrated by recent claims from the bank itself that it represents a solution to the mid- and long-term drivers of the migration crisis[1]. The EIB's growing development mandate is also being matched by an increased macro-economic role at European level: through two successive capital increases and its pivotal role in the Investment Plan for Europe, the EIB's standing and political power has significantly increased over the last ten years.

Yet now with approximately EUR 80 billion per year being deployed in and outside the European Union, growing responsibilities are also falling on the EIB's shoulders. This report critically analyses a little-known part of the EIB operations: its use of private equity funds. The EIB finances such investment funds in order to deliver benefits for small- and medium-sized enterprises (SMEs) in and outside of Europe.

This report presents a number of statistics and facts about recent investment funds financed by the EIB. It describes the use of tax havens and offshore incorporated private equity funds, frequent cases of revolving doors and the systematic lack of transparency involved in these type of operations. It also challenges the business model underpinning this type of development finance.

While the EIB's awareness and acceptance of its development role may be growing, knowledge and understanding among European decision-makers of some of the EIB's obscure and opaque lending practices remains thin. At a time when public pressure is mounting on EU institutions to seriously crack down on tax havens, the EU should make sure that its own financial institution, the EIB, ends such operations.

Even as financial institutions like the International Finance Corporation (IFC) of the World Bank Group are taking incremental steps to address the problems linked to the use of financial intermediaries, the EIB continues to systematically ignore calls from civil society and the European Parliament to increase the transparency of its operations and develop a responsible taxation policy. For instance, in April 2016, the Parliament asked the bank to "reinforce its due diligence activities so as to improve the quality of information on ultimate beneficiaries and to more effectively prevent transactions with financial intermediaries with a negative record in terms of transparency, fraud, corruption, organised crime, money laundering and harmful social and environmental impacts or registered in offshore financial centres or tax havens which resort to aggressive tax planning"[2].

As a watchdog coalition focusing on making public finance a key driver towards open and sustainable societies, Counter Balance calls on the European Investment Bank to clean up its act and establish a moratorium on its support to investment funds before it addresses and fixes the structural problems related to these operations.

1 http://www.eib.org/about/global-cooperation/migration.htm
2 Report on the European Investment Bank (EIB) – Annual Report 2014, European Parliament, (2015/2127(INI))

Introduction:

The EU House Bank supporting investment funds: why and how?

As an integral part of its business model, the EIB uses an increasing number of intermediated loans in its lending both inside and outside of the EU. In such cases, this means that the bank does not lend directly to a project, but instead uses what we will refer to in this report as "financial intermediaries".

This type of lending at the EIB has doubled in 15 years, accounting currently for approximately 1/3 of the bank's total operations[3]. In 2015, EUR 24.8 billion was loaned to European SMEs via intermediated operations. Outside of Europe, intermediated loans account for around 40% of the EIB's operations. In addition, the EIB Group also owns the European Investment Fund (EIF) which specialises in the provision of financial instruments such as venture capital and equity in investment funds.

There are two principal ways for these intermediated operations to take place:

1/ The EIB disburses large loans to private banks for these institutions to pass on (or "on-lend") in smaller loan tranches to final beneficiaries which are mainly SMEs.

2/ The EIB also conducts investment operations through financial intermediaries via investment and private equity funds, a further shift away from traditional project finance to investments via entities that clearly prioritise profit maximisation over concerns about sustainable development.

The stated objectives of the EIB make clear that all its intermediated loans must further at least one of the following policy goals:

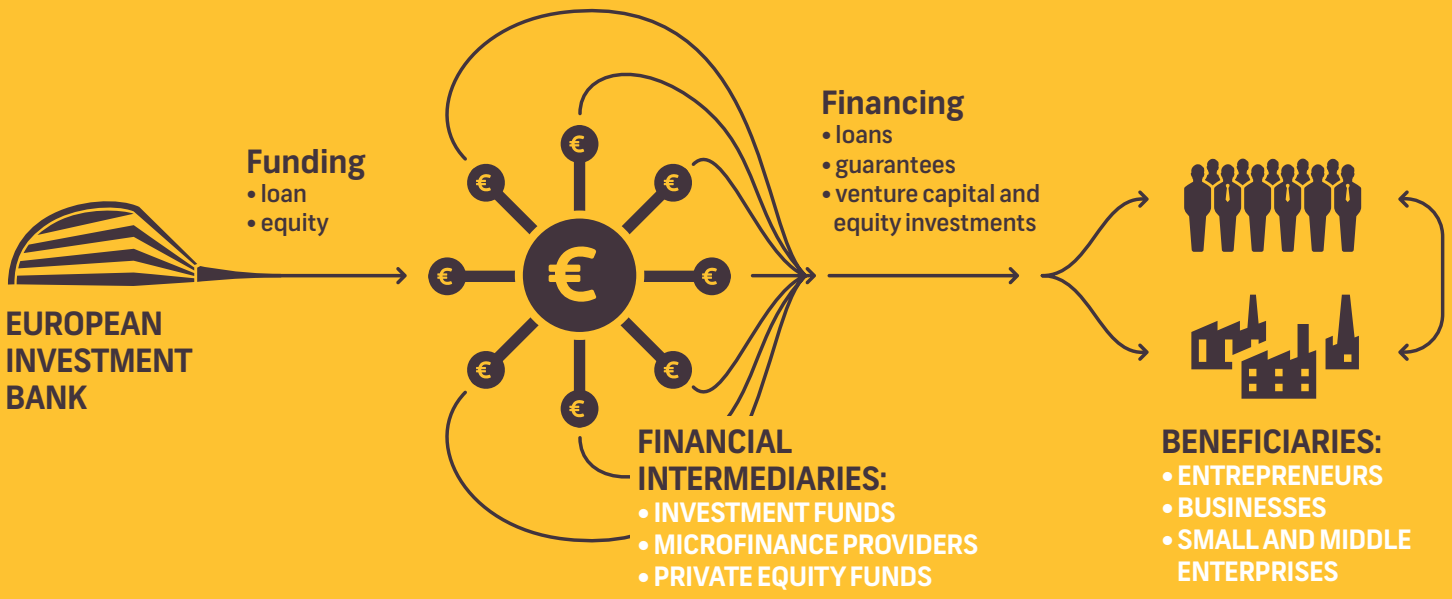
- "Increase in growth and employment potential – including SME and Mid-Cap support

- Economic and social cohesion by addressing economic and social imbalances, promoting the knowledge economy/skills and innovation and linking regional and national transport infrastructure

- Environmental sustainability – including supporting competitive and secure energy supply

- Action for climate-resilient growth"[4].

What are financial intermediaries?



3 EIB Annual Report 2015, http://www.eib.org/infocentre/publications/all/activity-report-2015.htm
4 http://www.eib.org/products/lending/intermediated/index.htm

Why focus on investment funds?

This report is based on research commissioned by Counter Balance to Merian Research. The researchers examined all investment funds supported by the EIB between 2011 and 2015 (see the "Methodology section" annexed to the report). The scope of the report does not cover EIB investments via commercial banks.

The report's specific focus on investment funds has been chosen in light of the growing push by international financial institutions to support, with an explicit development justification, these specific financial intermediaries, in particular in the poorest countries in recent years. In addition, this research was initiated following previous work by Counter Balance which identified concerns associated with the EIB's participation in private equity funds, especially in Africa[5].

Private equity funds: the black hole of development

Private equity has come under increased scrutiny in the last decade in the North, with many commentators describing it as "asset stripping", whereby the productive parts of a company are sacrificed in favour of the selling off assets and the forcing up of share prices to allow profit for short-term investors[6]. In the global South, the situation is slightly different: the profits are not necessarily made through selling assets, but rather by shedding labour, buying cheap companies after their privatisation – often through alliances with corrupt politicians – and selling them off at a higher price. Another way for private equity funds to operate is by building a portfolio of contracts, particularly in the infrastructure and energy sector – via public-private partnerships for instance - and then going public through a share offer.

Several actors have raised strong concerns about the labour, social and development impacts associated with private equity funds' operations and their speculative business model. Trade unions have warned against massive lay-offs consequent to take overs and the restructuring of companies carried out by these financial actors in a highly speculative way[7]. International institutions, such as UNCTAD, have raised concerns about the negative long-term development impacts associated with this kind of foreign direct investment, which remains highly non-transparent[8].

In its 2010 report "Hit and Run Development", Counter Balance questioned the rationale behind EIB support for such private equity funds, especially in Africa, the Middle East and the Pacific region.

Indeed, these are the regions where the EIB has been most active in supporting such funds. The EIB is active in around 50 funds in these regions, with a total value of nearly EUR 5 billion[9] and publicly acknowledges the "growing importance" of this sector of operations for the bank[10]. It has recently increased these type of operations: 2015 saw the EIB invest EUR 154 million in nine private equity funds in Sub-Saharan Africa, the Caribbean and Pacific regions (ACP), the EIB's highest ever total for a single year.

The bank claims that "these funds represent another way for [its] financing to reach thousands of small and medium-sized businesses that need investment to grow, create jobs and meet the demands of evolving populations"[11]. In order to promote the development of the private sector, access to finance is thus regarded as crucial by the EIB. Access to finance is without doubt a key issue in any development economics theory, and supporting financial sector development has also been a key priority of development assistance over recent decades.

However, the EIB's approach to development economics still closely resembles the "trickle-down theory" of the 1980s, as promoted by market fundamentalists. This theory insists that supporting private sector development and improving the investment climate for private investors, by reducing taxation and minimising public constraints, necessarily triggers economic growth and, in the longer term, some improvements of social and economic conditions for the poor too. Nevertheless, empirical evidence about how much

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5 'Hit and Run Development', Counter Balance, 2010, http://bit.ly/28M9s2c
6 The Economist, 2007: http://www.economist.com/node/9441256 ;
Rolling Stone, 2012: http://www.rollingstone.com/politics/news/why-private-equity-firms-like-bain-really-are-the-worst-of-capitalism-20120523
7 'Where the house always wins: Private Equity, Hedge Fund and the New Casino Capitalism'; International Trade Union Confederation; ITUC Reports; June 2007; Brussels
8 United Nations conference on Trade and Development, World Investment Report 2009, Geneva, July 2009
9 'Private equity operations outside the EU – a boost for business', EIB, June 2016
10 http://www.eib.org/infocentre/events/all/the-increasing-importance-of-equity-funds-in-acp-economies.htm
11 'Private equity operations outside the EU – a boost for business', EIB, June 2016

these policies contribute to development deeply questions the flawed conceptual assumptions behind this model[12].

Supporters of the role of private equity in development processes claim that complementary to existing lending facilities and microfinance programs, there is a growing need for private equity and venture capital in order to fuel the development of the private sector in Africa. Equity investments, it is argued, can be instrumental in helping small enterprises grow into medium-sized enterprises, and semi-formal businesses into formal businesses. Despite the interest in identifying and supporting local financial intermediaries, it is widely recognised that today several least developed countries do not have adequate private financial institutions in place. Therefore, the EIB considers the possibility to back international financial intermediaries registered abroad, which can operate from the outside into these countries, as worthy of its attention and investments. The use of international intermediaries which operate in multiple countries is considered by multilateral development banks[13] as the only option to channel resources toward the SMEs of specific developing countries in an effective manner, thus reducing transaction costs and timescales.

By supporting this model the EIB generates additional concerns beyond merely the delegation to intermediaries of performing adequate due diligence of their on-lending to the ultimate beneficiaries. Acting via international intermediaries, whose specific knowledge of local contexts remains questionable, the EIB distances itself even further from the clearly defined development objectives of its lending. Beyond this, the fact that these intermediaries are often located in tax havens and secrecy jurisdictions, as well as their dubious positive economic impact in developed countries, cast doubts over the growing interest of the EIB in backing such speculative funds which target rates of returns of more than 20% in the name of development.

Although the EIB has decided to strategically increase its support for private equity funds in developing countries, it remains unclear whether the use of private equity funds can achieve the goal to: 1) promote access to credit for SMEs, which are supposed to be the ultimate beneficiaries of this type of EIB lending, and; 2) contribute to employment creation, economic growth and consequently to poverty reduction. It can be easily argued that private equity funds have hardly any development mandate or objectives and that their knowledge of local contexts in which to operate mainly relies on market-driven analyses motivated by the financial services industry.

Hence, it is deeply questionable why these investment funds should get close to, let alone benefit from, public financial support that comes with a development tag.

It should be added that the EIB's support to entities identified as "microfinance and micro-insurance intermediaries" has been excluded from the scope of this research. The specific rationale and implementation of microfinance operations would require additional research and analysis.

Therefore, our research focused on the 29 private equity funds in which the EIB has invested between 2011 and 2015 (see the list of Funds annexed to this report).

The report articulates our main findings in the following three sections:

1/ Taxation issue: many of these investment funds are located in tax havens and secrecy jurisdictions

2/ The lack of transparency intrinsically linked with these investment funds

3/ Strong potential for conflicts of interests

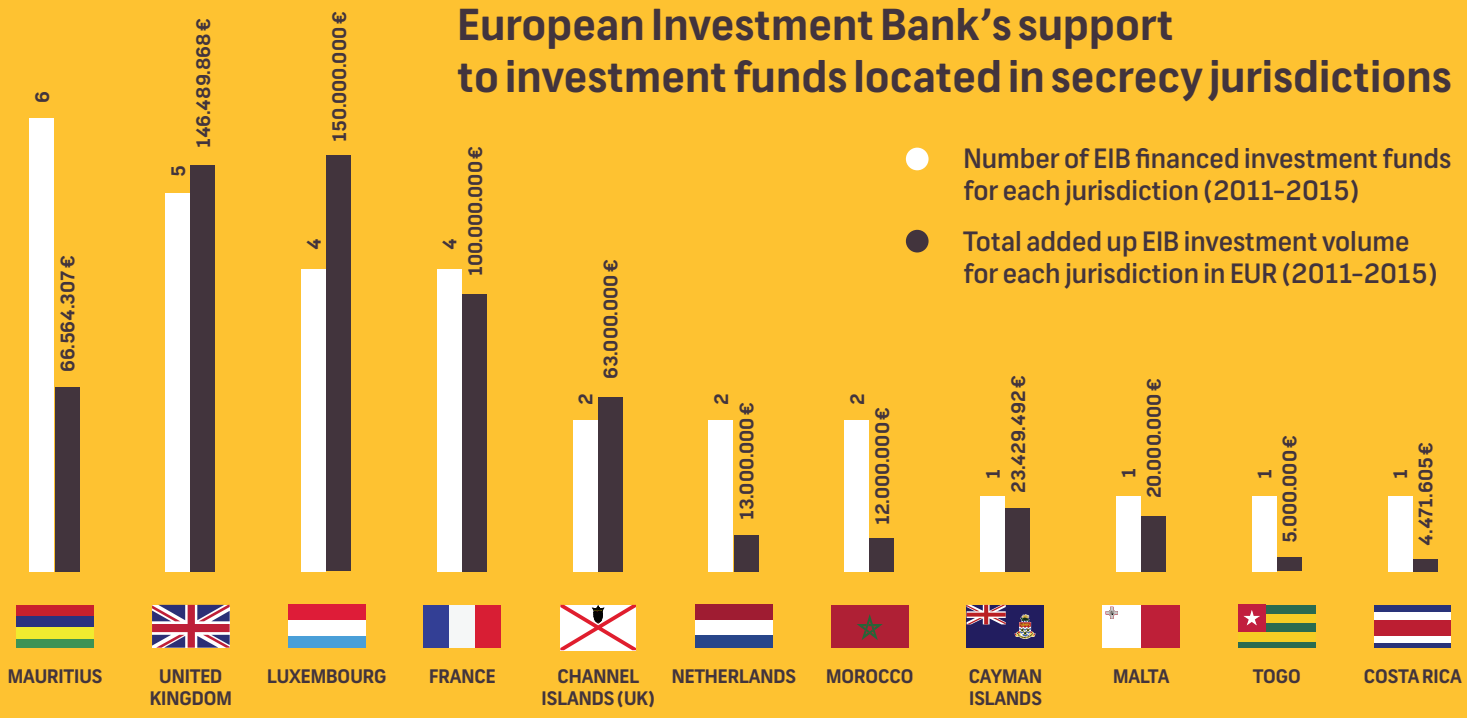
12 See for instance the criticisms of Joseph Stiglitz, pointing out that "Recent advances in economic theory have shown that whenever information is imperfect and markets incomplete, which is to say always, and especially in developing countries, then the invisible hand [of the market] works most imperfectly" ('Globalization and Its Discontents', Joseph Stiglitz, W.W. Norton & Company, June 2002).

13 See: http://www.ifc.org/ifcext/about.nsf/Content/Financial_Intermediaries

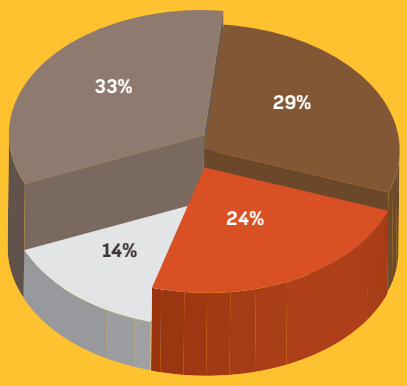
EIB investments ending up in tax havens

In the 2015 report "Towards a Responsible Taxation Policy for the EIB", Counter Balance pointed out the loopholes connected to the EIB's approach for fighting tax evasion and tax dodging[14]. The outcomes of this latest research confirm our previous assessment: **numerous EIB investments are taking place via problematic jurisdictions.** Digging into the jurisdictions where the funds or their management companies are registered, we identified the following striking trends.

European Investment Bank's support to investment funds located in secrecy jurisdictions



Source: EIB, 2016



Source: Tax Justice Network – FSI 2015 and EIB, 2016

EIB investment volumes added up and correlated with Financial Secrecy Index (FSI)

Financial Secrecy Index 2015:

- FSI TOP 10: Cayman Islands (5) + Luxembourg (6)
- FSI TOP 20: UK (15)
- FSI TOP 30: Mauritius (23) + Malta (27)
- Remaining: France (31) + Netherlands (41) + Costa Rica (67) + Morocco (-) + (Togo (-)

Facts and figures on EIB lending to investment funds in 2015

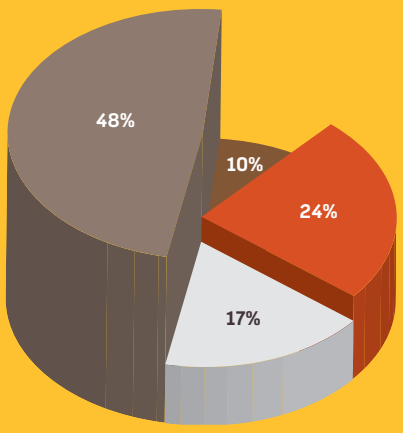
- Total amount invested: EUR 604 million
- Number of investment funds supported: 29

This funding should be in line with the commitment of the European Union to fight tax evasion and tax dodging

But where did that money really go?

- **From 2011 to 2015, the EIB invested EUR 470 million in investment funds located in secrecy jurisdictions**
- **in 2015 67% of the volume of EIB lending to investment funds went to clients located in Top 30 secrecy jurisdictions**
- **The country in which the largest number of EIB supported investment funds are domiciled is Mauritius**

14 'Towards a Responsible Taxation Policy for the EIB', Counter Balance and Re:Common, 2015



A similar story when assessing the location of Fund Management Companies

Jurisdictions of Management Companies according to Financial Secrecy Index (FSI) 2015:

- FSI TOP 10: Luxembourg (6)
- FSI TOP 20: Dubai (10) + UK (15) + Guernsey (17)
- FSI TOP 30: Mauritius (23) + Malta (27) + Canda (29)
- Remaining: France (31) + Netherlands (41) + Jordan (61) + Costa Rica (67) + Morocco (-) + (Togo (-) + Kenya (-) + Joradania (-)

52% of the funds' managers are located in the Top 30 secrecy jurisdictions

Source: Tax Justice Network – FSI 2015 and EIB, 2016

These figures show that despite policies in place at the EIB (especially its NCJ policy), its investments are still flowing through tax havens. This demands further clarifications to the EIB NCJ policy and for the elaboration of a responsible taxation policy which would introduce a stringent system of public country-by-country reporting for EIB clients (which would mainly cover multinational clients and intermediary partners) and improved due diligence on beneficial ownership. These would be two key elements for improving the effectiveness of the policies and the EIB's due diligence.

Despite policies in place at the EIB, investments are still flowing through tax havens

The EIB should stop claiming that it has the best standards in place among international financial institutions[16]. What the EU's bank now needs to do is clean up its act on tax havens.

The EIB and the fight against tax evasion and aggressive tax planning

In 2009, the EIB became the first international financial institution to adopt a public policy explicitly addressing the issue of offshore financial centres, then referred to as non-cooperative jurisdictions (NCJs). The EIB policy includes a general prohibition on investments linked to NCJs, except in limited circumstances. However, the policy lost most of its power not long after its adaptation. The bank had based its due diligence and compliance on the 'OECD black and grey list' as reviewed under the G20 mandate in 2009. Soon thereafter these lists became empty again as a result of tax havens signing information exchange agreements among themselves to comply with the G20 commitment. In fact global blacklisting processes have now mainly become a diplomatic exercise, even if, in the wake of the recent Panama Papers scandal, EU leaders have been calling for a new listing process to address these shortcomings.

As a result of pressure by civil society organisations and the European Parliament, in March 2014 the EIB updated its NCJ policy with an addendum that harmonises the EIB's approach with that of the Global Forum Global Forum on Transparency and Exchange of Information for Tax Purposes (hereafter the Global Forum). CSOs have repeatedly argued that the Global Forum uses unambitious criteria, as it predominantly focuses on banking secrecy instead of corporate tax dodging. In addition, the Global Forum does not include many developing countries therefore it cannot claim to be truly global. Since the inception of the Global Forum process, the EIB has thus retreated from its leading position in tackling tax avoidance to a less pro-active role shared by other financial institutions.

While the EIB's NCJ policy was ambitious at the time, it nonethless included a number of loopholes. A major problem is that the EIB's policy does not prohibit counter-parties from registering in a country other than in which they are economically active – and produce economic value – because of "other tax burdens that make the structure uneconomic". This implies that counter-parties are still permitted to move to offshore financial centres to benefit from lower taxation and/or higher secrecy. In addition, counter-parties can still operate in a prohibited jurisdiction if this jurisdiction offers a level of "corporate security". The policy remains unclear about what this can and might entail.

Therefore, for this chapter of the report we used the Financial Secrecy Index[15] of the Tax Justice Network, a "politically neutral ranking for understanding global financial secrecy, tax havens or secrecy jurisdictions, and illicit financial flows," which provides a more comprehensive picture of what we refer to here as "secrecy jurisdictions", "problematic jurisdictions" or "tax havens".

15 http://www.financialsecrecyindex.com/

16 According to the EIB's website, the bank is "committed to maintaining a leading role amongst IFIs against tax fraud, tax evasion and harmful tax practices as well as money laundering and terrorism financing". http://www.eib.org/infocentre/events/all/eib-stakeholder-engagement-workshop.htm

The black hole of transparency

When it comes to the transparency of the EIB's investments via private equity funds, we identify a further glaring failure: even though the EIB grants its lending under support from EU states (via a guarantee under its External Lending Mandate) and the EU budget (via European Development Funds for its Investment Facility in ACP countries), **the bank provides next to no information on where the money ends up**.

During our research, part of the analysis focused on the final beneficiaries of the private equity funds' investments, who are normally companies operating in a number of sectors, from food processing to technology, from energy to health services.

While for most of the funds reviewed the disclosed information was often limited (ten funds, or just over one third of those reviewed, disclose limited or no information), for six of them (21% of those reviewed) it was impossible to find any information whatsoever about their final beneficiaries.

Both at the EIB and at the investment funds it supports, we detected **a structural lack of transparency**. This is evident throughout the assessment and approval process with the investment funds, in the allocations to the financial beneficiaries as well as in the due diligence (or lack of) into the final destination of the funds.

The bank provides next to no information on where the money ends up

This is compounded by the EIB's rigorous protection of its clients' **commercial confidentiality**, as well as the client's interest in turn to protect the confidentiality of the ultimate beneficiaries of loans or equity. In this context of widespread business secrecy, the EIB appears reluctant to encourage intermediaries to disclose at least some details regarding the support they provide to third parties. This inflexible stance thus ignores the overwhelming public interest vis-a-vis commercial confidentiality in knowing how European public money is ultimately being deployed.

Repeated requests for information advanced by civil society to the EIB and the financial intermediaries have been met with a wall of silence – 'confidentiality agreements' and non-disclosure clauses are the most common grounds for EIB stonewalling. The Transparency Policy of the EIB has been structured in such a way that the refusal to disclose information falls into the scope of this internal EIB policy. For instance, Article 5.13 of this policy simply encourages intermediaries to make information covering its relationship with the EIB available[17].

The EIB discloses information on its intermediated lending in its annual reports (statistical and financial) and in its reports of the results of its lending outside of the EU. However, in both cases, only aggregated data are accessible, and apart from a few selected examples these reports only offer very broad information about the number of SMEs supported and the presumed number of jobs created – without any indication on the quality and sustainability of these alleged jobs.

Furthermore, the EIB does not shed any light on whether the investment funds it supports have any proven capacity and ability to manage – in line with EU standards – the environmental and social impacts and risks arising from its operations. Information on final projects financed through the intermediaries is unknown, even at an aggregated level.

Information on anticipated economic, social and environmental impacts is limited to repetitive theoretical statements that "final beneficiaries will be requested to comply with applicable national and EU legislation, as appropriate", or "the intermediary shall be required to ensure that the final beneficiaries undertake to implement and operate the relevant investments in conformity with national and applicable EU environmental law including the relevant international environmental agreements.[18]"

The European Parliament has repeatedly called on the EIB to revise its approach to financial intermediaries and step up the transparency of its operations. For instance, in April 2016, the Parliament asked the bank to "*reinforce its due diligence activities so as to improve the quality of information on ultimate beneficiaries and to more effectively prevent transactions with financial intermediaries with a negative record in terms of transparency, fraud, corruption, organised crime, money laundering and harmful social and environmental impacts or registered in offshore financial centres or tax havens which resort to aggressive tax planning*[19]". **This echoes repeat calls by the European Parliament since 2012 that have systematically been ignored by the EIB.**

So far – apart from organising promotional and informational stakeholders' workshops – the bank has not launched any serious process to revise its approach in this area. In terms of transparency, it lags behind the International Finance Corporation (IFC, the private sector lending arm of the World Bank group, long criticised by civil society for its dubious lending to financial intermediaries). Indeed, following an audit in 2013 which revealed that the IFC "did not have the information on the end use of funds available" and "knows very little about potential environmental or social impacts of its financial markets lending"[20], the IFC announced that it would disclose the high-risk sub-projects of the investment funds it supports, therefore allowing more public scrutiny over the real impacts of its operations[21].

17 http://www.eib.org/infocentre/publications/all/eib-group-transparency-policy.htm
18 Ibid
19 'Report on the European Investment Bank (EIB) – Annual Report 2014', European Parliament, (2015/2127(INI))
20 Compliance Advisor Ombudsman. (2012). "CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries", 10 October 2012. See: http://www.cao-ombudsman.org/newsroom/documents/Audit_Report_C-I-R9-Y10-135.pdf
21 "An assessment of transparency and accountability mechanisms at the European Investment Bank and the International Finance Corporation", Eurodad, 2015

Why does transparency matter?

• This situation means that a significant part of the EIB's lending activity is exempted from genuine transparency standards, and represents a failure to ensure any accountability concerning the ways in which significant loans are spent and projects are carried out.

• This makes it impossible for those to whom the EIB is accountable – other EU institutions or ordinary citizens – to understand what the real environmental, social and development impacts of its operations are.

• Furthermore, this approach prevents people impacted by projects financed through financial intermediaries from executing their right to complain to the EIB's complaints mechanism and the European Ombudsman.

• There is even a "competition" argument: if there is no transparency at both the EIB and the equity fund level, it is hardly impossible for companies not selected for financing to complain about being marginalised against market logic – at least in the absence of any transparent selection criteria and evidence of their implementation.

• Given the difficulty to understand who the final beneficiaries (investees) of investment funds are, it is often hard to analyse impacts on the ground. However, in a recent report entitled "The Suffering of Others"[22], Oxfam International and several international NGOs succeeded in documenting the human cost of the IFC's lending through financial intermediaries. Through case studies in Guatemala, Honduras, Cambodia, Laos and India, the report exposed the harmful human rights, environmental and social impacts of IFC loans channelled through financial intermediaries.



Source: Le Monde, 02.04.2015

22 https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/ib-suffering-of-others-international-finance-corporation-020415-en.pdf

Even more concerning for CSOs here is that the business model leading to such harmful impacts is not only a speciality of the IFC: it is becoming an ingrained model for different financial institutions, including the EIB which makes regular use of similar financial intermediaries.

• A recent example illustrates that such issues are certainly of relevance to the EIB. In 2016, CEE Bankwatch Network published a report on investments in hydroprojects in the Balkans[23]. Detailed research on the ground enabled CSOs to find out that the EIB has actually been financing dams in this region via financial intermediaries – including investment funds – to the tune of around EUR 437 million. Given the significant impacts that dams can have, especially in terms of displacement of populations, it is alarming that none of this information is available via either the EIB's website or its annual reports.

• It remains to be clarified why the EIB, which is both a publicly-backed institution carrying out EU development work and an avowedly non-profitmaking body, should be investing in funds that have neither expertise nor interest in development matters, and whose main purpose is short term profit. A development institution has development goals which should supersede any other financial return goal. Development impacts and financial returns are often incompatible, especially in the case of private equity funds which aim for double-digit rates of return in the short- and medium-term – the horizon of private equity funds operations.

Problematic EIB investments in Nigeria

Through a private equity fund called Emerging Capital partners Africa Fund II (ECP) the EIB, together with other development financial institutions including the UK's CDC, invested in Nigerian companies reported to be "fronts" for the alleged laundering of money. Indeed, Nigeria's Economic and Financial Crimes Commission has alleged links between these ECP-backed companies and the former governor of Nigeria's oil rich Delta State, James Ibori, and/or his associates, said to have been obtained corruptly by these companies.

Ibori and his associates are Politically Exposed Persons and thus it can be logically assumed that their identity was also known to the EIB and ECP. Nevertheless both the EIB and ECP didn't bother to investigate the case and instead continued to disburse money to the suspected companies.This did not change when Dotun Oloko, a Nigerian anti-corruption campaigner, repeatedly tried to get in touch with the EIB and other financiers involved to alert them about the companies receiving EIB money in Nigeria.

On account of the seriousness of the allegations, the case was brought to the UK parliamentary ombudsman who investigated how the Department for International Development (DfID) and CDC, the UK's financial institution which is fully owned by DfID, handled this case.

At the end of 2013 it presented its conclusions. DfID was accused of maladministration in its handling of the case. CDC should have referred the allegations made against ECP to the police, which it did not. The ombudsman also concluded that CDC failed to communicate effectively, didn't "act openly and accountable" and didn't deal with the case in a transparent way. The report was very critical with respect to the lack of due diligence of the beneficiary companies of the private equity fund and the lack of power CDC or DfID have over these funds' managers.

Overall the ombudsman warned against these types of intermediated lending and the related corruption risks. In this case, as an investor in the same fund (ECP) using the same instruments, these problems also apply to the EIB and other public investors investing in private equity.

Surprisingly, around the same time OLAF, the EU anti-fraud office, finalised its investigation into the EIB, coming to the contradictory conclusion that it actually had no mandate to investigate because the fund had lost no money.

The full story:
http://www.counter-balance.org/update-eib-and-corruption-the-ibori-case/

23 'Financing for hydropower in protected areas in Southeast Europe', CEE Bankwatch Network, December 2015



Strong potential for conflicts of interest

The research screened the CVs of the management and board members of each of the managing companies (and their respective ultimate owner, or the group of owners) of the 29 funds analysed. We looked for former positions held in well-known international investment institutions such as the EIB, the European Bank for Reconstruction and Development (EBRD), the IFC and the World Bank.

Any experience within one of these organisations is certainly not per se illegal, but rather represents an advantage when applying for a new position in a company that seeks to raise funds involving these institutional investors. Such cases of revolving doors are certainly no surprise in a business sector – private equity – where public and private institutions often co-finance the same projects and develop long-term business relationships.

However, the question remains how the EIB deals with the potential conflict of interest a former position held in an international investment institution could cause, when being granted funding. Indeed, any proximity between the EIB and funds' managers itself bears the risks of corporate capture. And it also brings further confusion in the delineation of what the private and public spheres are, especially in relation to managing the public budget – in this case derived from taxpayers money via the European Development Fund and the guarantees awarded to the EIB by the EU.

Some examples:

Channel Island based Clean Energy Transition Fund (CETF)

The fund was set up by Crescent Capital, a Turkey-based private equity firm. Its founder, Aygen Yayıkoğlu, previously worked at the EBRD's headquarters in London for nine years. He then headed the EBRD's country offices in the Balkans and the Caucasus and also worked for the IFC's regional infrastructure team based in Istanbul.

CETF's fund target is set at EUR 200 million, towards which the EBRD has contributed one quarter, EUR 55 million. One pending question is how are possible conflicts of interest being dealt with in the due diligence process? How many years must have passed until a former manager of an institutional investor may use his contacts in the organisation to apply for any kind of investment?

Dasos Timberland Fund II

The Dasos Timberland Fund II, based in Luxembourg, is a private equity fund focused on achieving "a well-diversified global timberland portfolio with European focus, combining the aspects of geographical, age, species as well as end-use diversification". According to its website, the fund's portfolio "combines mature and greenfield forest assets with an objective of generating early cash flow"[24].

It is managed by Olli Haltia (CEO), formerly (1996-2001) an economist at the EIB. As detailed in the fund's organigram, Pedro Ochoa is a Senior Advisor, having previously acted as Technical Advisor to the EIB (1986-2013).

In 2013 the EIB committed EUR 30 million to the Dasos Timberland Fund II.[25]

Business among friends



Source: Respective websites of fund management companies

The picture is striking:
In nearly half of EIB-supported investment funds, managers and board members held positions in public financial institutions. This raises questions about conflicts of interests and how the EIB selects its business partners.

Capital North Africa Venture Fund II: who benefits?

The Moroccan billionaire Othman Benjelloun is the ultimate owner of the Capital North Africa Venture Fund II, domiciled in Luxembourg, to which the EIB committed EUR 20 million in 2013[26]. The EIB's commitment is also supported by the EU via the European Neighbourhood Partnership Instrument (ENPI).

Benjelloun controls the fund through a long chain of trusts registered in Luxembourg. He is worth USD 2.4 billion and is reported to be the richest man in Morocco[27]. He is the owner and President of the Moroccan industrial holding Finance Com, through which he controls BMCE (Banque Marocaine du Commerce Exterieur), one of the most important Moroccan banks.

According to media reports, Benjelloun was a close friend to the King Hassan II who died in 1999 and benefited from large prerogatives, including the co-chairmanship of the Morocco-US council on trade and investments, a post he had to give up when corruption cases were levelled against him. Observers in the Moroccan capital city Rabat saw in Benjelloun's dismissal in 2001 a signal of the will of Morocco's new King Mohammed VI to continue the fight against corruption[28].

According to a Wikileaks cable, dated 23 May 2008, which revealed the internal correspondence of US diplomats, *"Othman Benjelloun hails from Fez and is Chairman and CEO of BMCE, Morocco's third largest bank. According to BMCE employees, a 'Fez mafia' dominates the bank's culture. Benjelloun and others like him belong to a long-standing, moneyed elite who contribute to Casablanca's prosperity"*[29].

This example again raises questions about the due diligence process carried out by the EIB before it grants multi-million euro support to companies owned by Politically Exposed Persons, and also about the rationale for the EIB behind financing the richest businessman in Morocco, instead of supporting local development projects through other channels. Since Benjelloun's Capital North Africa Venture Fund II does not disclose any information about the companies in which it invests, these doubts are even more problematic.

24 http://www.dasos.fi/html/en/dasos-timberland-funds/timberland-fund-ii/
25 http://www.eib.org/projects/pipeline/2011/20110147.htm
26 http://www.eib.org/products/lending/equity_funds/med_equity_funds/capital-north-africa-venture-fund-II.htm
27 http://answersafrica.com/richest-people-in-africa.html/4
28 Inter Press Service, Corrupt Officials Receive Heavy Sentences, 30 April 2001, link: http://goo.gl/vVaZOS
28 https://wikileaks.org/plusd/cables/08CASABLANCA104_a.html

Ways forward for the EIB to clean up its act

There are serious problems hanging over the financial support provided by the EIB to investment funds. Our main findings are that:

1/ Many of those investment funds are located in tax havens and secrecy jurisdictions – as defined by the Financial Secrecy Index.

2/ There is a lack of transparency intrinsically linked with these investment funds.

3/ There is strong potential for conflicts of interests via revolving doors.

For the time being, it appears that EIB investments in investment funds are still non-transparent, in spite of previous calls from the European Parliament and civil society for the bank to modify its approach and increase the transparency of its operations. Current EIB policies and practices are not robust enough to tackle these issues.

The rising trend for these types of investment techniques to be favoured by the EIB in turn places increased emphasis on the need for solid due diligence of projects (what are their justified positive development impact, as well as their potential environmental and social impacts, and what measures are being taken to mitigate these) and selection of project partners. While the EIB may insist that it selects "trusted and experienced partners" for such investments, the evidence suggests otherwise.

Given the fact that the EIB is planning to step up its investments via private equity funds, we are calling for a set of targeted initiatives:

- **Imposing a moratorium on the use of private equity funds.**

Problems linked to investment funds are merely linked to the business model underlying their use, that of ensuring a so-called "trickle-down effect" in national economies. All such funds operate via offshore financial centres contrary to any kind of development logic – it is abundantly clear that the wealth management logic of these speculative funds inherently runs contrary to development goals and policies.

Moreover, experience to date has shown that the EIB is not equipped to use its leverage as an equity participant to drive the practice of these funds in the direction of better outcomes. It would be easier and more logical for the EIB to support direct equity participation in local companies which are judged able and likely to support wider development goals through their work in a transparent and accountable way. Equity participation in principle requires more direct responsibilities for the EIB – or any other bank – than lending does. It is time for the EIB to take on these responsibilities and to act accordingly.

Incremental reforms would not be sufficient to genuinely tackle this issue. In order to lift the moratorium, the EIB would need to do undertake major reforms of its transparency policy, its approach to tax dodging and tax evasion and drastically impose limits on conflicts of interests.

- **Enhancing the transparency of the EIB's operations through financial intermediaries**

For other financial intermediaries used by the EIB (commercial banks in particular, as well as microfinance institutions and cooperatives), the bank needs to step up its transparency level. In accordance with its own transparency policy and EU principles on access to documentation and information, and progressively with International Aid Transparency Initiative standards, the EIB should ensure that intermediated loans are subject to the same transparency requirements as other types of loans. And, in particular, it should provide on its website information regarding:

- Selection criteria for all financial intermediaries supported by the EIB;

- Due diligence conducted for every financial intermediary, in particular concerning its capacity and capability to manage the environmental and social aspects of projects, and its development track record;

- All final projects which were supported through financial intermediaries and the development impacts of these projects and their contribution to EU external action objectives.

Finally, the EIB must ensure that all companies and financial institutions involved in its transactions disclose information regarding **beneficial ownership** of any legal structure directly or indirectly related to the company, including trusts, foundations and bank accounts. This would be a key step forward for the bank in order to ensure a high level of transparency in its operations, especially when operating through investment funds.

- Giving priority to the fight against tax evasion and tax dodging

The European Commission recalls in its communication External Strategy for Effective Taxation published on 28 January 2016 that European legislation prohibits EU funds from being invested in

entities in third countries which do not comply with international tax transparency standards. Therefore, it calls on the EIB "to transpose good governance requirements in their contracts with all selected financial intermediaries". It continues, regretting that "in the past [it] has had to block certain projects submitted by the [financial institutions – meaning the EIB] because they involved unjustifiably complex tax arrangements through harmful or no tax regimes in third countries".

In order to address these challenges, **the EIB should adopt a fully-fledged Responsible Taxation Policy by the end of 2017**. A first step in this regard should be the revision of its Non Cooperative Jurisdictions policy, as a key component of a broader taxation policy. An open and inclusive public consultation with all stakeholders should take place for both processes.

In order to be eligible for EIB financing and investment, all beneficiaries, whether corporations or financial intermediaries, which are incorporated in different jurisdictions should disclose externally audited country level information about their sales, assets, employees, profits and tax payments in each country in which they operate in their audited annual reports. Such a measure would be coherent with the most recent developments at EU level to **introduce country-by-country reporting requirements** for private banks and multinationals.

Finally, the EU and its financial arm the EIB need to be able to ensure they do not support clients which are engaged in harmful tax practices. This is a matter of policy coherence in the fight against tax avoidance. In addition, the EIB needs to do a better job supporting responsible corporate tax practices. Indeed, the EIB is not only a tool to trigger investments, claiming often that it has the capacity to improve the environmental, social and integrity standards of its clients.

- In order to ensure policy coherence between the goals of EU external action and the EIB development mandate, there needs to be strong action taken by the EU institutions to whom the EIB is accountable. **The European Commission and the European Parliament need to step up their pressure on the EIB to drastically change its approach regarding financial intermediaries.**

The international private financial sector should not be used by the EIB as a primary vehicle for channelling development funding to local and indigenous private companies. Screening financial intermediaries both ex-ante and ex-post would absorb too many resources without necessarily generating a positive outcome. It could divert capacity from trying to directly support local public and private sectors in line with a development logic of mobilising domestic resources and capacities. It is worth keeping in mind this capacity issue: although its lending capacity is twice the size of that of the World Bank, the EIB's staff is five times smaller than that of the World Bank.

In conclusion, despite some improvements in the due diligence of the EIB in assessing the environmental, social and human rights impacts associated with its operations – as a result of civil society pressure over the last decade – the systemic use of financial intermediaries risks watering down these advances.

ANNEX 1: Methodology

The research focused on the 29 private equity funds in which the European Investment Bank has invested between 2011 and 2015. Each of these funds invests, in turn, in the capital of non-listed private companies with a focus on specific sectors and/or geographical areas.

The preliminary quantitative analysis screened the jurisdictions of EIB financed funds and their respective management companies. A further screening was conducted on the CVs of the management and board members of each of the managing companies (and their respective ultimate owner) with the purpose of detecting former positions held in well-known international investment institutions such as: the EIB, the EBRD, the IFC, the World Bank, the IMF, and Proparco.

The preliminary analysis has identified potential controversial aspects in two areas:

1. The jurisdictions where the funds or their management companies are registered;

2. Conflict of interest between international institutions and the funds' partners.

Around 90 companies and projects have been screened (at least preliminarily) in total. The data on the final beneficiaries of the 29 funds' investments was retrieved from the websites of the funds, from specialised databases and through an extensive open source research.

ANNEX 2:
EIB-supported investment funds (2011-2015)

Name of fund	Year	EIB commitment in million of EUR	Incorporated	Region of focus
UK Energy Efficiency Investments Fund LP	2014	24.95	United Kingdom	
Mirova – Eurofideme 3 FPCI (Fonds Professionnel de Capital InvesNssement)	2014	40	France	EU
Mid Europa Fund IV	2014	50	Channel Islands	Central & Eastern Europe and Turkey
Glennmont Clean Energy Fund Europe II	2013	50.1	United Kingdom	Eurozone & UK
Aberdeen UK Infrastructure Partners LP	2012	31.44	United Kingdom	EU
Clean Energy Transition Fund (CETF)	2011	13	Channel Islands	Turkey and neighbouring countries
European Energy Efficiency Fund	2011	75	Luxembourg	EU
Brownfields Redevelopment Fund	2014	20	France	Benelux, France
Althelia Climate Fund	2013	25	Luxembourg	Africa, Asia and Latin America
Dasos Timberland Fund II	2013	30	Luxembourg	Worldwide (70% in EU)
EcoEnterprises Fund II	2011	4.47	Costa Rica	Latin America
Novastar Ventures East Africa Fund	2015	8	Mauritius	East Africa
Energy Access Ventures Fund	2015	10	France	East Africa, possibly all sub-Saharan Africa
Synergy Private Equity Fund	2014	11.37	Mauritius	West Africa (Nigeria, Ghana)
Portland Caribbean Fund II	2014	23.43	Barbados, Cayman Islands	Caribbean Basin, Colombia, Central America
Convergence ICT Fund	2013	19.25	Mauritius	Sub-Saharan Africa
I&P Afrique Entrepreneurs	2012	7	Mauritius	West Africa
Adenia Capital III	2012	12	Mauritius	Indian Ocean and West Africa
Cauris Croissance II	2011	5	Togo	West Africa
Catalyst Fund I	2011	8	Mauritius	East Africa
Capmezzanine I	2015	12	Morocco	Morocco, Tunisia, Egypt and West African countries
Euromena III	2014	20	United Kingdom	North Africa and Middle East
Badia Impact Fund	2014	8	Netherlands	Jordan
Abraaj North Africa II (ANAF II)	2014	20	United Kingdom	Morocco, Algeria, Tunisia, Egypt
Mediterrània Capital II (Mediterrania Capital II SICAV PLC Malta)	2013	20	Malta	Maghreb
Capital North Africa Venture Fund II (CNAV II)	2013	20	Luxembourg	Maghreb, Egypt and West Africa.
PME Croissance	2012	5	Morocco	Morocco
The Palestine Growth Capital Fund	2012	5	Netherlands	Palestine
Meridiam Infrastructure Africa Fund (MIAPF)	2015	30	France	Sub-Saharan Africa

September 2016

Counter Balance

Challenging Public Investment Banks