/ SUBMISSION /

TO THE REVIEW OF EIB ANTI-FRAUD POLICY

Counter Balance
Challenging Public Investment Banks

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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.

In its mission as a watchdog, the Counter Balance coalition has been monitoring several problematic projects supported by the Bank which have been – or still are – under investigation for fraud and corruption. In various reports we documented several of these controversial cases on which the Bank failed to take sufficient action. These projects range from huge infrastructure projects (such as Italian motorways or mega gas pipelines) to investments in multinational corporations (loans to Volkswagen as part of the so-called *"Dieselgate"* scandal) and equity in investment funds.

For several years, Counter Balance and its Italian partner Re:Common have documented the EIB's involvement in infrastructure projects in Italy under investigation for fraud and corruption. Back in 2015, Re:Common published the report *"Italian Malaffare – European money: Or how the European Union funds Italian infrastructures linked with Corruption"*. A year later, in April 2016, another report called *"Highway to Hell"* was published by the two organisations, providing an in-depth analysis of two major infrastructure projects in the Veneto region in Italy: the Passante di Mestre highway bypass, and the infamous MOSE project in Venice.

In parallel, we identified broader trends of state capture and illicit financial flows through public financing of large infrastructure projects at EU level. These phenomena are not confined to the EIB: they also affect various public banks, as well as the European cohesion and regional development funds. We also realised that many controversial practices, from conflict-of-interests-generating revolving doors between government and industry to un-transparent use of taxpayers money via shadowy investment funds, were actually often legal. This was the topic of our report *"Corrupt but legal: Institutionalised corruption and development finance"*.

In November 2019, we compiled our previous work and developed further recommendations in the report *"Is the EIB up to the task in tackling fraud and corruption? Challenges for the EU Bank's governance framework"* in November 2019. Most of the elements of analysis and recommendations below are extracted from this report.

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OUR ANALYSIS OF THE STATE OF PLAY

The EIB is the financial arm of the European Union, tasked under the EU Treaties with *"making long-term financing available to sound investments"* that support the priorities of the European Union. As such, it has financed thousands of projects across the world since its creation 60 years ago and has become the largest multilateral lender in the world. Over the years, the *"EU Bank"* (as the EIB is known) has expanded its operations via various capital increases decided by its shareholders - EU member states – and is currently responsible for implementing numerous financial instruments under the EU budget on behalf of the European Commission.

Given the expanding scale of its financing, it would be of course unrealistic to imagine that none of these investments have been affected by fraud and corruption. The traditional focus of the EIB on large-scale infrastructure projects – a sector particularly prone to corruption practices – and cross-border operations also represents a serious risk factor.

The European Parliament has taken a strong position via its annual resolutions on the EIB. In 2016, for the first time it called on the Bank to *"stop further loan disbursements to projects under ongoing national or European corruption investigations"*, pointing especially to road projects in Italy for which the EIB is called *"once again, to suspend all forms of funding"*. In May 2018, the Parliament reiterated its call and pointed to a set of EIB-backed projects that testify to flaws in the Bank's due diligence and control functions, despite positively noting *"the importance given by the EIB to its policy of zero tolerance of fraud, corruption and collusion"*.

In response, the EIB claims that it already has in place a *"Zero tolerance to fraud and corruption policy"*, it is second to none in that field among public banks, and is able to track all of its investments down to the last Euro. According to the Bank, its control functions and external scrutiny by other institutions are working properly.

But in our 2019 report, a key finding is that, under current EU law, the EIB is in effect a *"free zone"* where staff have very wide powers of discretion in respect of the enforcement of anti-corruption policies. Despite being an EU body, there is no EU public law that governs how the EIB is governed. In effect, the EIB's internal governance rules are simply internal rules and there are no sanctions that can be applied by the courts if they are broken or unenforced. There is not even EU legislation that provides for the EIB to have in place anti-money laundering rules.

Such anti-corruption policies that exist are enforced through private contracts with borrowers: as such, they are not open to challenge by third parties, such as ordinary citizens, unless they have a direct interest in the contract. Whilst the contracts typically give the EIB the right to suspend or withdraw a loan where there is suspicion of fraud or corruption, they impose no duty to do so: and may contain clauses that actually hamper the ability of the EIB to investigate or take action.

Likewise, the contracts may contain clauses requiring borrowers or intermediary funds to prevent and deter prohibited conduct - but they place no obligation on the EIB to enforce these measures. The EIB thus operates in a hermetically-sealed bubble of discretion – protecting it from legal challenge when that discretion is exercised to turn a blind eye to corruption.

Our conclusion is clear: at the time being, the EIB is not up to the task in tackling fraud and corruption, partly due to weaknesses in its internal mechanisms, and partly due to the unsatisfactory governance framework and external scrutiny on its activities, including by OLAF. The flaws in the bank's due diligence and control functions are at odds with EIB's self-proclaimed *"Zero tolerance to fraud and corruption policy"*. This jeopardizes significantly the soundness of European investments in and outside of Europe. This means the problem needs to be urgently addressed.

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WE CONCLUDED THAT THERE IS A LARGE DISCRETION FOR THE EIB ON HOW IT INVESTIGATES CORRUPTION CASES:

>>> In certain cases, the EIB did not wait for the end of criminal proceedings to act and suspend/sanction its client.

>>> In certain cases, the EIB published summaries of its investigations and provided updates, while in other cases it completely lacks transparency.

>>> In all cases, the EIB ultimately disbursed its loans, whether investigations at national or European (OLAF) level – or at the EIB itself – had been opened or not.

Hence, in addition to reinforcing accountability of EIB's governance and its supervision, we consider it crucial to dramatically reinforce the internal policies of the EIB, starting from its Anti-Fraud Policy. A status quo is not in the public interest or beneficial to the European public good, as it would not solve the current problems affecting EIB's operations and reputational risks linked to them.

The review of EIB's Anti-Fraud policy should not only be a technical exercise, it is about how the EIB ensures its loans are not misused, and how it can show citizens that it is taking steps in the right direction.

In this context, the limited proposed changes to the draft new policy are not sufficient in our view to address the serious weaknesses of EIB internal policies. Therefore, below are spelled out the key changes needed for the Anti-Fraud policy to help the EIB raise the bar on the fight against fraud and corruption.

I. *THE NEW ANTI-FRAUD POLICY SHOULD INTRODUCE PROVISIONS UNDER WHICH THE EIB MUST EFFECTIVELY FREEZE PROJECTS IN WHICH CREDIBLE SUSPICIONS HAVE BEEN RAISED AND BREAK CONTRACTS WITH CORRUPT CLIENTS*

As requested by the European Parliament, the EIB should be in a position to *"stop further loan disbursements to projects under ongoing national or European corruption investigations"* and set this obligation in stone in its Anti-Fraud policy.

Where the corruption allegations are assessed as strong enough for the bank and/or OLAF to open the case and start investigation, the contract should be suspended or a decision on contract award should be postponed until the investigation is concluded. The decision on suspension of contract and/or recovery of misapplied funds should be possible not only on the basis of final court decision.

In its Right of Reply response from 18 January 2019, the EIB indicates that *"while the Bank can suspend in case of serious concerns, the concerns need to be serious, and such an approach cannot be generalised. Also the legal framework for certain business lines (e.g. contributing to investment funds) does not allow EIB (like any other investor) to refuse to contribute when there is a call for capital. That is the nature of the project and once the EIB signs the agreement, the Bank is committed, unless certain things occur, as specified in the investment agreement – EIB cannot suspend disbursements based on suspicions or rumours of misconduct, there needs (at the very least) to be a finding if not a criminal court judgement"*.

"The presumption of innocence is a fundamental principle of the legal process and one of the most important rights of the defence (see article 48 of the European Charter of Fundamental Rights). Imposing penalties or sanctions on the sole basis of suspicions would not only erode due legal process but would also pave the way to arbitrary decision making at the level of EIB projects."

This is exactly the kind of approach that leads us to the critical conclusions spelled out in our report. No-one is suggesting (as mischievously implied by the EIB) that loans should be suspended on the basis of rumours. The allegation must indeed be serious – a test of which is whether or not investigatory authorities have opened investigations, since such investigations are only ever opened where the allegations are credible and serious.

To continue funding loans when national investigations are under way thus flies in the face of the EIB's own stated position – namely that it *"can suspend in case of serious concerns"*.

The justification by the EIB of its legal obligations under certain contracts, especially for its support to investment funds, is also deeply worrying: it is in the public interest that the EIB does not tie its hands by signing contracts or agreements leading to disbursing money even when corruption allegations and investigations by public authorities are launched – without appropriate exit clauses to keep the bank out of potentially fuelling a corrupt scheme or project.

Beefing up contractual clauses with EIB clients in relation to fraud and corruption is a prerequisite for a proper implementation of the EIB policies, standards and sanctions toolbox. Straightforward suspension clauses in case of serious and credible corruption allegations and the opening of investigations at national or European level should be inserted into contracts with clients.

As flagged in the EIB's response to the draft of this report, *"the EIB does not have the powers, nor the role, of a law enforcement agency or prosecution authority (...), the EIB fulfils its role by investigating suspected Prohibited Conduct within the context of the Bank's activities and, whenever needed, referring to competent authorities."* The EIB Fraud Investigations Divisions *"conducts administrative investigations on the basis of the inspection and information clauses embedded in its financing agreements"*. This gives another important reason to integrate into contracts with clients strong covenants providing an extensive competence for the EIB to investigate, inspect and publicly report on potential prohibited conduct.

At the same time, we would like to reiterate the importance of the disclosure of anti-corruption clauses in finance contracts between the EIB and the client as they form the basis for the EIB's investigations. We believe transparency of these contracts would serve the public interest as well as it would help to clarify the anti-corruption provisions envisaged in the contract agreement between the EIB and the promoter.

It is positive to see a new section consolidating the contractual provisions to be inserted in contracts with EIB clients. Nevertheless, we would propose to reinforce this section (and the section F on remedies) by adding a clear reference to the inclusion of a provision on the EIB's ability to suspend disbursements and terminate contracts in case of any violation of the Anti-Fraud policy or the opening of national or other official investigations.

2. *THE NEW POLICY SHOULD ENSURE MORE TRANSPARENCY ON THE HANDLING OF COMPLAINTS*

Despite legitimate concerns about protecting investigations and the decision-making process at the EIB, the EIB has a moral duty to act in a transparent way and demonstrate to European citizens that it handles controversial case in line with its *"zero-tolerance to fraud and corruption policy"*.

Reports by the IG/IN and OLAF related to EIB operations should be disclosed, and on a case-by-case examination, meaningful summaries should be published at least – and much earlier than in the Volkswagen case. All decisions about exclusions should also be systematically disclosed. The EIB should implement the Ombudsman's recommendation to *"remove the presumption of non-disclosure related to information and documents collected and generated during inspections, investigations and audits, including after these have been closed."*

Then more transparency on the handling of complaints and the division of tasks between the EIB and OLAF is necessary. At the time being, it is impossible to know if the EIB is still investigating once it has handed a case over to OLAF, and how it follows-up on OLAF conclusions.

Furthermore, the outcomes and main conclusions of Proactive Integrity Reviews should be made public on the EIB's website.

This set of information should be included in the annual EIB Anti-Fraud report, together with a table summarizing the number of alerts received, investigations opened by IG/IN, cases transmitted to OLAF and dealt with by OLAF.

The previous experience from the controversial EIB loan to the Volkswagen Group is quite telling. The European Parliament, in two resolutions adopted in February and May 2018, called on the EIB to be transparent about its handling of the case and to disclose the report.

The Annual report on the control of the financial activities of the EIB for 2016 states the following:

96. [The European Parliament] regrets that the 'Dieselgate' cases raised a number of questions over the fact that Volkswagen had received EIB loans through fraud and deception; asks the EIB to follow OLAF's recommendations on taking active steps in implementation of its anti-fraud policy; underlines the secretive nature of the EIB's handling of the case and urges the bank to disclose OLAF's report on its Volkswagen loan, and to publish as a minimum a meaningful summary of this report;

Then, in March 2019, following a complaint by the EUObserver journalist Peter Teffer, the European Ombudsman ruled maladministration against the EIB and issued the following recommendation to the Bank: *"The Ombudsman considers that release of the summary by the EIB is insufficient, particularly as the report contains several facts which are in the public interest to be disclosed. She therefore recommends that the EIB should grant public access to the report and recommendation, as well as the internal notes drawn up by the Bank, with redactions only for personal data and any other information which could lead to individuals being identified"*.

3. *CLARIFYING RESPONSIBILITIES TOWARDS NATIONAL AUTHORITIES*

The Bank often hides behind the involvement of national governments in backing controversial projects, like in the case of Italian mega-projects. Hence, it is not sufficient for the EIB to only rely on information provided by national authorities, which could themselves bear responsibilities in corrupt schemes.

Under its Anti-Fraud policy and under EU law, there is no obligation for the EIB to refer suspected prohibited conduct to national authorities and prosecutors when investing outside of the European Union.

Then, regarding an investigation carried out by a national authority which may involve EIB financing, the EIB shall liaise and assist the national authority, but prompt action on suspending loans is not guaranteed since the EIB *"may decide to await the results of such an investigation and request a copy of their findings before taking further action"* (Article 68 of the current Anti-Fraud policy).

While we acknowledge the flexibility offered by this provision, there is still a risk that cases do not get investigated and/or prosecuted for one of the following reasons: the EIB is not a police authority; the remit of OLAF is limited; national authorities can ignore the information received from the EIB.

Therefore, the revised Anti-Fraud policy should make it **compulsory for the EIB to refer suspected prohibited conduct to national authorities and prosecutors, even when outside of the European Union.**

The EIB is arguing that in countries where national judicial systems are problematic and rule of law may not be upheld, this could cause serious problems. If there is this risk, then, arguably, the EIB should not be investing in the first place. This issue raises few questions: should the EIB be providing loans in contexts where repression is such that the EU's public money cannot be protected because of the risks that such repression poses to anti-corruption investigations? Or should there be contractually agreed processes for investigating outside of the country involved – in the same way as there are processes for international arbitration?

Then, in the case of an investigation carried out by a national authority which may involve EIB financing, the EIB shall do its utmost to stick to its requirement to liaise and assist the national authority and ultimately bear the **obligation to request the findings of the investigation.**

Intensifying and promoting pro-active exchanges with law enforcement and anti-corruption agencies at national level to facilitate the exchange of information on cases of mutual interest concerning suspected prohibited activities will be a complement to the above-mentioned steps.

4. RAISING THE BAR ON PROTECTION OF WHISTLEBLOWERS

The EIB Whistleblowing policy has been revised through a process taking place behind closed doors and without room for external stakeholders to provide inputs to this process. To our disappointment, the renewed policy covers internal but not external informants – even if such external informants were in 2018 the source of 31% of the cases dealt with by IG/IN.

At the moment, the EIB has created a digital reporting form, available in 30 languages, which can be used by external informants, but without a clear process indicated on how the EIB will deal with the complaints.

Therefore, this gap should be covered under the new Anti-Fraud Policy by reinforcing paragraph 56 dealing with ways of reporting instances of fraud and corruption. This section should indicate what are the procedures, timelines and guidelines to update whistleblowers on how complaints are handled and better include informants within the investigation process. The tools at the disposal of the Compliance Office (OCCO) to provide protective measures for whistleblowers and to penalise any retaliation on whistleblowers should be explicitly described.

In its report *"Investing in integrity"*, Transparency International EU also recommends to include the possibility for the whistleblower to appeal the outcome of the investigation. This right to challenge decisions – for both internal and external informants – should materialize via a legal protocol attached to the renewed policy. Finally, a wider dissemination of the reporting channels and protection tools available for whistleblowers would encourage informants to contact the EIB.

5. BETTER CONTROLLING THE USE OF FINANCIAL INTERMEDIARIES

The integration of the European Investment Fund (EIF) into this single EIB Group policy is a positive step forward. Still, some issues that are relevant for the EIB's use of financial intermediaries and investments via funds remain unresolved, and even increased now that the EIF operations via funds of funds or securitisation are also part of this policy.

Renewed standards on financial intermediaries should be adopted in 2020 and take into account lessons learnt from both the internal EIB evaluation on its activities in the ACP region and its pro-active integrity review on intermediated operations. The standards shall, inter alia, address the need for better due diligence on the fraud and money-laundering risks linked to the Bank's intermediated operations. The Bank's approach that the responsibility for control of intermediated operations is left to the borrower/financial intermediary poses a serious risk to the EU's financial interest and anti-corruption mechanism as a whole. We believe the EIB needs to take responsibility to ensure financial intermediaries apply strict anti-fraud policy and show equally zero tolerance for corruption. This should be clearly stated in the new Anti-Fraud Policy.

For instance, when supporting private equity funds, the Bank should not permit contractual clauses that might impede an investigation into corruption, for example by limiting rights to inspect a funds' books or those of companies in which the fund is invested. In addition, contracts with intermediary funds should not prevent the suspension of disbursements where corruption is credibly suspected. The Bank itself acknowledges that it is able to condition capital call contributions on *"certain events"* occurring or not occurring. *"Certain events"* – using EIB's wording – could well refer to an investigation. But this would probably mean that the investor gets a lower rate of return. And if it is not really not feasible for a public institution to stop disbursements when corruption allegations emerge, then public money should simply not be channelled through such investment funds.

The EIB argues that investment funds it supports are subject to the surveillance of the relevant national financial regulator where the fund is established – meaning that Anti Money Laundering / Countering Financing Terrorism controls should be systematically and continuously carried out by the regulated entities, as required by law. But numerous money laundering and corruption scandals at European and international level involving investment funds and private banks show that there are serious shortcomings in surveillance taking place at national level.

The fact that the EIB performs a *"Know Your Customer"* due diligence on all new EIB clients in order to detect possible compliance or integrity concerns is supposed to complement regulation at national level. But as the examples below show, this is not always sufficient to avoid prohibited conduct and ensure a sound monitoring of intermediated projects.

Financial operations going through commercial banks bear serious risks for the EIB. A January 2018 evaluation from the EIB focuses on its operations via financial intermediaries in the Africa Carribean Pacific region, under the Investment Facility.

Its findings confirm our analysis about the lack of control, monitoring and reporting on intermediated operations:

"In ACP, where there is no obligation to transfer the interest rate advantage, it is very difficult to trace EIB funding to specific final beneficiaries, let alone projects."

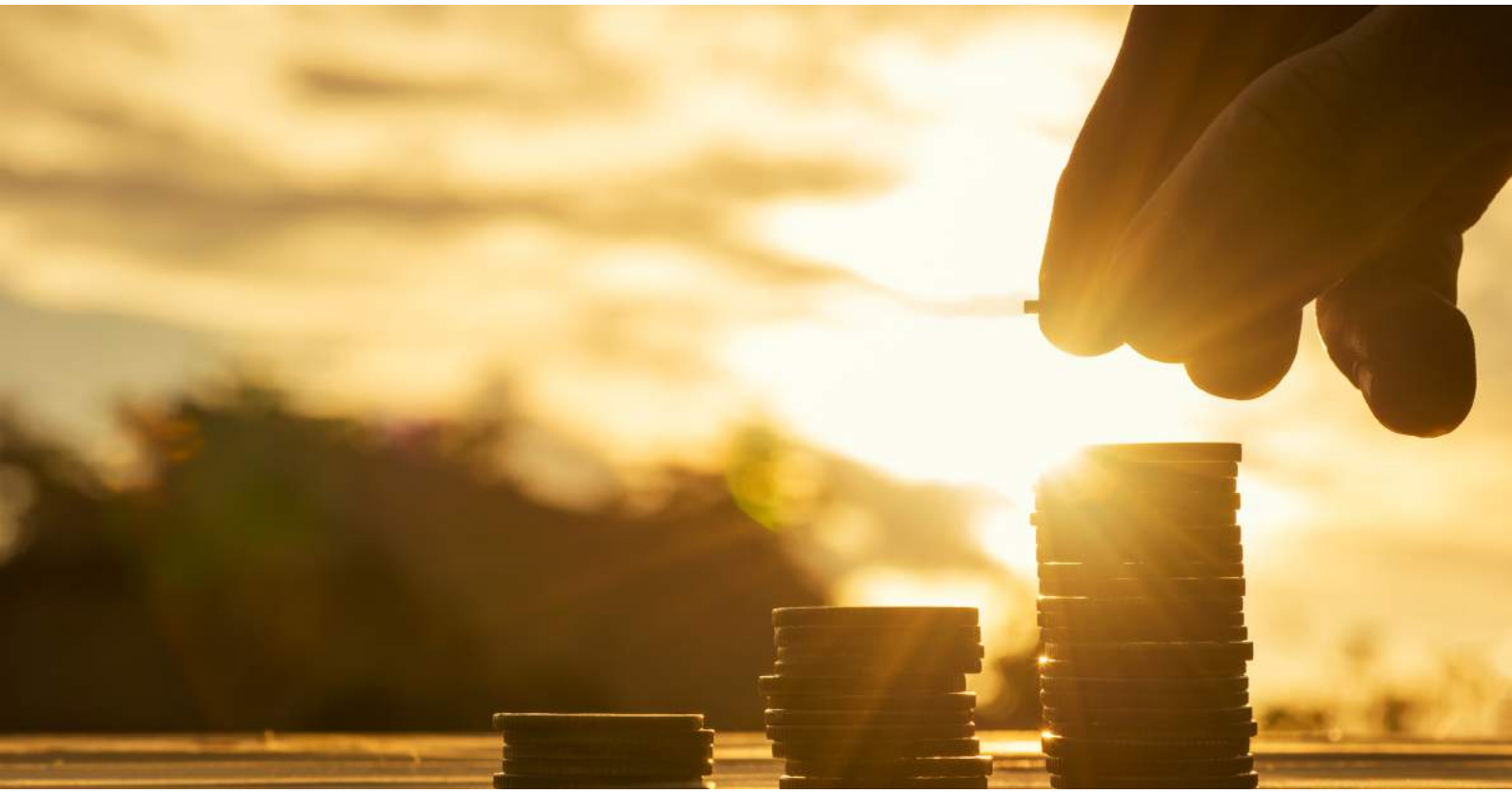
"Moreover, as money is fungible and allocation lists are found to be interchangeable, ensuring the compliance with Environmental & Social safeguards at the allocation level is no guarantee against reputational risk. The intermediary could be engaging for the most part in funding projects that do not meet the EIB's E&S standards or are in non-eligible sectors, while submitting the sample of its funding for eligible projects to the EIB. It would be difficult to imagine that the EIB's reputation would remain unblemished if it emerged that one of the financial intermediaries it financed was involved in such activities."

This casts serious doubts about how much control the EIB really has over the intermediary institution, and if any solid mechanisms are in place to avoid EIB funds being misused.

In its response to our draft report, the EIB indicated that this EIB's independent evaluation mentioned above *"does not include any recommendation regarding fraud and corruption"*. However, our analysis is that the conclusions of this evaluation testify for the lack of control of the EIB over its intermediated lending.

This weakness certainly opens the door to misuse of the Bank's funds.

A case study of Proactive Integrity Review (PIR) on intermediated loans for SMEs (page 12 of the EIB 2017 Anti-Fraud report) also shed lights on serious issues. While it is welcome that PIRs were recently covering intermediated operations, its findings are clear: intermediated operations using EIB funds face serious risks of misuse and money laundering practices. This confirms the concerns that civil society groups have been raising for a decade with the EIB.



6. *REVAMPING INTERNAL GOVERNANCE*

A **stronger role for the EIB Board of Directors** in relation to the fight against fraud and corruption is necessary. In this context, we welcome the fact that the annual reports of the IG/IN will be sent and discussed by the EIB Board of Directors. Still, the Board of Directors should be properly informed about ongoing investigations, exclusion procedures and their outcomes by IG/IN – and not only by the Management Committee - and on major compliance issues by OCCO on a regular basis, and not only through the annual report only.

Then, as recommended by the EIB Audit Committee in its 2018 report published in July 2019, *"the control functions of the Bank need to be appropriately and sufficiently staffed in terms of both financial and human resources. Existing vacancies in the control functions need to be filled and the recruitment process needs to be streamlined to ensure appropriately staffing and decrease excessive reliance on consultancy contracts"*. This is especially relevant has the number of cases dealt with by IG/IN has doubled from 2015 to 2018.

7. PUBLICATION OF BENEFICIAL OWNERSHIP

Without further ado, the EIB should **publish on its website the Beneficial Ownership (BO) of its clients** – including intermediary clients and investees through investment funds - in order to heighten the visibility of its operations and help deter corruption and conflicts of interest. This should be the case for the natural persons who ultimately control or benefit from companies who directly benefit from its loans.

This publication of BO information should be made compulsory to EIB clients via its contracts. The 2015 EU Anti-Money Laundering Directive opens up for such possibility with the setting up of national registers of beneficial owners. Although the Directive sets out legal obligation only upon the EU Member States, its importance should not be underestimated. The Directive recognises the principle of transparency of information on beneficial ownership: it is legitimate to make available to the general public a defined array of information regarding the beneficial owner (name, date of birth, nationality and country of residence).

The disclosure of clients BO information by the EIB could raise issues related to the privacy rights of beneficial owners, but the transparency of BO information can be achieved in accordance with the General Data Protection Regulation (GDPR). There are no legal impediments which prevent the EIB to publish such information if the EIB previously obtains the consent of its clients through a contractual clause. The EIB could disclose such beneficial ownership by integrating a specific clause in the contracts with its clients.

A more ambitious and transparent approach to corporate welfare should indeed make it possible for a public bank to disclose the identity of those benefiting from public funding. The EIB can legitimately update its policies in order the reflect the evolution of EU law on the subject.

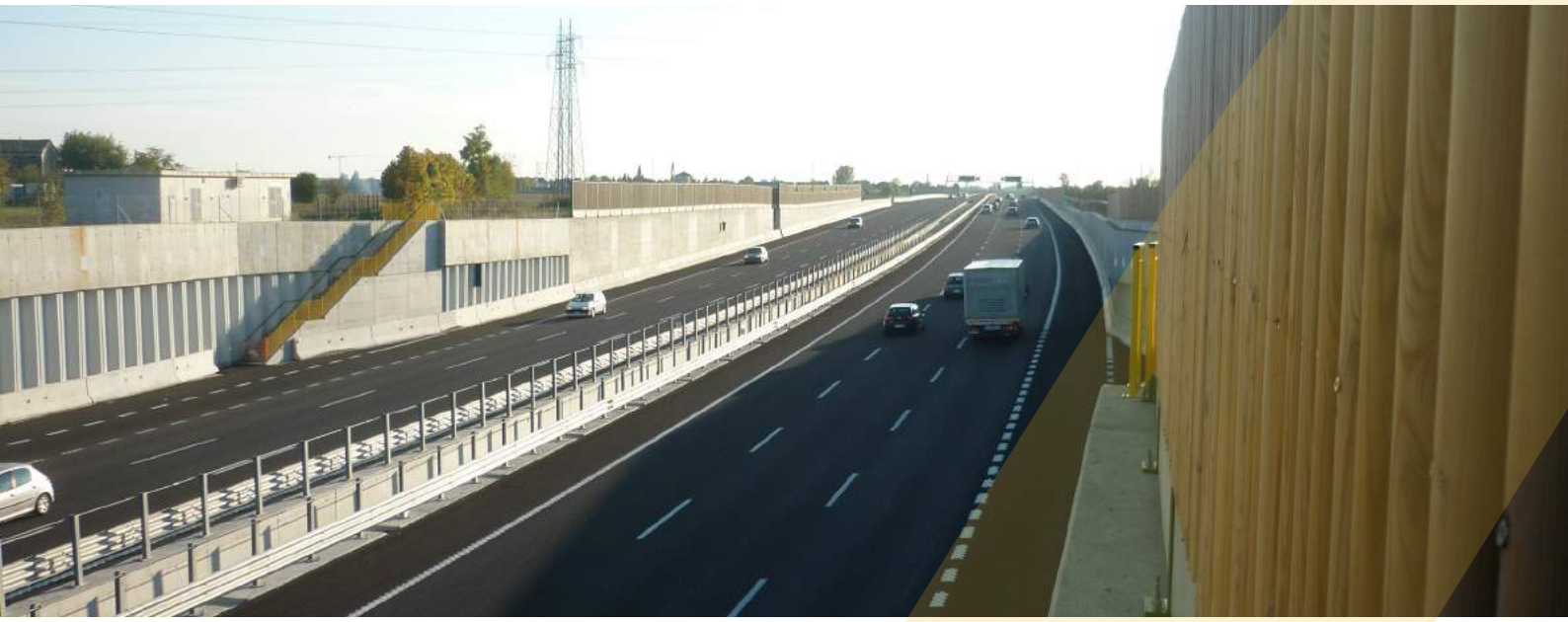
8. BETTER EX ANTE DUE DILIGENCE AND KNOW YOUR CUSTOMER NEEDED

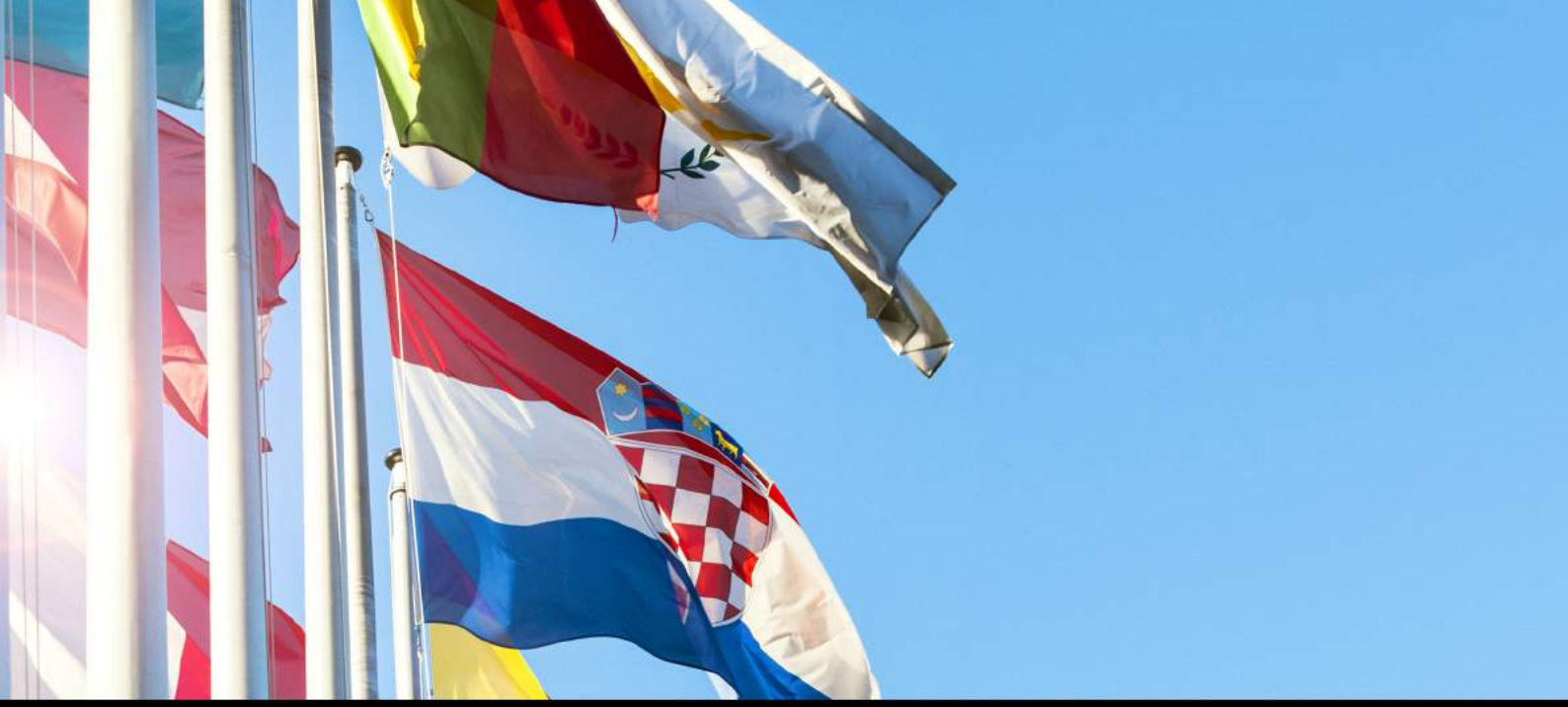
In our research about EIB's support to controversial projects in Italy and its various loans Passante di Mestre, MOSE and the A4 Motorway, it appeared that the Bank is boxing off projects into silos. In November 2017, it told us that *"to our knowledge, the elements raised in your letter about the MOSE project are not related to the Passante di Mestre or A4 Motorway widening projects financed by the EIB"*.

It went further in a March 2018 letter, *"we would like to reiterate that, to the best of the Bank's knowledge, there are no criminal investigations affecting the Passante di Mestre or the A4 Motorway projects financed by the EIB. The allegations mentioned in your letter are not directly linked to the Passante di Mestre and A4 Motorway projects financed by the EIB, but to other infrastructure projects where some subcontractors contracted in the framework of the Passante di Mestre and A4 Motorway projects were involved; these other infrastructure projects took place three/ four years after the completion of the Bank's project. At this stage, the Bank has no evidence of any misuse of EIB funds in relation to the Passante di Mestre and A4 Motorway projects."*

This is concerning, given that there are proven links between various actors involved in the MOSE project, and those involved in the Passante di Mestre and widening of A4 motorway projects. Such links were proved to be part of a corrupt system of relations where, as detailed by public prosecutors in Venice, beyond MOSE, the same Consorzio Venezia Nuova *played a key role in facilitating contracts for all infrastructure in the region*, including Passante. Public vehicles, such as this consortium, have been managed purely for private interests and have become – de facto – the highest decision-making bodies able to direct the public-private relationship at all levels by defining the rules applicable to all actors involved, whether public or private. In short, an indissoluble and permanent combination of the public and private spheres created with the aim of benefiting a few. With its siloised approach, the EIB failed to see what the prosecutors in Italy brought to light and the court convicted.

This demonstrates the need to strengthen ex ante due diligence and Know Your Customer procedures at the EIB, given the fact that the EIB is entering into business with clients and individuals with a negative track record on fraud and corruption. A principle of precaution should at least apply for the Bank. The Bank should take a *"whole deal"* approach to due diligence not a siloised one.





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