

Briefing for the European Commission – September 2018

European Investment Bank and financial intermediaries: key issues and way forward

Counter Balance, Bankwatch and partners have identified a persistent lack of transparency and assessment of the economic, environmental and social impact of the EIB's intermediated operations, which may undermine development impacts. So far they have not been addressed properly by the Bank despite regular calls from the European Parliament and NGOs to do so.

The scale of intermediated operations in EIB's portfolio has been steadily growing since a decade. In the European Union, over the last three years the EIB lent almost EUR 23 billion annually through financial intermediaries which is approximately 34% of its entire EU lending. Outside the EU, lending through financial intermediaries is even higher in proportions. Over the last three years the EIB supported external intermediaries with EUR 23.2 billion which represented over 36% of its entire lending in third countries. These significant volumes make it even more crucial for the EIB to address structural issues described above.

Therefore, we call on the European Commission to decisively influence the EIB in the framework of the ongoing drafting of the Standards on Financial Intermediaries. We expect that Standards set clear obligations to publish names of the final beneficiaries' projects and related environmental information. It is in the interest of the European Union and the Commission to ensure that European public funds channelled via the EIB are fully traceable and do not bear reputational risks linked to money-laundering, corruption or harmful social and environmental impacts.

• Structural issues with Financial Intermediaries

By outsourcing part of its lending, the EIB outsources part of its due diligence and monitoring responsibilities as well. Relying on intermediaries to carry out due diligence represents a risk which can seriously undermine the quality and positive outcomes of the lending. It is commonly assumed that since the final beneficiaries receive relatively small investments, there is limited scope for social and environmental impacts. However the cases of small hydropower in sensitive areas of the Western Balkans and corruption allegations around intermediary investments in Africa show that this is not necessarily the case.

The cases of the [Kamena reka, Bistrica 97-99 and Ilovac small hydropower plants in Macedonia and Croatia](#) respectively show that in practice, leaving due diligence to intermediaries and national procedures has led to insufficient assessments and a dilution of the chain of responsibilities. Regular monitoring is also near-impossible given the remote locations of many plants. The EIB must at all times remain responsible and provide more clarity on how these procedures are to be carried out in order to improve transparency and avoid misuse of funds.

Lack of disclosure by the EIB

The EIB carries out lending with support from EU states and the EU budget (via the European Development Funds for its Investment Facility in ACP countries and External Lending Mandate in the

rest of the World). Despite this, the bank provides next to no information on where the intermediated 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 protecting 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 in knowing how European public money is ultimately being deployed.

Currently the EIB does not publish any information except the name of financial intermediaries and the purpose of the project. This makes it impossible to assess the economic and social impact of the loans.

Repeated requests for information by civil society to the EIB and 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 available¹.

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 and intermediary banks it supports have any proven capacity and ability to manage – in line with EU standards – the environmental and social impacts and risks arising from their operations. Information on final projects financed through the intermediaries is not provided, 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."²

The European Parliament has repeatedly called on the EIB to revise its approach to financial intermediaries and step up the transparency of its operations. Eg., 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*

¹ <http://www.eib.org/infocentre/publications/all/eib-group-transparency-policy.htm>

² Ibid

*which resort to aggressive tax planning*³. This echoes calls by the European Parliament since 2012 that have 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,”⁴ the IFC announced that it would disclose high-risk sub-projects of the investment funds it supports, therefore allowing more public scrutiny over the real impacts of its operations⁵.

A significant part of the EIB’s lending activity is exempt from genuine transparency standards, which represents a failure to ensure accountability concerning the ways in which significant loans are spent and projects are carried out. 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 also a “competition” argument: if there is no transparency at either the EIB or the intermediary level, it is hardly impossible for companies not selected for financing to challenge refusals – at least in the absence of any transparent selection criteria and evidence of their implementation.

Given the difficulty in understanding who the final beneficiaries of intermediaries are, it is hard to analyse impacts on the ground. However, in a 2015 report entitled “The Suffering of Others”, Oxfam International and several international NGOs succeeded in documenting the human cost of the IFC’s lending through financial intermediaries⁶. 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.

A January 2018 [evaluation](#) from the EIB focuses on its operations via financial intermediaries in the Africa/Caribbean/Pacific (ACP) region, under its so-called Investment Facility. Its findings confirm our analysis about the lack of control, monitoring and reporting on intermediated operations. Among the key critical findings are:

- *“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**. Indeed, despite transparency requirements concerning the source of funding, most beneficiaries interviewed did not know they received funding from the EIB.”* Moreover, the evaluation finds that *“**allocation lists are mutually interchangeable**; financial intermediaries were able to swiftly replace allocation requests with new ones when the EIB objected to a proposed allocation, or the proposed allocation would require additional scrutiny by EIB Services”*. This suggests that intermediaries have a portfolio of projects

³ ‘Report on the European Investment Bank (EIB) – Annual Report 2014’, European Parliament, (2015/2127(INI))

⁴ 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

⁵ “An assessment of transparency and accountability mechanisms at the European Investment Bank and the International Finance Corporation”, Eurodad, 2015

⁶ [ib-suffering-of-others-international-finance-corporation-020415-en.pdf](#)

from which they draw a sample to submit as allocation requests to the EIB. Therefore, the evaluation questions the extent to which the “*allocation system is useful for reporting and guaranteeing against reputational risk in the ACP context*”.

- Environmental and Social (E&S) risks: “*EIB E&S safeguards are always taken up with financial intermediaries, although they are not always followed through satisfactorily. All contracts contain clauses with respect to E&S aspects and individual allocation requests (i.e. for an EIB allocation above EUR 200,000) need to be accompanied by a completed E&S sheet. **The quality of these sheets was generally found to be low and no trace was found of a dialogue between the EIB and the intermediary with an aim of improving them.***” This contradicts one of the arguments often used by the bank: to reach out to specific economic sectors in Africa, it needs to work with few partners that have access to these sectors. And if these are not always “best in class” partners, the EIB’s participation in these funds lead to a significant improvement of their practices and E&S standards.

- “*Moreover, **as money is fungible and allocation lists are found to be interchangeable, ensuring the compliance with E&S 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 doubts about how much control the EIB really has over the intermediary institution.

- “*The coverage and quality of ex-post reporting on allocations, through the mandatory annual allocation reports, was found to be very weak*”.

- The evaluation makes several recommendations, for example: “*The EIB should adapt tools and processes to improve monitoring and reporting of IF policy objectives. In particular, it should explore how progress towards achieving the expectations set at appraisal stage could be monitored*”.

- The EIB Management Committee reply to the evaluation partly agrees with the findings, and states that a “*follow-up action plan for the implementation of the action points as entailed by the Management response will be further developed after Board approval*”.

Lack of disclosure by intermediaries

The EIB [Environmental and Social Handbook](#) (2013) contains clauses for Global Loans and Funds that require financial intermediaries to publish environmental data

“For mid-cap and global loans and for funds the EIB normally delegates the verification of any NTS and ESIS and other environmental and social documents to the intermediary or fund manager and does not publish such documents on its own website but requires the intermediary or fund manager to do so.”⁷

The EIB does not comply with the provision of the Handbook in relation to ensuring the disclosure of relevant environmental and social documents. This situation prevents the public from scrutinising projects financed through financial intermediaries for their compliance with EIB standards. The level of disclosure and transparency of projects financed through financial intermediaries is substantially lower than of projects financed by the EIB directly. For instance, some private equity funds disclose

⁷ Paragraph 340, page 160

names of investee companies but no information about the environmental or social dimensions of their operations. Or in the case of Balkan hydropower projects, financial intermediaries disclose no information, not even the names of their final beneficiaries. This is in contradiction with the EIB's procedures which delegate disclosure obligations to the financial intermediary.

The EIB must require financial intermediaries to disclose environmental and social information in line with the Aarhus Convention and EU legislation on the basis of its Environmental and Social Handbook. This requirement needs to be included in its finance contracts in order to be effective.

However, it is not. **In a letter of 14 December 2017, the EIB confirmed that “the finance contracts do not contain requirements or undertakings specifically related to the public disclosure of environmental information, as this is covered by the general requirement to comply with environmental law, and ultimately remains under the responsibility of the counterparts and the national competent authorities.”**

At Bankwatch's request, on 6 March 2018 the EIB shared redacted versions of contracts with commercial banks and public banks. The only provision of the contracts that relates to information disclosure is a general provision that projects need to be in line with “Environmental Law”.

However, a general requirement to comply with environmental law does not constitute a requirement for the financial intermediary to publish environmental information related to EIB-financed projects **as required by the Handbook.**

Usually, national legislation does not oblige financial institutions to publish environmental information which is the competence of the public authorities. On the contrary, financial institutions are subject to national banking law which requires confidentiality in regards to clients and their undertakings.

Moreover, outside of the EU it is commonly the case that environmental legislation is not sufficient to ensure the disclosure of environmental and social information even by public authorities.

The EIB, as an EU institution, is subject to a different public disclosure regime than commercial financial institutions on the national level and even national development banks. The EIB is subject to EU environmental legislation, including disclosure of documents.

The EIB's procedures require that all EIB-financed operations shall comply with national legislation and international conventions and agreements ratified by the host country and operations within the EU, Candidate and potential Candidate countries must comply with EU horizontal and/or applicable sectoral legislation. Specifically for operations with financial intermediaries (for Global Loans) projects are covenanted to comply with appropriate environmental and social legislation: *In the EU, Candidate and potential Candidate countries, compliance with EU, national and international environmental and human rights legislation will be made a condition for each subproject under the global loan, as well as EIB environmental and social standards.*⁸ The lack of transparency however prevents any monitoring regarding compliance with this provision.

Hydropower in the Balkans

⁸ Ibidem, page 155

Bankwatch's [issue paper](#) on information disclosure by the EIB's financial intermediaries and [a report](#) on adverse impacts of hydropower projects in the Balkans demonstrates the shortcomings of the EIB's current approach to intermediary lending. The EIB is outsourcing information disclosure and due diligence to financial intermediaries but this results in zero information disclosure on final beneficiaries and substandard project appraisal and monitoring.

In 2017 Bankwatch carried out a [survey](#) of financial intermediaries in the Balkans. None of the banks shared information proactively. Only Sparkasse Bank shared details of one project upon request. Some of the banks actively argued against disclosure based on banking secrecy. In most jurisdictions this problem can be circumvented by obtaining a consent from the client. Some of the banks argued that local authorities have a responsibility to publish. However this is often not happening in the case of small hydropower plants as they are sometimes exempted from having environmental impact assessments carried out. Even if the authorities did publish environmental information, it is still important to know that the project in question was financed by public money.

Lack of transparency and integrity in EIB-financed private equity funds

In September 2016, Counter Balance published a report called [The Dark Side of EIB Funds](#) which analysed a little-known part of the EIB's operations: its use of private equity funds. We focused on the final beneficiaries of the private equity funds' investments - companies operating in a number of sectors, from food processing to technology, from energy to health services.

The report concluded that between 2011 and 2015 the EIB supported private equity funds incorporated in tax havens and problematic jurisdictions. In addition, this report stressed the systematic lack of transparency of these types of operations, both from the EIB and the investment fund's side.

For most of the funds reviewed the disclosed information was limited (ten funds, or just over one third of those reviewed, disclose only a few names of investee companies or simply no information), for six of them (21% of those reviewed) it was impossible to find any information whatsoever about their final beneficiaries.

From Nigeria to Eastern Africa, are EIB funds backing dubious practices?

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

The links that Nigeria's EFCC and other law enforcement agencies have alleged between ECP-backed companies in Nigeria and associates of James Ibori raise many questions about the due diligence performed by ECP and the EIB.

James Ibori and his associates named in the widely spread EFCC affidavit can be considered as Politically Exposed Persons and thus it can be logically assumed that their identity was also known to the EIB and the ECP. Nevertheless both the EIB and ECP did not bother to investigate the case and instead kept on disbursing money to the companies mentioned in the affidavit.

This did not change when Dotun Oloko, a Nigerian anti-corruption campaigner, repeatedly tried to get in contact with the EIB and other DFIs involved to alert them about the companies receiving EIB money in Nigeria. Not only did the EIB and other DFIs initially refuse to meet with Mr Oloko in the presence of a confidant, it was proven that the UK's Development agency DfID did not properly protect Mr Oloko's identity as a whistleblower. This is a serious violation of the duty to protect whistleblowers as they take considerable risks especially in countries where the rule of law is weak, like Nigeria. As a consequence Mr Oloko is not able to return to his mother country Nigeria.

Because of the seriousness of the allegations the case was brought to the UK parliamentary ombudsman who investigated how DfID and CDC, the UK's DFI which is fully owned by DfID, handled this case. At the end of 2013 it presented its [conclusions](#):

Both DfID and CDC have been accused of maladministration for handling the case. First of all Mr Oloko's identity should have been much better protected⁹. Additionally, CDC should have referred the allegations made against ECP to the police, which it didn't. 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 of 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. More specifically the Ombudsman's report reveals that:

- Many fund managers have simply refused to implement CDC's Business Principles, without CDC being able to take any action against them;
- Even after CDC made it a contractual obligation for fund managers to sign up to their new investment code, CDC has only "limited rights" to the accounts and records of fund managers;
- CDC has no rights whatsoever to force a fund manager to withdraw from an investee company.

In the report CDC clearly admits it has almost no power over the manager and what the intermediary invests in. This is problematic especially when using public money aimed at development. The ombudsman especially raised concerns about intermediated lending and the related corruption risks. As an investor in the same fund using the same instruments, these problems also apply to the EIB and other public investors investing in private equity.

At the EIB, the story got progressively buried. Surprisingly, around the same time OLAF finalised its investigation about the EIB investments, coming to the contradictory conclusion that it did not find any evidence of fraud. OLAF also stated that it might consider administrative recommendations, but to our knowledge it was never followed by any specific action.

A few years later, in 2016, our UK colleagues at The Corner House got contacted by other whistleblowers denouncing wrongdoing by the same investment fund ECP. This time, the allegations revolved around bribery and collusion by ECP in its activities in Eastern Africa (Kenya, Uganda and Tanzania). There are pending court cases in the US and Mauritius on this matter¹⁰.

The whistleblowers contacted the public banks supporting the ECP fund, including the EIB. Eventually, they met with the bank's investigation unit, which followed up with a field mission in Africa. Nevertheless, since these steps taken in 2016 and 2017, there hasn't been any update from the EIB.

⁹ Government apologises for naming whistleblower - BBC Newsnight (19/1/2012)

¹⁰ The judgement on the US case is available here <https://www.courtlistener.com/opinion/4408763/barnwell-enterprises-ltd-v-emerging-capital-partners/>

At least twice, evidence came to the EIB that one of the funds it invests in has been mismanaged. Instead of seriously investigation the alleged wrongdoings, the EIB kept investing in the fund and ignoring red flags. The EIB failed to acknowledge the structural problems with its client when they came to light, raising a key question: how many red flags must there be before the Bank stops backing a client? What did the EIB do when confronted with the evidence? Has an internal investigation been launched about the most recent allegations?

What integrity clauses is the EIB inserting in its contracts with clients? From such cases, there are two main possibilities: either the EIB does not insert sufficient integrity clauses to be activated once prohibited conduct occurs, or the EIB does not activate these integrity clauses, for whatever reason.

- **A potential way forward**

In light of the issues above, below are our key recommendations for the EIB, which the European Commission should promote within its oversight and executive roles towards the bank:

- **The Standards on financial intermediaries currently under preparation must be ambitious, business as usual is not an option.** The guidelines need to design a conclusive and effective approach that will enhance transparency and should rely on the elements listed below.
- **Enhanced monitoring of intermediated operations:** Enhanced monitoring of sub-projects should be a pre-requisite for the EIB before entering into new intermediated operations. Mainstreaming such an approach throughout all EIB operations is necessary in order for the Bank to really assess the impacts of its projects and track where its funds are ending up.
- **Pro-active disclosure of data on its intermediated operations:** The EIB should start disclosing aggregated, statistical data on its intermediated operations, as well as information about subprojects, for example by making sure that the webpage of the financial operation contains a list of pre-approved projects.
- **Strengthen obligations and transparency via contract clauses with intermediaries:** In order to make sure that EU legislation and EIB standards are really implemented, and that information about sub-projects can be disclosed, the EIB should enshrine strong provisions in contract clauses with intermediaries. The EIB should go further than what commercial banks require in this regard.
- **The EIB Management Committee should disclose its follow-up actions on the ACP FI evaluation,** including the information presented to the ACP Investment Facility Board. A thorough action plan needs to be developed in order to address the serious flaws identified by the evaluation report.
- In line with a recent [Decision](#) by the European Ombudsman that recommends redrafting of the Article 5.13 of its Transparency Policy concerning intermediated loans in order to ensure that the same transparency standards are applied for both direct and intermediated operations. Therefore **the EIB should modify its approach to information disclosure to make it unambiguous and effective.** This should be at minimum mentioned in the guidelines and elaborated in the relevant policies like the EIB Transparency Policy.
- **The Commission should require the EIB to operate only with financial intermediaries which are equipped to implement a pro-development approach supporting the specificity of SMEs in each country.**
- The EIB must not cooperate with intermediaries with **negative track record** in terms of transparency, fraud, corruption and environmental and social impacts. Unfortunately, the argument that the EIB's cooperation with an intermediary "which is not the best in class" will help improve its E&S standards is not matched by evidence. Hence, a stringent **list of criteria**

- for selection of financial intermediaries** must be established by the EIB jointly with the EC and be publicly available.
- **More reporting on the reality of EIB's support to financial intermediaries:** As a major and opaque element of its lending, EIB's portfolio of financial intermediaries needs to be thoroughly assessed in the EIB reports to the Parliament and the Council and provide sufficient information for other EU institutions to exert genuine scrutiny on the bank.