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Counter

Balance

Challenging
Public
Investment
Banks*April 7, 2020*

Dear Chair and Vice-chairs of the CONT Committee,

Flagship BBC programme reports allegations of bribes, fraud and mismanagement in Kenya company owned by European Investment Bank (EIB)-financed private equity fund: concerns that the EIB has signed away powers to protect billions of pounds of EU aid money.

A recent report¹ by Counter Balance raised concerns that the European Investment Bank (EIB)'s use of financial intermediaries, such as private equity funds², is putting EU aid money and development finance at financial or reputational risk through alleged or actual mismanagement, corruption, fraud or other abuses by the companies in which the intermediary funds are invested.

Given these concerns, we are writing to draw the CONT Committee's urgent attention to shocking allegations, reported on last night by the award-winning BBC documentary programme *African Eye*. The programme reported on serious concerns of alleged fraud, bribery and other highly questionable business practices by two British managers appointed by a European Investment Bank (EIB)-backed private equity fund to run its investee Kenyan firm **Spenco**³. The allegations are vehemently denied by the managers.⁴ A transcript of the programme is attached.

¹ https://www.counter-balance.org/wp-content/uploads/2019/10/Report_OnlineVersion_EIB_Corruption_Oct2019.pdf

² As at the end of June 2019, the EIB has invested in 47 active private equity funds in the Africa, Caribbean and Pacific (ACP) regions, to which it has committed a total of €705.9m. Aggregate commitments to these funds amounted to €6.4bn for investments in sectors supporting EU development objectives in the ACP regions.

³ The Africa Eye documentary is available at https://www.youtube.com/watch?v=bQinLY0m_jg&feature=youtu.be

⁴ The response of the managers to the allegations is recorded at https://www.youtube.com/watch?v=bQinLY0m_jg&feature=youtu.be

As detailed below, the EIB was informed by Spencon whistle blowers in 2015 and again in 2016 of many of the allegations reported by *Africa Eye*. Despite this, the EIB took no action to save the company. With the demise of Spencon, East Africa has lost its largest home-grown infrastructure development company. Spencon once employed thousands of Africans: over its nigh 40 years of existence, it executed over 200 infrastructure projects of national importance across eight African countries. Former employees featured in the *Africa Eye* report are living in penury. Far from being used to reduce poverty, poorly controlled EU funds may have promoted it.

We believe that there is an urgent need for a parliamentary inquiry into the EIB's response to the concerns raised by the Spencon whistle blowers. We are concerned that the EIB's contracts with the private equity fund – ECP Africa Fund II (“**ECP Africa**”) – may have prevented the bank from taking the actions necessary to ensure that EU funds were spent for the purposes intended. If so, the ramifications for the EIB's wider use of private equity funds are disquieting. How many other contracts similarly constrain the EIB from protecting EU money?

The background to the allegations reported by *Africa Eye* and our concerns are set out in more detail below.

/ EIB'S INVESTMENT IN SPENCON /

The EIB is invested in Spencon through ECP Africa⁵, an investment vehicle for the US private equity firm Emerging Capital Partners (ECP).^{6,7}

ECP Africa has invested a total of \$15 million in Spencon, its first investment taking place in September 2006.⁸

This investment was lost with the demise of Spencon. A key question is therefore whether the EIB could have taken action to prevent this loss of EU funds.

⁵ The European Investment Bank invested Euro 38.2 million to the ECP Africa Fund II (also known as EMP Africa Fund III) in 2006. See: <https://www.eib.org/en/products/equity/funds/ecp-africa-fund-ii>: <https://www.eib.org/en/projects/pipelines/all/20050319>

⁶ https://web.archive.org/web/20111001063147/http://www.ecpinvestments.com/investments_search.xml?media=fund&p=1012&d=1048
https://web.archive.org/web/20110705071522/http://www.ecpinvestments.com/portfolio.xml?f=fund&q=1005&id=1005&view=fund&media=history&_sort=date&p=1012

⁷ In 2017 US court proceedings (Barnwell Enterprises Ltd v Emerging Capital Partners (1:16-mc-02581), Emerging Capital Partners stated that it “manages ECP Africa pursuant to contract” and that “ECP Africa in turn manages Spencon International Ltd., also referred to as Spencon Services Ltd. (“Spencon”), a Kenyan operation incorporated under the laws of Mauritius”. See: <https://ecf.dcd.uscourts.gov/doc1/04515925448>

⁸ See: https://web.archive.org/web/20110705071522/http://www.ecpinvestments.com/portfolio.xml?f=fund&q=1005&id=1005&view=fund&media=history&_sort=date&p=1012

/ ALLEGATIONS REPORTED ON BY AFRICA EYE /

The alleged bribery, fraud and mismanagement reported on by *Africa Eye* took place after 2014. At the time, ECP Africa controlled 98% of Spenco's shares.

Based on interviews with former staff and thousands of leaked Spenco emails, messages and documents, the programme reported on allegations that two ECP Africa-appointed British managers:

- >>> Made highly questionable cash payment for official documents which one leading UK lawyer, who was instrumental in drafting UK anti-bribery legislation, believes need investigating under the UK's bribery act.
- >>> Hired a convicted criminal who, according to the Receiver in Uganda, sold company assets at grossly undervalued prices and also, with the managers' knowledge, paid the proceeds into his personal bank account.
- >>> The administrators, PWC, say \$1.6 million dollars has not been accounted for by the former executive directors. Ugandan Police says they are working with Interpol to question the managers.
- >>> Failed to pay Kenyan staff during the final months of the company even while the managers continued to draw their own salaries (each is reported to have earned over \$20,000 a month).
- >>> Used company funds and equipment to build a golf practice area for their use at a time when the company was facing insolvency. The managers do not deny this but state that the golf practice area gave an impression of a thriving company.

The managers vehemently deny any wrongdoing. ⁹ Emerging Capital Partners denies any wrongdoing and have responded to each of the allegations in their reply.¹⁰

We recognise that the CONT Committee does not have the powers or the means to investigate allegations of criminality. This is a matter for law enforcement agencies. However, as outlined below, the case raises a number of policy concerns that fall within the CONT Committee's remit.

⁹ The responses of the two managers are at https://www.youtube.com/watch?v=bQinLY0m_jg&feature=youtu.be.

¹⁰ The responses of of ECP are at https://www.youtube.com/watch?v=bQinLY0m_jg&feature=youtu.be

/ THE EIB WAS TOLD OF ALLEGATIONS IN 2015 /

Many of the allegations reported on in the Africa Eye programme were first reported to the EIB by Spencon whistle blowers in 2015 and 2016.

The whistle blowers reported their concerns under the EIB whistle blower protection scheme. However, now that the allegations are in the public domain, they are of the view that there is an overwhelming public interest in the responses they received from the EIB being on the record.

We are informed that:

>>> On **7 December 2015**, the whistle blowers sent a Memorandum (via Counter Balance) to the EIB detailing a number of allegations of bribery, fraud and mismanagement by ECP Africa-appointed managers. The allegations included evidence of what would appear to have been improper payments by Spencon via so-called “collection agents”.

>>> On **14 December 2015**, Counter Balance sent an update to the EIB, setting out further allegations.

>>> On **28 January 2016**, an investigator from the EIB’s Inspectorate General Department *[name redacted due to an objection by the EIB and the investigator]* responded to Counter Balance. The investigator reported that the Inspectorate General was analysing the information submitted and proposed a meeting.”

>>> On **19 February 2016**, one of the Spencon whistle blowers, together with a legal representative, and Counter Balance met in Brussels with the Inspectorate General’s investigator *[name redacted due to an objection by the EIB and the investigator]* and the Head of the EIB’s Investigation Unit, *[name redacted due to an objection by the EIB and the Head of the EIB’s Investigation Unit]*. The EIB undertook to investigate the alleged payment of bribes.”

>>> On **7 April 2016**, the EIB provided the whistle blowers with assurances that their identities would be kept confidential. The EIB also provided a case number for their investigation (2016-IN-006).

>>> On **26 October 2016**, the whistle blowers and their lawyer met with EIB investigators in London. Further allegations – relating to suspected embezzlement of company assets by the two ECP Africa-appointed managers – were reported by the whistle blowers, in addition to allegations of racism and mistreatment of Spencon staff.

¹¹ Email from the EIB to Xavier Sol, “RE: Letter and Memorandum on ECP and EIB investments”, 28 January 2016.

>>> On **28 October 2016**, the whistle blowers' lawyer provided the EIB with some 27 documents that the EIB had requested in support of the allegations raised.

>>> On **7 November 2016**, the EIB wrote to the whistle blowers' lawyer, requesting the names of witnesses they might interview to gather "any further information that may be relevant to the factual determination of the issues you have raised, to the extent that any prohibited". The additional information requested was provided to the EIB.

>>> In **February 2017**, the EIB visited Kenya as part of its investigations, including conducting interviews with Spenco employees.

>>> On **19 November 2017**, the whistle blower's lawyer wrote to the EIB's investigator [*name redacted due to an objection by the EIB and the investigator*] requesting an update on the EIB's investigation and a clear timeline as to when a decision might be expected. The whistle blowers also sought confirmation that the EIB has powers to act should it confirm fraud and malfeasance by ECP Africa in relation to Spenco. The EIB did not respond and, since November 2017, the EIB has not contacted the whistle blowers, their lawyer or Counter Balance.

We are unaware of any action taken by the EIB relating to the allegations of bribery, fraud and mismanagement, despite a legal duty to ensure that EU funds are not spent in the furtherance of crime. No action was taken to save the company from bankruptcy.

/ ECP'S OVERSIGHT ROLE AS FUND MANAGER /

The use of intermediary funds, such as ECP Africa, as investment vehicles is often justified on the grounds that such funds have a strong local presence and are able to ensure better oversight than investments that are made directly by institutions such as the EIB. Among the six key benefits of EIB investments in SME and mid-cap funds listed on the EIB's website, one is the "hand-off approach" and another that "investment decisions [are] delegated to the fund manager"¹². The expectation is that a direct, hands on approach by the funds brings managerial discipline to investee companies. Emerging Capital Partners ("ECP"), the fund manager for ECP Africa, also stresses the value of its "on the ground" approach to its funds' investments.¹³ The company states that "it works closely with investees to implement best practices and strengthen business leadership. Frontline presence contributes to deep market insight and unique opportunities."¹⁴

The public might therefore legitimately expect that ECP exercised tight oversight of ECP Africa and that it would have been aware of actions taken by the appointed British managers in Spenco. There is also a legitimate expectation that the EIB took steps to ensure such oversight.

¹² <https://www.eib.org/en/products/equity/sme-mid-caps-funds/index.htm>

¹³ ECP's website carries the strapline "Experienced. Disciplined. On the Ground". See: <https://www.ecpinvestments.com/>

¹⁴ <https://www.ecpinvestments.com/>

It is therefore of some considerable concern that ECP has denied knowledge of the alleged misconduct of the ECP Africa-appointed Spenco managers.¹⁵ As the Africa Eye programme legitimately asks: “How could ECP not have known what was going on?”

This is a question that now needs to be urgently addressed. Did ECP Africa make representations to the EIB as to its management of investee companies? Were undertakings given? And, if so, have they been breached? Was the EIB aware of such breaches? And, if so, why did it not act?

/ OVERSIGHT SIGNED AWAY ? /

From Counter Balance’s meetings with the EIB Inspectorate General Department’s investigator **[name redacted due to an objection by the EIB and the investigator]** and the Head of the Investigations Unit, **[name redacted due to an objection by the EIB and the Head of the EIB’s Investigation Unit]**, we have no doubt that the allegations raised by the Spenco whistle blowers were taken seriously by the EIB’s Inspectorate General Department and the EIB’s Investigation Unit. However, we are concerned that the EIB’s ability to safeguard EU funds in cases where companies invested in through private equity funds are accused of bribery, fraud and mismanagement has been fatally compromised by the contracts that the EIB has entered into with the fund managers.”

In that regard, we would draw your attention to the findings of a 2014 inquiry by the UK’s Parliamentary Ombudsman which commented on the constraints such contracts create for oversight by investors. The Parliamentary Ombudsman looked at contracts entered into by CDC Group, the UK’s development finance institution, which is a co-investor with the EIB in ECP Africa. It found that CDC:¹⁶

>>> Had only “limited rights” to the accounts and records of fund managers and, in some cases, no rights at all (para 44):

>>> Had no rights whatsoever to force a fund manager to withdraw from an investee company (para 44): and

>>> Had no rights to carry out anti-money laundering checks on portfolio companies (para 45).

The contracts between the EIB and its fund managers should be assessed. Are there clauses that run counter to, or have a chilling effect on, the ability of the EIB to ensure that EU funds are used for the purposes that the law requires?

¹⁵ ECP’s response to the allegation made by Africa Eye are at https://www.youtube.com/watch?v=bQinLY0m_jg&feature=youtu.be.

¹⁶ https://www.ombudsman.org.uk/sites/default/files/Handling_allegations_of_corruption_0.pdf

The allegations reported by Africa Eye should not be treated in isolation. How many other investments are similarly dogged by alleged mismanagement and other problems that the EIB is powerless to address because of the contracts it has signed?

A third of EIB's operations are estimated to be channelled through financial intermediaries, including investment funds such as ECP Africa.¹⁷

The EIB shed lights on serious issues around intermediated operations in a case study of a pro-active integrity review extracted from its 2017 Anti-Fraud report¹⁸. Its findings are clear: intermediated operations using EIB funds face serious risks of money laundering practices and misuse of funds.

When drafting its report on corruption in 2019, Counter Balance sought feedback from the EIB. In its Right to Reply response¹⁹, the EIB acknowledged that “the legal framework for certain business lines (e.g. contributing to investment funds) does not allow the 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 events occur, as specified in the investment agreement. A general policy principle committing the Bank to stop disbursements in case of suspicions of Prohibited Conduct is therefore not realistic”. So once the EIB supports an equity fund, it is problematic that it claims that it cannot refuse to contribute to a call for capital if corruption allegations emerge. 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 channeled 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 / Combating the Financing of 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 this is not always sufficient to avoid prohibited conduct and ensure a sound monitoring of intermediated projects.

¹⁷ In 2019, the EIB operations benefiting SMEs amounted to EUR 25.5 bn, see <https://www.eib.org/en/events/annual-press-conference-2020.htm>

¹⁸ See page 12 of the 2017 EIB Anti-Fraud report https://www.eib.org/attachments/general/reports/ig_fraud_investigations_activity_report_2017_en.pdf

¹⁹ https://www.counter-balance.org/wp-content/uploads/2019/10/Report_OnlineVersion_EIB_Corruption_Oct2019.pdf

/ CALL FOR INQUIRY /

In light of the above, we call up the CONT Committee to convene an urgent inquiry to:

>>> Establish what the EIB knew and when about the allegations aired in the Africa Eye documentary:

>>> Establish what actions the EIB took to address alleged corruption and fraud by the ECP Africa-appointed Spencon managers:

>>> Establish whether the EIB was justified in allowing Spencon to go bankrupt despite having an opportunity to save the company by acting to prevent alleged mismanagement and thereby protect EU funds:

>>> Establish whether ECP Africa was in breach of commitments made to the EIB relating to the management of investee companies and whether the EIB could have taken action against ECP Africa:

>>> Establish the extent to which the contract between the EIB and ECP Africa prevented the EIB from taking actions to protect EU funds or to ensure that EU funds are spent in accordance with the law.

>>> Establish the extent to which the EIB's current investments through private equity funds have been put beyond parliamentary oversight and accountability. Should you require further information, please contact us. We would be very happy to meet to discuss these concerns.

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We look forward to hearing from you.

Sincerely yours,

Xavier Sol, Director of Counter Balance

