Counter Balance
Challenging the European Investment Bank

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c/o CEE Bankwatch

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Counter Balance critique on the new version of the "EIB policy towards weakly regulated, non-transparent and uncooperative jurisdictions".

Playing with the words, not closing the loopholes and capital flight

On December 15th 2010 the European Investment Bank made public the new version of its policy on offshore financial centres, better to say tax havens, or "secrecy jurisdictions" which have been renamed Non-Cooperative Jurisdictions (NCJ). The new version replaces the interim policy on offshore financial centres made public by the Bank in August 2009, in the aftermath of the G20 decisions on the fight against tax havens and harmful tax practices and in response to widespread civil society critique of the weak due diligence process in the Bank on corporate taxation issues, in particular in the context of the EIB lending outside of the EU.

Despite it is fair to say that the EIB is one of the few international financial institutions which adopted a public comprehensive policy on offshore financial centres - and thus its policy is clearly more advanced than other commitments by other IFIs - it remains highly questionable whether such a policy commitment is enough to curb illicit financial flows in the context of the operations funded by the Bank at the benefit of European corporations, in particular as concerns the EIB external lending.

Recent Counter Balance research ("Hit and Run development", report published Novembre 2010) shows that the abuse of tax havens[1] is systemic by private equity funds finance by the EIB (11 out of 12 cases as concerns Sub-Saharan Africa in the period 2007-2009). Similarly several financial intermediaries backed by the EIB so called "global loans" - today named "intermediated loans" - are located in tax havens and still some operations carried out by European corporations with EIB support happens through financial vechicles located in questionable jurisdictions.

[1] The Financial Secrecy Index (FSI) developed by Tax Justice Network creates a ranking which identifies the jurisdictions that are most aggressive in providing secrecy in international finance, and which most actively shun co-operation with other jurisdictions. It attaches a weighting to each jurisdiction, according to the scale of cross-border financial services activity that it hosts. The two measures – the opacity score, and the weighting, are combined to create the Financial Secrecy Index. Most of the jurisdictions listed in the FSI have been described as tax havens. The countries listed as secrecy jurisdictions according to the FSI for 2009 are listed here:
http://www.financialsecrecyindex.com/2009results.html

The European Parliament and key European governments keep urging the EIB to do more, well beyond current commitments. The new version of the policy is clearly not enough to make the Bank immune from contributing to the unacceptable capital flight from developing countries to Europe and other advanced economies.

This short policy briefing outlines ten significant loopholes and reasons why the policy adopted by the Bank is inadequate to the task and suggests changes to the policy which hopefully the European Parliament and the European Council will require the Bank to adopt in the context of the definition of the new External Lending Mandate for 2011-2013. It is a matter of reputational risk for the whole European Union if its main financial arm does not align its behaviour to what democratic institutions ruling the Union call for.

Ten loopholes to be addresed

1. **Black and grey lists** - "I.3 Reference Lists" (page 7)

"point 4) *In the absence of relevant Reference Lists or the applicable EU Framework, the EIB may decide to carry out an independent assessment and monitoring of the relevant jurisdiction, in accordanace with the EU Framework and internationally accepted standards and best practices."*

Current reference lists adopted by international institutions are primarily based on the OECD black and grey lists whose shortcomings are evident: today no country is blacklisted and only four are on the grey list, as if tax havens do not exist any longer in the world!

Therefore the EIB should mandatory carry out an independent assessment and monitoring of the relevant jurisdiction, regardless of the listing of countries under relevant lists or the EU Framework. This additional due diligence would be helpful in any case and would complement the judgement given under international and European reference lists. The fact that EIB would take a tougher stand in some cases would contribute to show EU strong commitment in the fight against tax havens and could thus trigger additional action at international level.

2. **Mandatory enhanced due diligence** - "I.4 Basic Principles" (Page 7)

"point 2) *Enhanced Vigilance on all Non-Cooperative Jurisdictions"*

Current language is still weak comparing what an Enhanced Due Diligence would imply, according to standardised procedures under international best practices concerning the fight against money laundering and financing terrorism.

3. **Supporting financial intermediaries in tax havens? - "**II.A Prohibition" (page 8)

"In any event, the Bank will not make investments supporting the financial sector in any Prohibited Jurisdiction, unless the supported financial entity serves as an intermediary for the Bank's investments in other permitted sectors of the relevant Prohibited Jurisdiction"

It is highly questionable that, given that money is fungible and financial and capital markets are highly liberalised, an intermediary in a prohibited jurisdiction – that means an internationally recognised tax havens – operates just in permitted sectors – presumably at the benefit of the local economy - with EIB money. Therefore such an exemption should be avoided.

It should be added that prohibiting upfront the possibility that financial intermediaries backed by the EIB operate in prohibited jurisdictions is not penalising for the population of those countries, given that the present policy already provides that under specific conditions the Bank can do direct lending to entities incorporated in those countries – in particular for projects taking place in those territories and proven not to be related to money laundering and other illegal practices. In short, where risk is higher the fact that the Bank lends directly to the ultimate beneficiary could allow stronger control and accountability and reduce risks for the Bank's reputation too.

4. **Too many justifications allowed for corporations for being registered in tax havens** - "II.B Enhanced Vigilance" (Page 8)

"...the EIB may participates in NCJ Operations provided that:
... the relevant counterparty/ies can provide adequate justifications for recourse to the relevant structure. Such justifications may include tax neutrality for investors from different jurisdictions; avoidance of double taxation and other tax burdens that could make the structure uneconomical; a legal framework not equally available in the jurisdiction where the project is physically located; corporate security for companies and investors seeking a platform not equally available in their respective countries of incorporation or residence; marketability of the structure in accordance with standard market practice. The above justifications shall be satisfactory to the Bank and shall ensure adequate transparency to the benefit of the tax authority in all concerned jurisdictions."

This point should be probably regarded as the main loophole in the whole policy.
It is well known the there is an abuse of the double taxation argument and similarly of other arguments mentioned above concerning the need to harmonise the presence and conduct of investors coming from different jurisdictions. All highly questionable. However saying that the EIB could accept the decision of a corporation operating a project in a specific country to register in a different country which is a tax haven just because there might be other tax burdens that make the structure uneconomical is literaly a joke! Similarly why the Bank accepts that the investor has the right to be incorporated in a tax haven if the legal framework desired by the investor for operating is not available in the country where the project is implemented? These are too many and unacceptable justifications by the investors that the Bank according to the policy is ready to accept and not to reject upfront in any case. Given the importance of taxes for public development it is unacceptable for a public institution to support this obvious way of evading taxes.

5. **The Management Committee should always impose additional tax disclosure obligations in the case of "cross-border" operations** – "III.2 Tax Disclosure" (Page 9)

"The Management Committee may therefore impose, in the measures implementing this Policy, additional tax disclosure obligations for such [Cross-Border] operations even if none of the jurisdictions involved qualifies as an NCJ."

The Management Committee should mandatorily (*"shall"*) impose additional tax disclosure for cross-border operations, given the difficulty to check capital flows in highly liberalised global markets and in a context where individual countries have different domestic taxation regimes.

6. **Mandatorily relocation also for controlling entities of counterparties, which are located in a Non-Cooperative Jurisdiction** – "III.3.b Relocation Undertaking" (Page 10)

" *Upon recommendations by the Office of the GCCO [Group Chief Compliance Office], the Relocation Undertaking may also be imposed on the entity controlling the relevant contractual counterparty, in the event that such controlling entity is incorporated in an NCJ*" .

It is key that the relocation undertaking be mandatorily ("shall") imposed also on any entity controlling the relevant counterparty of the Bank, given the typical "shell companies" game played by investors when they structure investments abroad.

7. **Too soft with those violating the policy** - "III.3.d Remedies" (Page 10)

"In the event of breach of the above relocation requirements, the Bank may have recourse to appropriate measures, including cancellation or suspension of the financing and, where applicable, exclusion from future EIB operations."

An authomatic ("shall") cancellation – excluding the suspension option – of the financing should take place in this event, as well as the EIB should authomatically apply an exclusion ("blacklisting") from future EIB operations of the company violating the policy. Why the EIB is so soft with evident violators when these have been already informed about the Bank's policy by signing the Intergirty Covenant?

8. **Make public the Integrity Covenant** - "III.4 Intergrity Covenant" (Page 11)

The Intergrity Covenant including in EIB lending contracts outside of the EU should be made public at the time of the approval of the operation by the Bank. Because the public has the right to know the commitment of the company not to abuse tax havens and whether additional transparency and integrity provisions have been included in the contracts upon request of the EIB.

9. **Also provisions concering harmful tax practices should be included in the financial contracts** - "III.4 Intergrity Covenant" (Page 11)

"In particular, appropriate provisions can be included in the legal documentation of the fund which the Bank participates to address compliance issues, including but not limited to anti-money laundering, combating the financing of terrorism, anti-fraud, and compliance with this Policy and its implementing provisions."

It should be explicitely mentioned that also compliance issues related to harmful tax practices and illicit flows should be included in the legal documentation of the fund which the EIB participates.

10. **Annual report by the Bank to the European Parliament on the implementation of the Policy** - "V. Further Review" (Page 11)

Given the ongoing review of the Policy by the Bank and its board it is important that the Bank would attach a comprehensive report on the implementation of the present Policy to the Annual Report to the European Parliament, detailing the number of application turned down because not complying with the Policy and the number of relocation requested and implemented according to the Policy.

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