

Counter



Balance



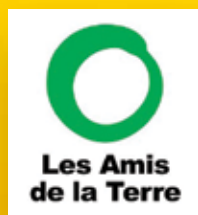
Challenging
the European
Investment
Bank

Hit and run development

Some things the EIB would
rather you didn't know about
its lending practices in Africa,
and some things that can
no longer be covered up

November 2010

The mission of “**Counter Balance: Challenging the EIB**” is to make the European Investment Bank an open and progressive institution delivering on EU development goals and promoting sustainable development to empower people affected by its work.
This new campaign is promoted by:



Written by :

Antonio Tricarico (CRBM), with the contributions of Isabella Besedová and Anna Roggenbuck (CEE Bankwatch Network), Anders Lustgarten (Bretton Woods Project), Claudia Apel (Merian Research), Dotun Oloko and in cooperation with Merian Research



Edited by :

Greig Aitken (CEE Bankwatch Network)

Graphics and lay out :

FGD

Text closed on 15th October 2010



Contents

List of abbreviations 3

Executive summary 4

Introduction 7

Chapter 1: **The black hole of transparency** 17

Chapter 2: **The black hole of due diligence** 21

Chapter 3: **The black hole of development** 31

Conclusions and recommendations 39

LIST OF ABBREVIATIONS

ADB	ASIAN DEVELOPMENT BANK
EIB	EUROPEAN INVESTMENT BANK
EU	EUROPEAN UNION
IF	INVESTMENT FACILITY
IFC	INTERNATIONAL FINANCE CORPORATION
IFI	INTERNATIONAL FINANCIAL INSTITUTION
SMES	SMALL- AND MEDIUM-SIZED ENTERPRISES

Executive summary

The role of the European Investment Bank (EIB) in development finance has rapidly expanded in recent years, as has the bank's own understanding of this role. Yet with now, according to its 2009 loan volumes, more than €10 billion per year being deployed by the EIB outside the European Union, this report critically analyses the lending tools, the development ideologies and the on-the-ground practices that lie behind the EIB's ever-increasing development lending volumes. In particular, it focuses on the growing use by the EIB of intermediated loans and private equity funds on the grounds that these are primary tools that can deliver benefits for small- and medium-sized enterprises (SMEs) in developing countries.

The report presents a number of case studies of recent controversial projects in Africa funded by the EIB, including the use of tax havens and offshore incorporated private equity funds, and describes the coming to light of various corruption scandals involving EIB clients. While the EIB's understanding and acceptance of its development role may be growing, knowledge and understanding among European identified decision-makers (for example, within the European Parliament or within relevant ministries in EU member state governments) of some of the EIB's obscure and opaque lending practices in Africa remains thin – this report seeks to address that.

As an integral part of its development lending, the EIB is using an increasing number of intermediated loans in its lending outside the EU – this type of EIB lending has doubled in ten years, accounting for up to 37 percent of the bank's non-EU lending in 2009. That is, the EIB is disbursing large 'global' loans to private banks for these institutions to then pass on (or 'on-lend') in smaller loan tranches to SMEs. In recent years, this practice has been used particularly in Africa and eastern Europe. The EIB is pushing ahead with 'framework loans' that pre-approve projects as a group instead of appraising them individually. The EIB is also conducting an increasing amount of its development investing via private equity, a further shift away from traditional project finance to investments via entities that clearly prioritise profit maximisation over concerns about sustainable development.

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

That this report presents a variety of cases where the EIB's due diligence and project partner selection have been compromised casts doubts not only on how fit for purpose these newly favoured investment models are – part of a worrying 'financialisation' of development that appears to be running unchecked even now in the aftermath of the most recent global economic crisis brought about by the disastrous 'financialisation' that has run rampant throughout the global economy in recent decades – but also on the overall development effectiveness of the EIB's activities in developing countries. When viewed as a whole, the EIB's own development economics model demands concern and scrutiny particularly now as its new external lending mandate awaits definition by the European Parliament and the EU member states.

When it comes to the transparency of the EIB's intermediated development finance, a further glaring failing is identified by the report: even though the EIB grants all of its European intermediated finance in Africa – and elsewhere – with a guarantee from the EU member states, the bank provides next to no information on where this money ends up, principally because it is not obliged to provide rigorous feedback. This is compounded by the EIB's rigorous protection of its clients' commercial confidentiality, as well as the interest of the latter to protect the confidentiality of the ultimate clients benefiting from the loans. In this context of widespread business secrecy, the EIB appears reluctant to encourage intermediaries to disclose at least some details regarding the global loans they have been allocated. This inflexible stance thus ignores the overwhelming public interest over commercial confidentiality in knowing how European public money is ultimately being deployed.

The report concludes that the international private financial sector should not be used by the EIB as a primary vehicle for channelling development funding to local and indigenous private companies. Screening financial intermediaries both ex-ante and ex-post would absorb too many resources without necessarily generating a positive outcome and would divert capacity from trying to directly support local public and private sectors according to a development logic of mobilising domestic resources and capacities. At the same time, support for locally established, but mostly foreign controlled, financial intermediaries could easily lead to the repatriation of local savings and profits at any time, thus contributing to capital flight from poor to rich countries, against the intrinsic rationale of development aid.

Therefore the Counter Balance coalition believes that EIB support for financial intermediaries should be restricted only to local financial institutions that do not operate in offshore financial centres and are knowledgeable about the needs of local SMEs, that have a substantial local ownership, that are equipped to implement a pro-development approach – in line with transparent and verifiable criteria – and that disclose in a timely manner all relevant information to the public in Europe and developing countries.

Counter Balance further believes that EIB participation in private equity funds should be ended. All such funds operate via offshore financial centres contrary to any

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

“Lending institutions are not giving up on Africa despite decades of abuse of aid flows and concerns over whether aid even works as a tool to improve growth and alleviate poverty.”

Financial Mail, South Africa, 26th March 2010

Introduction

The role of the European Investment Bank – the EU's bank and the largest public financial institution in the world by lending volume – in development finance has rapidly expanded in recent years, as has the bank's own understanding of that role. Traditionally used to fund projects within the EU member states, **the EIB approved projects outside the EU totalling €10.3 billion in 2009 – with contracts signed for €8.6 billion –, a significant increase on the figure for 2008 of €6.1 billion¹.** With much of that increase coming as a result of policies implemented after the financial crisis to alleviate liquidity problems and speed the disbursement of loans, stringent and effective due diligence and project selection have become all the more crucial.



The EIB is leading a global trend in the transformation of development finance by increasing lending to the private sector – possibly at concessional terms too by blending grant financing and commercial financing. As such the EIB can be seen as a European version of the International Finance Corporation (IFC) – the private sector lending arm of the World Bank Group. Individual European donor countries are also increasingly empowering bilateral institutions which, along similar lines as the EIB and the IFC, lend primarily to the private sector at commercial terms in the name of development. This despite the fact that it remains very unclear – and indeed questionable – how much development priorities, as defined in national development strategies as well as in commitments from the international communities and included in European laws, are guiding the operations and actions of these institutions.

Recent controversial projects financed by these bodies, as well as the use of tax havens by their beneficiaries and the emergence of various corruption scandals tainting their operations, cast additional doubts about the development effectiveness of these “new” development financial institutions.

The EIB's central role in EU development operations, and in particular its development obligations, has also come into sharper relief in recent years. An ongoing dispute between the European Council, Commission and Parliament, EU member states and the bank itself about the objectives of the EIB was partially resolved in November 2008 by an intervention from the European Court of Justice (ECJ).

The ECJ annulled the legal basis for EIB lending outside a narrow interpretation of the EC Treaty; the ECJ also made it clear that the EIB is obliged to fulfil a poverty and sustainable development mandate. The EIB's amended mandate for lending outside the EU now states that:



In relation to developing countries in particular, EIB financing operations should foster: sustainable economic and social development of these countries, more particularly in the most disadvantaged amongst them; their smooth and gradual integration into the world economy; the campaign against poverty; the general objective of developing and consolidating democracy and the rule of law; the general objective of respecting human rights and fundamental freedoms; as well as compliance with objectives approved by the Community in the context of the United Nations and other competent international organisations².

1. EIB Group: Key Statutory Figures, http://www.eib.org/about/key_figures/index.htm; EIB Annual Report 2008, <http://www.eib.org/about/publications/annual-report-2008TEST.htm?lang=en>

2. Decision No 633/2009/EC of the European Parliament and of the Council of 13 July 2009 granting a Community guarantee to the European Investment Bank against losses under loans and loan guarantees for projects outside the Community, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?ur i=OJ:L:2009:190:0001:01:EN:HTML>

While formally that ruling only applies to the EIB's lending in the Mediterranean region, Eastern Europe, Asia and Latin America, and not to its lending in African, Caribbean and Pacific (ACP) countries where it operates under the Cotonou Agreement³, the precedent has been set. Nor does the EIB seem to take issue with it – after years of resisting any form of 'development' label, the EIB now states that it is "an active development partner of the ACP countries, and that it has an "overriding aim in ACP regions... to support projects that deliver sustainable economic, social and environmental benefits"⁴."

The primary mechanism via which the EIB invests in ACP countries is the Investment Facility (IF), which supports almost solely private sector projects. The IF's 2009 report makes clear the EIB's desire to "take more risk", "do more, better and faster" and "streamlin[e] procedures"⁵. Given the bank's limited manpower, however, 'doing more and faster' necessarily involves considerable delegation.

The EIB is using an increasing number of intermediated loans in its lending outside the EU – this type of EIB lending has doubled in ten years, accounting for up to 37 percent of the bank's non-EU lending in 2009 – and it is passing large lump sums onto regional banks for them to pass on smaller chunks to SMEs. It is pushing ahead with 'framework loans', which pre-approve projects as a group instead of appraising them individually. This practice has been used particularly in Africa and eastern Europe in recent years, nearly twice more than it is used within the EU, and puts an enormous onus on good due diligence and selection of project partners. And then there is private equity.

The EIB has declared that it wants to see "an increased proportion of equity investments" in the IF portfolio, and the numbers are already rising. The IF's total equity investment in January 2008 stood at €926 million, up from €566 million in January 2007 and €394 million in January 2006⁶. Of the €450 million added to the pot in 2009, €335 million of it went either to equity investments or lines of credit,⁷ signalling a major shift away from project finance and onto delegated investments through intermediaries

on whose list of priorities, certainly in the case of private equity funds, sustainable development comes below maximising profit.

Private equity has come in for increased scrutiny in recent years, with many commentators describing it as "asset stripping", whereby the productive parts of a company are sacrificed in favour of selling off assets and forcing up share prices to profit short-term investors⁸. Given these reservations, it remains to be clarified why the EIB, which is both a publicly-backed institution carrying out EU development work and an avowedly non-profitmaking body, should be investing in funds that have neither expertise nor interest in development matters, and whose main motivation is short term profit. The question of whether a non-profit development institution does indeed "ensure that its funds are employed as rationally as possible in the interests of the Community"⁹, as its own Statute requires it to do, by investing in private equity is one that will be increasingly debated in the future.

All these developments cast serious doubts about the overall development effectiveness of the EIB's action in developing countries at a crucial time for the definition of its new external lending mandate. The EIB's approach to development economics still closely resembles the "trickle-down theory" of the 1980s, as promoted by market fundamentalists. Supporting private sector development and improving the investment climate for private investors, by reducing taxation and minimising public constraints, will necessarily trigger economic growth and, in the longer term, some improvements of social and economic conditions for the poor too. Controversial empiric evidence about how much these policies lead to development deeply questions flawed conceptual assumptions behind this model.

3. The "Partnership Agreement between the members of the African, Caribbean and Pacific Group of States of the one part and the European Community and its Member States of the other part" was signed on 23 June 2000 in Cotonou, Bénin – hence the name "ACP-EC Partnership Agreement" or "Cotonou Agreement". It was concluded for a twenty-year period from March 2000 to February 2020, and entered into force in April 2003. It was for the first time revised in June 2005, with the revision entering into force on 1 July 2008.

Compared to preceding agreements and conventions shaping the EC's development cooperation, the Cotonou Agreement represents further progress in a number of aspects. It is designed to establish a comprehensive partnership, based on three complementary pillars: development cooperation, economic and trade cooperation, and the political dimension.

The partnership is centred on the objective of reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy (Art. 1). The 2005 revision focussed among other issues on a more flexible and more effective implementation of the Investment Facility, which is managed by the European Investment Bank.

More information is available at: http://ec.europa.eu/development/geographical/cotonouintro_en.cfm

4. <http://www.eib.org/projects/regions/acp/index.htm>

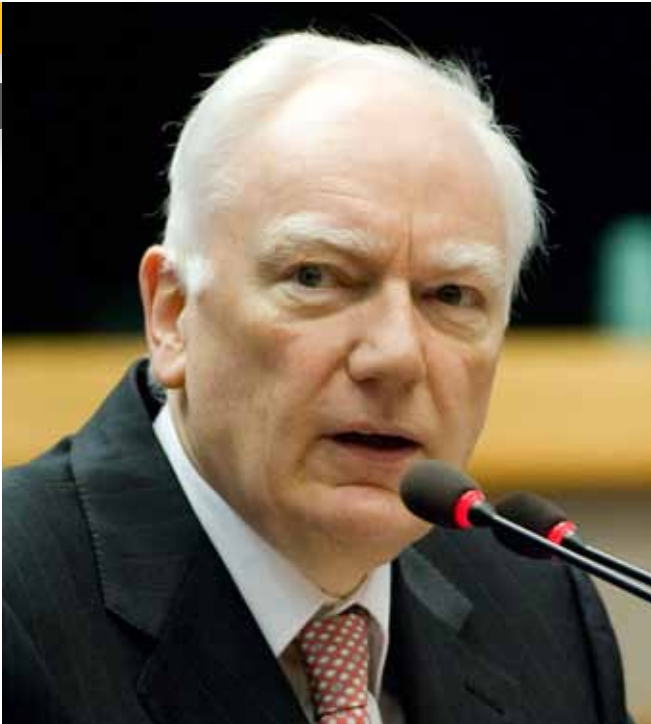
5. Investment Facility, Annual Report 2009, p.2, <http://www.eib.org/projects/publications/investment-facility-annual-report-2009.htm>

6. Investment Facility, Annual Reports 2008 and 2007, <http://www.eib.org/projects/publications/investment-facility-annual-report-2008.htm>; <http://www.eib.org/projects/publications/investment-facility-annual-report-2007.htm>

7. Investment Facility, Annual Report 2009, p.22, <http://www.eib.org/projects/publications/investment-facility-annual-report-2009.htm>

8. See, for example, Larry Elliott and Dan Atkinson, *The Gods That Failed*, (London: Vintage), 2009, chapter 6

9. EIB Statute, Article 20, <http://www.eib.org/about/publications/statute.htm?lang=en>



EIB president Philippe Maystadt announced in 2008 that a breakthrough in transparency had been achieved by the EIB as regards its lending to SMEs via financial intermediaries. The recipient SMEs are now to learn that they are benefitting from EIB loans – but how to find out about these SMEs, and what they are doing with European money?

Joseph Stiglitz, Nobel Laureate for Economics and former chief economist at the World Bank, has notably criticised¹⁰ the IMF for causing great damage as a result of the economic policies it prescribed for developing countries to follow in the 1980s and 1990s in order to qualify for IMF loans or for loans from banks and other private-sector lenders that look to the IMF to indicate whether a borrower is creditworthy. In particular, Stiglitz has pointed out that “Recent advances in economic theory have shown that whenever information is imperfect and markets incomplete, which is to say always, and especially in developing countries, then the invisible hand [of the market] works most imperfectly”.

However the new trend of operating via private financial intermediaries raises additional concerns and a new set of problems. Civil society questions this new approach which could de facto lead to the ‘financialisation’¹¹ of development finance in the long-run – a substantial risk surely in the immediate aftermath of the biggest financial crisis we have lived through in the last 80 years.

Critical questions should be raised particularly in the case of European public finance, of acute relevance to the EIB, given that the new EU Lisbon Treaty sets clear

horizontal objectives for the entire external action of the Union, which should permeate within the definition of any new development finance architecture, the revised trade policy¹² of the EU and the new European single institutional framework on international investment, currently under discussion in Brussels and European capitals, and to be approved by the European Parliament and the European Council in 2011¹³.

Contradictions about how the EU intends ultimately to prioritise development and human rights objectives across the board within its entire external action under the so-called ‘policy coherence for development approach’ clearly emerge in the text of the above-mentioned draft policies and in the new Green Paper by the European Commission on EU development policy in support of inclusive growth¹⁴, in which support for private sector growth and European foreign direct investments in developing countries is still regarded – as a monolithic and unproven assumption – as a key lever for fostering development.

10. Globalization and Its Discontents, Joseph Stiglitz, W.W. Norton & Company, June 2002

11. Financialisation has been variously defined and is understood to include any of the following: ‘the phenomenal expansion of financial assets relative to real activity; the proliferation of different types of assets; the absolute and relative expansion of speculative as opposed to real investment; a shift in the balance of productive to financial imperatives within the private sector whether financial or not; increasing inequality in income arising out of the weight of financial rewards; consumer-led booms based on credit; the penetration of finance into ever more areas of economic and social life such as pensions, education, health and provision of economic and social infrastructure’. [Excerpt from “Whither Development Finance? Elisa Van Waeyenberge and Jeff Powell, Eurodad, June 2010]. In short, financialisation could be seen as the dominating role of financial markets as the mediation and exclusive link between, on the one hand, companies and individuals and, on the other, the needs they might have throughout their lives (pensions, education, health, housing, consuming, etc.).

12. Europe seeks means to ensure fair access, Joshua Chaffin and Daniel Schäfer, Financial Times, 21st October 2010

13. European Commission Communication [2010]343 final, 7th July 2010, Towards a comprehensive European international investment policy

14. European Commission Communication, Green Paper, EU development policy in support to inclusive growth and sustainable development. Improving the impact of EU development cooperation, Brussels, October 2010

Beyond the questionable development rationale and effectiveness of most of these EIB-backed operations, the use of financial intermediaries – including private equity funds – contains many risks in terms of lack of transparency and related possible fraud and corruption, particularly when this is very little information available about the final recipients of EIB funds directed via financial intermediaries. The fact that some of the intermediary institutions are based in tax havens and secrecy jurisdictions amplifies these concerns. To date the EIB has claimed to implement adequate corporate governance screening of its beneficiaries, defined as eligible for its financing because they are “trusted and experienced financial partners¹⁵”, in the words of some EIB officials. Finally, despite some improvements – as a result of civil society pressure in the last 15 years – in the due diligence of the EIB in assessing the environmental, social and human rights impacts associated with its operations, the systemic use of financial intermediaries risks water-

ing down these advances. The responsibility to screen impacts associated with individual operations to be financed is being fully delegated to intermediaries that, in the main, are not development institutions and usually lack adequate in-house environmental, social and human rights expertise. The limited monitoring exerted by the EIB on the intermediaries, beyond fiduciary conditions attached to the disbursed “global loans”, also presents a major limitation.

In short it remains unclear whether the use of intermediaries can, in the end, achieve the goal to promote access to credit for SMEs, which are supposed to be the ultimate beneficiaries of this type of EIB lending and to take the role of main development actors through their contribution to employment creation and economic growth, and consequently to poverty reduction.

15. Telephone interview conducted by Merian Research with officials from the EIB Communications Department in June 2010.

The structure of this report

This report is based on research carried out by Merian Research and commissioned by Counter Balance: Challenging the European Investment Bank to examine all EIB credit lines given to sub-Saharan African countries in the last three years (January 2007-December 2009). The research involved contacts and interviews with EIB officials, as well as with some 25 officers from more than ten different African banks that have received EIB support.

It should be noted that sub-Saharan African countries are classified by the EIB under the Africa-Caribbean-Pacific region category, with the exception of South Africa which stands alone given specific cooperation agreements governing the relationship between the EU and this emerging economy. North African countries, which are part of the Mediterranean region, have not been considered in this research and study, despite the growing attention and lending of the EIB toward this region in recent years.

The report's specific focus on Africa has been chosen given the growing push by international financial institutions to support, with an explicit development justification, financial intermediaries in particular in the poorest countries in recent years. As for the Mediterranean region, although similar problems and concerns do exist, it is also true that the pattern of foreign direct investments in the region is developing along a quite different path

in line with the region's different economic and political contexts.

Regarding sectoral classification by the EIB, of the 17 loans to financial intermediaries identified – and as itemised in Table 1 –13 are regarded by the bank as “credit lines”, while four are named as “individual loans” under the “services” category. It should also be noted that the majority of the operations screened have been financed through the IF, with the exception of the two cases selected in South Africa – not eligible under this specific facility – and two “individual loans” in Nigeria and Western Africa, that have been financed only with the EIB's own resources. This indicates that so far the EIB is not willing at all to take particular risks with its own capital in its lending to Africa, given that financing through the IF – which administers EU member states' budgetary funds – poses no risk for the bank's resources.

A second component of the research also checked the EIB's equity participations into private equity funds and banks operating in Africa, which further invest in a variety of companies and financial institutions. This additional focus has been included because of similar concerns associated with the use of financial intermediaries in the EIB's lending and also due to the growing interest among development finance institutions to regard private equity funds as a primary vehicle for supporting African economies.

All these operations take place via the IF – to date equity participation by the EIB is possible only in sub-Saharan Africa and the Mediterranean region where specific facilities have been established with the remit also to cover direct equity participations by the bank into companies and financial institutions, mainly banks and private equity funds (respectively the IF and the Facility for Euro-Mediterranean Investment and Partnership, FEMIP). Technically all 12 operations screened – as itemised in Table 2 – are classified by the EIB under the “services” sector. It should be added that in the time period considered (2007-2009) only one equity participation by the EIB into commercial banks occurred, namely Capital Financial Holdings in the Central Africa region.

It should be added that EIB support (either through lending or equity participation) to entities named as “micro-finance and microinsurance intermediaries” has been excluded by the research, despite the growing commitments by the bank in this sector in the last two years. Even though the definition of microfinance institutions

and the ways in which these operate also raise concerns, the specific rationale and operationalisation of micro-finance operations would require additional research and an additional analysis.

The report articulates the main findings of the research in three sections that deal with the concerns raised above:

1. the lack of transparency intrinsically linked with intermediated loans;
2. the limited due diligence which has been performed by the EIB so far in most of these operations, and;
3. the dubious development rationale and effectiveness of these operations, particularly when it comes to the EIB’s support for private equity funds.

The report ends with conclusions and specific recommendations flagged for European decision-makers who are urged to define the EIB’s new external lending mandate by early 2011.

EIB FINANCING FACILITIES¹⁶

THE EIB FINANCES A BROAD RANGE OF PROJECTS IN ALL SECTORS OF THE ECONOMY, WITH THE REQUIREMENT THAT PROJECTS MUST ADHERE TO AT LEAST ONE OF THE EIB’S LENDING OBJECTIVES AND BE ECONOMICALLY, FINANCIALLY, TECHNICALLY AND ENVIRONMENTALLY SOUND. FOR NON-EU LENDING THESE OBJECTIVES ARE DEFINED IN THE EXTERNAL LENDING MANDATE OF THE BANK AS WELL AS THE COTONOU FRAMEWORK FOR ACP COUNTRIES.

EIB CLIENTS ARE PUBLIC AND PRIVATE SECTOR BODIES AND ENTERPRISES. AS A RULE, THE BANK LENDS UP TO 50 PERCENT OF THE INVESTMENT COSTS OF A PROJECT.

THE EIB HAS TWO MAIN FINANCING FACILITIES:

1. **INDIVIDUAL LOANS:** PROVIDED TO PROJECTS AND PROGRAMMES COSTING MORE THAN €25 MILLION WHICH ARE IN LINE WITH EIB LENDING OBJECTIVES.
2. **INTERMEDIATED LOANS** (ALSO KNOWN AS “GLOBAL LOANS”): CREDIT LINES – OR INDIRECT LOANS – TO BANKS AND FINANCIAL INSTITUTIONS TO HELP THEM TO PROVIDE FINANCE TO SMEs WITH ELIGIBLE INVESTMENT PROGRAMMES OR PROJECTS COSTING LESS THAN €25 MILLION (€10 MILLION IN THE CASE OF ACP COUNTRIES). MICROFINANCE HAS ALSO BEEN PROVIDED BY THE EIB IN SOME COUNTRIES.

CREDIT LINES ARE GRANTED TO INTERMEDIARY BANKS AND FINANCING INSTITUTIONS IN THE COUNTRY IN WHICH THE PROJECT IS BASED. THESE INSTITUTIONS PASS ON THE EIB FUNDS TO THE PROMOTERS, GENERALLY SMEs AND LOCAL AUTHORITIES. TO QUALIFY AS AN SME, A COMPANY MUST NORMALLY HAVE FEWER THAN 250 EMPLOYEES.

THE CONDITIONS OF FINANCING (INTEREST RATE, GRACE PERIOD, LOAN PERIOD ETC) ARE DETERMINED BY THE RESPECTIVE EIB PARTNER BANK. MATURITIES TYPICALLY RANGE BETWEEN 5 AND 12 YEARS. LENDING DECISIONS UNDER THESE SCHEMES REMAIN WITH THE FINANCIAL INTERMEDIARIES.

PROJECT PROMOTERS ARE REQUESTED TO APPLY DIRECTLY TO ONE OF THE INTERMEDIARY BANKS AND FINANCING INSTITUTIONS, WHICH OPERATE AT THE NATIONAL, REGIONAL OR LOCAL LEVEL. REQUIREMENTS FOR LENDING APPLICATIONS MAY VARY ACCORDING TO THE RESPECTIVE INTERMEDIARY. THE EIB PUBLISHES A LIST OF BANKS AND FINANCIAL INSTITUTIONS ELIGIBLE FOR BEING INTERMEDIARIES FOR INVESTMENTS FINANCED WITHIN THE FRAMEWORK OF THE EIB’S CREDIT LINES.

FURTHERMORE THE EIB CONCEDES **FINANCIAL GUARANTEES** AS WELL AS **TECHNICAL ASSISTANCE** ON SPECIFIC OPERATIONS WITH THE SUPPORT OF THE EUROPEAN COMMISSION UNDER THE IF FOR ACP COUNTRIES AND THE FACILITY FOR EURO-MEDITERRANEAN INVESTMENT AND PARTNERSHIP (FEMIP). IN BOTH CASES THE EIB CONCEDES ALSO PRIVATE EQUITY PARTICIPATION INTO COMPANIES, BANKS AND FINANCIAL INSTITUTIONS, SUCH AS PRIVATE EQUITY FUNDS. FURTHERMORE, UNDER THE IF THE EIB CAN ALSO SUBSIDISE THE INTEREST RATES OF SPECIFIC LOANS WITH A DEVELOPMENT PRIORITY.

THE EIB GROUP HAS A LONG STANDING RECORD IN MICROFINANCE TOO. SINCE 2000, IT HAS SUPPORTED **MICROFINANCE** INSTITUTIONS (MFIs), FUND PROVIDERS AND OTHER INDUSTRY STAKEHOLDERS IN ADDRESSING SPECIFIC MARKET FAILURES AND PROMOTING FINANCING SOLUTIONS FOR MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs) AND LOW INCOME SELF-EMPLOYED. OPERATIONS ARE FINANCED FROM THE EIB’S OWN RESOURCES OR UNDER THE EUROPEAN UNION’S MANDATES AND USES A COMBINATION OF FINANCIAL AND NON-FINANCIAL INSTRUMENTS. THE EIB GROUP HAS TO DATE BEEN ACTIVE IN MICROFINANCE IN SUB-SAHARAN AFRICAN, CARIBBEAN AND PACIFIC COUNTRIES (ACP REGION) AND THE MEDITERRANEAN PARTNER COUNTRIES.

THE EIB GROUP PROVIDES FUNDING TO MFIs IN THE FORM OF LOANS, GUARANTEES AND EQUITY PARTICIPATIONS. THE EIB CAN EITHER BE A DIRECT INVESTOR IN OR LENDER TO MFIs OR INDIRECTLY FINANCE MFIs THROUGH SPECIALISED INTERMEDIARIES, SUCH AS MICROFINANCE INVESTMENT VEHICLES (MIVs) OR MICROFINANCE HOLDING GROUPS, IN WHICH THE BANK CAN ALSO BE AN INVESTOR.

16. Compiled from the EIB website: www.eib.org

ACP FINANCING FACILITIES¹⁷

THE MONETARY AMOUNTS DEVOTED TO FUNDING IN THE ACP COUNTRIES AND OVERSEAS COUNTRIES AND TERRITORIES (OCTs) ARE SET BY THE SUCCESSIVE FINANCIAL PROTOCOLS OF THE COTONOU AGREEMENT.

PROJECT FINANCING BY THE EIB IS PROVIDED THROUGH:

- THE IF WHICH IS FUNDED BY THE EUROPEAN DEVELOPMENT FUND (EDF), I.E. THE EU MEMBER STATES' BUDGET, ALONGSIDE;
- THE EIB'S OWN RESOURCES.

THE IF WAS ESTABLISHED UNDER THE COTONOU AGREEMENT AND THE OVERSEAS ASSOCIATION DECISION FOR PROJECT FINANCING IN THE 77 COUNTRIES WHICH MAKE UP THE ACP GROUP AND THE 20 OCTs. IT IS MANAGED – UNDER MANDATE – BY THE EIB AND IS FUNDED FROM THE RESOURCES OF THE EU MEMBER STATES.

THE IF IS A REVOLVING FUND, I.E. LOAN AMORTISATIONS ARE REINVESTED IN NEW OPERATIONS, WHICH MAKES IT A FINANCIALLY SUSTAINABLE FACILITY. IT PROVIDES FINANCIAL INSTRUMENTS THAT ALLOW FOR SUPPORT OF HIGHER-RISK OPERATIONS.

THE IF SUPPORTS PROJECTS THAT PROMOTE THE DEVELOPMENT OF THE PRIVATE SECTOR AND COMMERCIALY-RUN PUBLIC ENTERPRISES. INVESTMENTS IN THE INFRASTRUCTURE SECTOR AND THE FINANCIAL SECTOR ARE A PRIORITY.

THE IF CONTRIBUTES TO ADD FURTHER VALUE TO OPERATIONS FINANCED BY THE EIB THROUGH THE PROVISION OF GRANTS FOR FINANCING INTEREST RATE SUBSIDIES AS WELL AS, TO A CERTAIN EXTENT, PROJECT-RELATED TECHNICAL ASSISTANCE.



17. Compiled from the EIB website: www.eib.org

Table 1

Intermediated loans included in the research

* IF stands for "via the Investment Facility"

Hit and run development:

Some things the EIB would rather you didn't know about its lending practices in Africa, and some things that can no longer be covered up

	NAME	STATE	INVESTMENT*	CORRESPONDING INTERMEDIARY	DATE
1	BANQUE DE DEPOT ET DE CREDIT DJIBOUTI	Djibouti	€ 2.000.000,00 (loan, services; IF)	• Banque de Dépôt et de Crédit Djibouti	26.05.09
2	BDEAC PRET GLOBAL IV	Central Africa	€ 25.000.000,00 (credit line; IF)	• Banque de Développement des États d'Afrique Centrale (BDEAC)	26.08.09
3	CAPITAL INVESTMENT LINE III	Zambia	€ 20.000.000,00 (credit line; IF)	• Stanbic Bank Zambia Ltd, • Standard Chartered Bank Zambia Ltd, • African Banking Corporation Zambia Ltd, • Finance Bank of Zambia Ltd • Investrust Bank Plc	26.11.08
4	DBSA MUNICIPAL INFRASTRUCTURE LOC	South Africa	€ 60.000.000,00 (credit line)	• Development Bank of Southern Africa (DBSA)	26.06.09
5	ECOBANK REGIONAL FACILITY	West Africa	€ 50.000.000 (loan, services)	• Ecobank Transational Inc.	17.11.09
6	EDFI EUROPEAN FINANCING PARTNERS III	ACP States	€ 100.000.000 (credit line, IF)	• European Financing • Partners III	08.05.09
7	IDC V LINE OF CREDIT	South Africa	€ 60.000.000,00 (credit line)	• Industrial Development Corporation of South Africa Limited (IDC, state-owned)	08.05.09
8	INTERCONTINENTAL BANK	Nigeria	€ 50.000.000,00 (loan, services)	• Intercontinental Bank	28.12.07
9	MALAWI GLOBAL LOAN III	Malawi	€ 15.000.000,00 (credit line; IF)	• Standard Bank, Blantyre • First Merchant Bank • National Bank of Malawi	04.06.08
10	PRET GLOBAL III (GABON)	Gabon	€ 7.000.000,00 (credit line; IF?)	• BGFIBANK Gabon • Banque Gabonaise de Développement (BGD) • FINANCIAL BANK GABON	10.12.07 cancelled on 23.07.09
11	PRET GLOBAL PRO PME II	Cameroon	€ 4.000.000,00 (credit line; IF)	• PRO-PME Financement S.A.	28.06.07
12	NIGER - PG SECTEUR FINANCIER III	Niger	€ 8.000.000,00 (credit line; IF)	• Banque Internationale pour l'Afrique au Niger (BIA), Niamey • Bank of Africa Niger (BOA Niger), Niamey • Société Nigérienne de Banque (Sonibank), Niamey	19.12.08
13	NIGERIA FRAMEWORK LOAN	Nigeria	up to € 240.000.000 (loan, services; IF?)	• First Bank of Nigeria, Guaranty Trust Bank, Stanbic IBTC	15.12.09
14	PRIVATE ENTERPRISE FINANCE FACILITY	Kenya	€ 20.000.000,00 (credit line; IF)	• FINA BANK Nairobi	07.12.07 "No funding requests made by the intermediary Bank, and facility subsequently expired"
15	PEFF-UGANDA	Uganda	€ 30.000.000,00 (credit line; IF)	• Allied Bank International (ABI), • Barclays Bank of Uganda (BBU), • Crane Bank, • Diamond Trust Bank Uganda (DTBU), • East African Development Bank (EADB), • DFCU Ltd., • Nile Bank.	31.08.07
16	RWANDA GLOBAL LOAN III PRIVATE SECTOR SUPPORT	Rwanda	€ 5.000.000,00 (credit line; IF)	• Banque de Kigali	25.05.09
17	RW - GL II PRIVATE SECTOR SUPPORT	Rwanda	€ 10.000.000,00 (credit line; IF)	• Banque Rwandaise de Développement (7 million) • Banque Commerciale du Rwanda (3 million)	21.12.06 02.02.07

Table 2

EIB-backed private equity funds included in the research

* All operations via the Investment Facility and classified under “services”

	NAME	STATE	INVESTMENT*	CORRESPONDING INTERMEDIARY	DATE
1	ADLEVO CAPITAL AFRICA	Mauritius	€ 13.983.080,00	• Adlevo Capital Africa LLC	17.10.08
2	AFRICAP II	Mauritius	€ 4.014.388,00	• AfriCap Microfinance Investment Company Ltd Mauritius	25.10.07
3	AFRICINVEST FUND II LLC	Mauritius	€ 20.000.000,00	• African Capital Partners LLC Delaware (affiliate of Tun-invest Finance Group SA)	19.12.08
4	AGRI-VIE FUND PCC	Mauritius	€ 7.987.752,00	• SP-Aktif Investments (Pty) Ltd Durbanville • Sanlam Private Equity Ltd South Africa	30.12.09
5	ATLANTIC COAST REGIONAL FUND	Mauritius	€ 14.590.205,00	•	18.07.08
6	AUREOS AFRICA FUND	Mauritius	€ 27.146.251,00	• Aureos Capital Limited Mauritius	02.09.08
7	CAPE III (Capital Alliance Private Equity III Limited)	Nigeria	€ 30.000.000,00	• African Capital Alliance Ltd Lagos	15.05.09
8	FIPA - ANGOLA PRIVATE EQUITY FUND	Luxembourg	€ 4.054.054,00	• Angola Capital Partners LLC Delaware	04.11.09
9	GROFIN AFRICA FUND		€ 14.146.272,00	• GroFin	14.08.09
10	PAN-AFRICAN INVESTMENT PARTNERS II LTD	Mauritius	€ 28.372.819,00	• Kingdom Zephyr Africa Management Company New York	26.06.09
11	SHORECAP II	Cameroon	€ 9.984.690,00	• US Financial Institution.	21.12.09
12	CAPITAL FINANCIAL HOLDINGS	Luxembourg	€ 5.000.000,00	• Commercial Bank -Cameroun (CBC) • Commercial Bank Tchad (CBT) • Commercial Bank-Centraafrique (CBCA)	11.12.07

Hit and run development:

Some things the EIB would rather you didn't know about its lending practices in Africa, and some things that can no longer be covered up

Table 3

EIB EXTERNAL LENDING THROUGH FINANCIAL INTERMEDIARIES (“credit lines/global loans” only)

YEAR	CREDIT LINES	TOTAL	% OF TOTAL	INCREASE OF % CREDIT LINES/TOTAL AGAINST 1999
2009	3186	8597	37.06	112,71%
2004	995	3543	28.08	61,19%
1999	703		17.42	

EIB Annual Report, Statistical Data , years 1999, 2004, 2009

Some intermediated loans to individual financial intermediaries have been classified as services thus are not counted in these figures.

Table 4

EIB use of credit lines per region outside EU in last five years

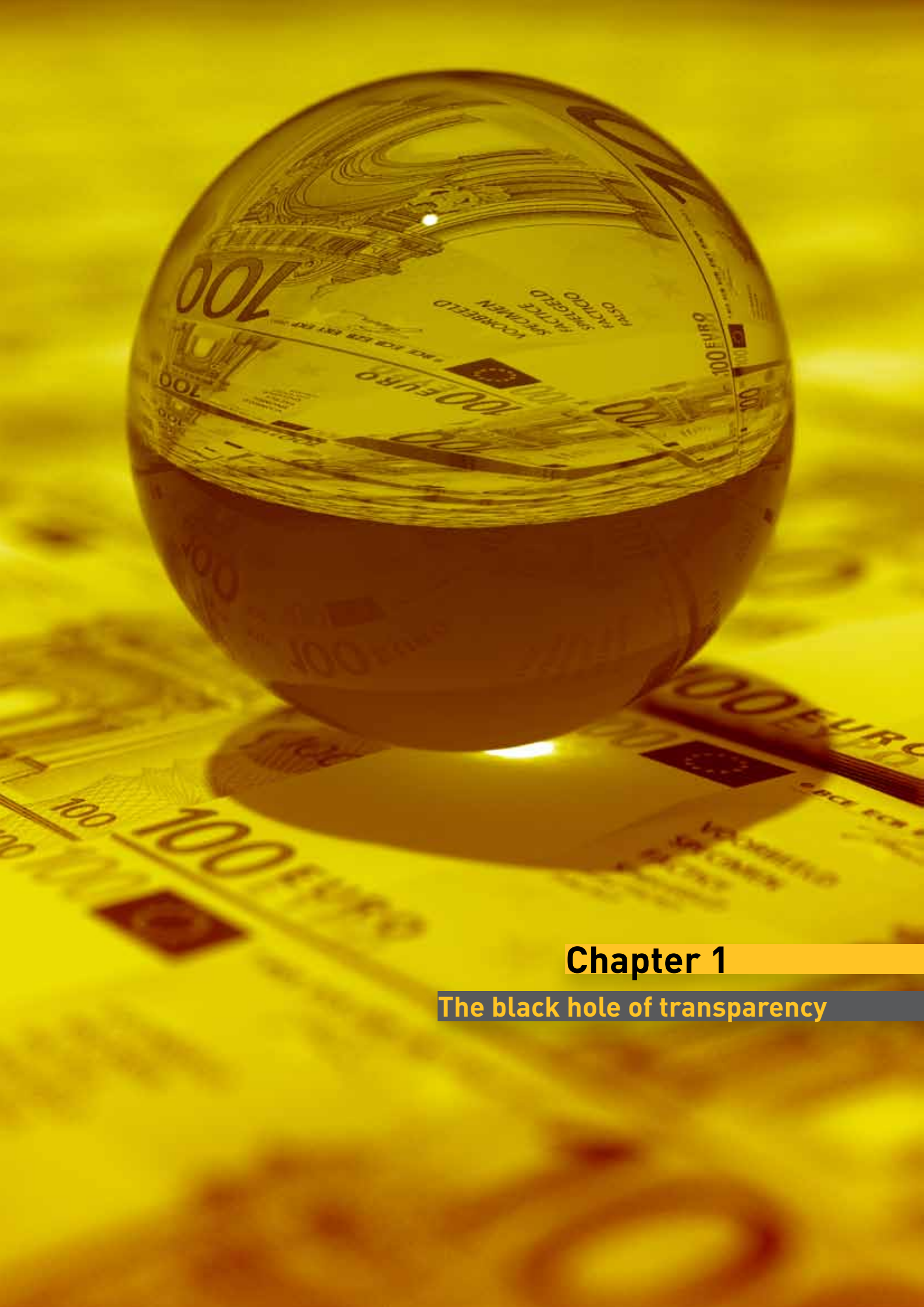
REGION	CREDIT LINES	TOTAL LENDING (IN MILLIONS OF €)	AVERAGE PERCENTAGE OF CREDIT LINE AGAINST TOTAL LENDING
TOTAL 2005-2009	8890	30295	29.34
Euro-Med	1282	6810	18.82
ACP-OTC	1319	3465	38.07
South Africa	120	821	14.62
ALA	423	3921	10.78
Eastern Neighbours	5746	15278	37.60

Source

EIB Annual Report, Statistical Data , years 2004

Hit and run development:

Some things the EIB would rather you didn't know about its lending practices in Africa, and some things that can no longer be covered up



Chapter 1

The black hole of transparency

When it comes to assessing the credit lines of the EIB, a critical issue is their structural lack of transparency. This is evident throughout the assessment and approval process with the intermediary banks, in the allocations to the financial beneficiaries as well as the due diligence (or lack of) on the final destination of the funds.

Even though the EIB grants all global loans in Africa with a guarantee from the EU member states, it provides next to no information on where this money ends up. Moreover, in the case of the EIB's private equity participation in specific funds, although the direct ownership should permit the EIB to play an even more active role in the financial companies it invests in – including granting the possibility of ensuring more disclosure of information – in reality the level of transparency remains close to zero.

In recent years repeated requests made by civil society to the EIB and the financial intermediaries for specific information has been met with a wall of silence – 'confidentiality agreements' and non-disclosure clauses are the most common grounds for EIB stonewalling. As the findings of this report show, however, there is cause for alarm about this black hole at the heart of the EIB's operations in the developing world.

Committed to transparency, but...

The reasons why the EIB, in spite of its stated commitment to transparency and its willingness to collaborate with all stakeholders, discloses no information on the destination of its global loans once they arrive at local banks and intermediaries, are primarily because of commercial confidentiality and "competitive interests" in the banking sector. A typical EIB response to a request for information on global loans reads:

"Concerning your request for project details, however, please note that the Bank does not disclose information on individual allocations made by local banks to support investment by their own customers under credit lines established with the EIB. This information falls within the competence of the intermediary bank as part of the normal business relationship between a bank and its customers (§5.2.10, p9 of the Bank's Transparency Policy)"¹⁸.

The only exception is for global loans that have been fully disbursed. For such cases, and after repeated requests, the EIB disclosed to Counter Balance the number of allocations and the percentage of these per sector of intervention – this applies only to one of the 17 credit lines researched for this report¹⁹.

In general, the beneficiary banks, on their side, remain reserved about the projects that have received the EIB's global loans. Usually projects and enterprises are granted credit facilities, financed up to a maximum of 50 percent by the EIB loan, whilst the other 50 percent is derived from the resources of the local bank or other investors. With respect to this point the EIB has clear views too: "Please also note that although the EIB encourages the intermediary banks to make available information covering its relationship with the EIB, they are often not at liberty to share their clients' information with (...) civil society, due to confidentiality agreements²⁰."

Notably, in the course of researching this report, EIB staff provided contradictory information to the report researchers. Furthermore, commitments from the EIB to send information additional to the little released so far – once different departments within the bank have cleared the scope of the information requests made on the selected operations – have not materialised at the time of publication. This illustrates the controversial nature of the EIB's approach to information disclosure when it comes to global loans.

For instance, one contacted EIB officer provided significant information about a credit line to FINA Bank of Kenya. At first the officer talked about the loan to FINA Bank having been stopped "due to recent troubles in Kenya". In the IF report for 2009, while it is reported that no money has yet been transferred to FINA Bank, on the EIB's website the loan's status is noted as approved, without additional specification. Only subsequently did the EIB inform that: "No funding requests were made by the intermediary Bank (FINA Bank) and the facility subsequently expired²¹."

More generally, once these type of loans are granted and transferred, the EIB claims to conduct spot tests, sending its staff on-site to selected projects. The banks chosen to act as intermediaries in order to on-lend to SMEs and projects are – according to an EIB officer – "trusted and experienced financial partners". Yet as the analysis developed in the second chapter of this report will show, there are serious questions about the ability of the EIB to choose authentic trusted and experienced partners – at least from a development perspective – and to adequately verify results on the ground.

18. EIB, 2010. EIB Mail on credit lines, 28 June.

19. EIB reply to CEE Bankwatch Network request in October 2010; PRET GLOBAL PRO-PME II: 30 allocations; Country: Cameroon; Sectors: Transportation and Storage (42%), Manufacturing (17%), Accommodation and Food Service Activities (12%), Human Health and Social Work activities (9%), Education (6%), Water Supply, Sewerage, Waste Management and remediation activities (5%), Agriculture, Forestry and Fishing (4%), Construction (3%), Wholesale and retail trade (2%).

20. EIB, 2010. EIB Mail on credit lines, 28 June.

21. EIB, 2010. EIB Mail on credit lines, 28 June.

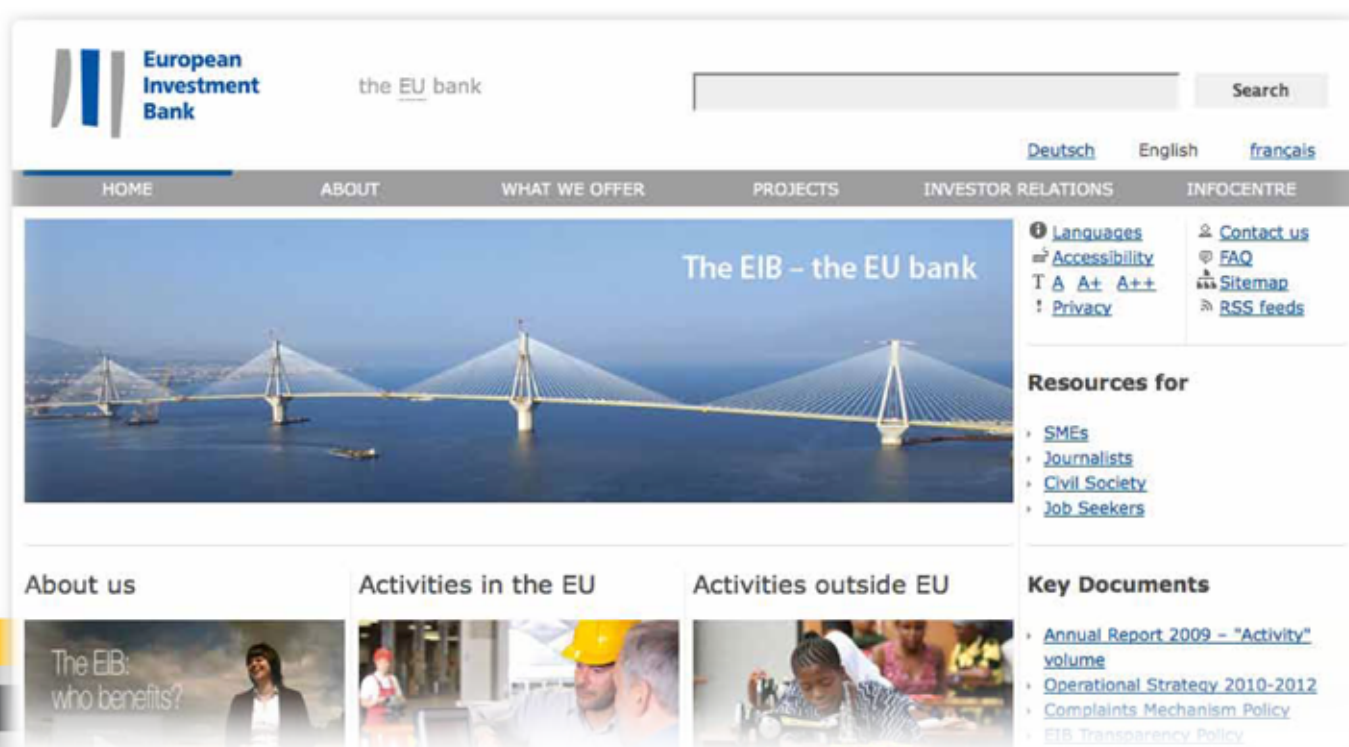
Who does not want to disclose in the end – the EIB or the intermediary banks?

What happens, then, when enquiries are made directly to the intermediary banks regarding how this money, funded and backed by EU taxpayers, is being spent? The buck gets passed back to the EIB. Nonetheless, the EIB appears reluctant to encourage intermediaries to disclose at least some details regarding the global loans they have been allocated

Moreover, most contacts at the intermediary banks keep detailed information under wraps due to confidentiality agreements with the EIB. For instance, Lerato Mangope, head of corporate finance at the Industrial Development

Company of South Africa, informed us that she would have to ask for the EIB's permission in order to provide us with the names of a few examples of projects financed. Notably, while copying researchers in a mail to the EIB, Mangope wrote: "Please advice (sic) if you could speak to Claudia Apel, regarding the questions posed to IDC. I would not want to breach any confidentiality or contractual agreements. I am sensitive (sic) to provide information about our clients."

Well beyond this specific case, this is a standard response received from many banks that have been granted global loans by the EIB – it is next to impossible to gather information about particular projects financed with EIB money under this particular investment model.



The EIB's website: recently given an attractive facelift, but still not forthcoming about the destinations or the results of global loan investments.

Not much better on the web

Information provided on the EIB's website regarding the loans signed is quite often incomplete and misleading. Time and again the EIB publishes details of global loans signed for specific countries and with particular financial intermediaries, yet on closer inspection this turns out not to be the case.

Take, for example, the Malawi Global Loan III for €15 million – published on the EIB's website under Nat Bank. Yet, it transpires that Nat Bank did not take up this loan apparently due to the EIB's 'onerous conditions'²². The loan has inexplicably ended up with First Merchant Bank,

where only €5 million has been disbursed so far. Other cases include: Pret Global Loan III (Gabon) for €7 million, cancelled²³ – yet the EIB does not provide this information in the loan profile on its website²⁴; and the Private Enterprise Finance Facility of €20 million for Fina Bank of Kenya²⁵ – the loan apparently has been stopped due to 'recent troubles in Kenya'²⁶.

These are just three examples out of many, and notably you would not know any of this from the EIB's published information about these loans. It lists the original details as though nothing has changed, and will provide limited information only after repeated requests.

22. See: <http://www.eib.org/projects/pipeline/2006/20060177.htm>

23. EIB, 2010. EIB Mail on credit lines, 28 June.

24. EIB, 2010. EIB Mail on credit lines, 28 June.

25. See: <http://www.eib.org/projects/press/2007/2007-132-fina-bank-partners-with-european-investment-bank.htm>

26. EIB, 2010. EIB Mail on credit lines, 28 June.

Furthermore, in the case in Malawi, our researchers concluded that not just incomplete or contradictory information may have been provided by the EIB, but also inaccurate information. Nat Bank Malawi claimed that another bank, NBS Bank Malawi, instead accessed the loan. However, this information turned out not to be true, with NBS Bank also denying that it had accessed the loan. Ultimately it is still unclear if that part of the global loan to Malawian banks has been granted to other intermediaries involved in the operation or to others, yet the EIB does not seem to regard this as a problem – its website continued to carry incorrect information at the time of publication.

It further emerges, as a quite common practice and feature, that it can take some time for the disbursement

of EIB global loan funds to begin – though the reasons for this are unclear. For instance, this is the case of the BDEAC Prêt global IV: granted in August 2009 and not yet disbursed²⁷. The same applies with the Rwanda Global Loan III, granted in October 2009²⁸.

Finally, it is legitimate to wonder about the specific ownership and organisational features – and, ultimately, the past records and priority fields of intervention – of the so-called ‘trusted and experienced financial partners’ that the EIB maintains that it cooperates with. Other than a general list of intermediaries classified per region on the EIB website, additional relevant information about these institutions is lacking.

At stake: public interest versus commercial interests

The lack of transparency on the part of the EIB hides not only the real results of the global loans signed in Africa – there are also information gaps regarding loans not taken up, not spent or cancelled due to any number of reasons ranging from poor EIB conditions to suspected fraud.

The overall lack of transparency also masks possible incompetence from the EIB in its administering of the global loan process and its allocating of funding, including its poor choices of what are supposed to be ‘trusted partners’, and the lack of adequate due diligence on banks, their associates and the projects funded..

Crucially, the prevailing lack of transparency allows the EIB to not disclose the real beneficiaries of its funding, allowing it to argue that global loans are beneficial simply because they have been allocated to the intended market. When there is no effective way of verifying such claims, as no information is published on where these loans end up, this cannot be accepted.

Furthermore, what sort of follow up or due diligence is carried out on the recipients of the global loans? The EIB claims that its staff are sent on-site to conduct spot checks on selected projects. Perhaps not surprisingly, if any such checks do take place, no results are published.

No more excuses

As the examples above show, the EIB is not conducting itself adequately when it comes to global loans in Africa. It cannot be permitted to continue to operate in this manner, where minimal transparency allows the bank to mask its poor record. There can be no excuse for not publishing accurate, up to date information on the EIB website regarding the true levels of disbursement for global loans. There is also no excuse for publishing neither details on the intermediaries involved nor the background due diligence checks conducted on these entities and their management boards.

Ultimately, while there is a case for privacy and confidentiality at the borrower level to be maintained, there is no excuse for not disclosing general details regarding projects funded, including the nature and size of the final beneficiary companies and any links they may have to the intermediary banks through related third parties and entities. This information is known to the EIB, so it ought to be made available and published on its website.

An EU guarantee is in place for all such African global loans. As such the public is entitled to know how, to whom and where its publicly backed funding is being allocated by the EIB, and what kind of job the EIB is doing to keep track of these large sums of development finance.

27. EIB, 2010. EIB Mail on credit lines, 28 June.

28. EIB, 2010. EIB Mail on credit lines, 28 June.

Chapter 2

The black hole of due diligence



A second general set of concerns regards the due diligence carried out by the EIB in the case of credit lines given to financial intermediaries and the bank's support for private equity funds.

The EIB has often been criticised for lagging behind other multilateral development banks as far as the adoption and implementation of environmental and social safeguards policies are concerned – policies which ought to minimise any harm associated with EIB financed projects. Civil society pressure, as well as repeated requests from the European Parliament over the last decade, have led to improvements in some of the EIB's policies in this regard, although actual practice on the ground remains questionable in several cases²⁹.

The growing use of intermediated loans and private equity funds threatens to reverse this trend, given EIB delegation to financial intermediaries of the due diligence on impacts associated with individual projects that the latter are funding with money derived from EIB global loans or through the participation of EIB equity.

It is fair to add that, in general, the practice of delegating the responsibility for due diligence to other financial entities is a growing feature within development finance. Concerning lending to public institutions, most donors have embraced the country system approach, through which due diligence and environmental and social assessments are delegated to host governments which then disburse funds. In the case of so-called budget support mainly conceded by the European Union, funds are directly used by governments in line with transparent priorities set out in national development strategies.

While this trend is to be welcomed as it encourages developing countries' emancipation from economic conditionalities attached by donors to grants and loans for them, it still raises questions about the attendant decrease of accountability for donors and international financial institutions which are no longer regarded as being primarily responsible for the appropriate and useful use of public funds.

Given the complete lack of information about specific environmental and social due diligence carried out in the case of the 17 credit lines and intermediated loans analysed by the research on which this report is based, it is worth at least assessing what the EIB – which primarily lends to the private sector – claims to do in the case of financial intermediaries, and also looking at where there are major conceptual shortcomings and risks in this new practice of delegating due diligence responsibility to private sector entities.

Environmental and social assessment of EIB intermediated loans

The EIB's social and environmental standards, which are described in the "Statement of Environmental and Social Principles and Standards"³⁰ approved in 2009, apply to all forms of EIB operations, both in the public and the private sector. Nevertheless, in all EU, candidate and potential candidate countries, environmental and social standards apply without qualification, while outside the EU these principles and standards are used only as benchmarks. The environmental and social assessment is a part of the EIB project's due diligence and it depends on the type of operation in question.

Intermediated or "global" loans are characterised by the fact that the final beneficiaries and their projects are not known at the stage of the EIB's ex-ante environmental and social assessment, nor even before the loan contract is signed with the intermediary financial institution. **Therefore it is not possible to identify the potential environmental and social impacts of individual loans given by the intermediary to the ultimate beneficiaries at the stage of the EIB's project due diligence.**

According to the EIB's "Environmental and Social Practices Handbook"³¹ – an operational document which describes the EIB's environmental and social due diligence – the EIB may carry out an environmental and social assessment of a particular global loan operation, which would include an assessment of the approach and capacity of the intermediary institution, and of the context in which it operates.

As a result of the preliminary appraisal, the EIB must confirm the following statements:

- The financial intermediary will undertake to promote compliance of the sub-projects with relevant national and EU law.
- Compliance with EU, national and international environmental legislation will be made a condition for each sub-project under the granted Global Loan.
- All sub-projects financed under the proposed loan will, by virtue of conditions in the loan contract, be required to comply with the relevant national legal framework, be acceptable in environmental terms to the EIB and be in line with EU environmental policy and law.
- The borrower/promoter has a proven track record of good environmental management, including the capacity to evaluate an environmental impact assessment, where required, according to the environmental assessment principles, standards and practices applied by the EIB.

29. For instance, in the case of the Bujagali Dam in Uganda – the largest ever private energy project in Africa and financed by the EIB since 2007 – earlier this year local communities, with the support of Ugandan and international lawyers, filed a formal complaint to the internal grievance mechanism of the EIB concerning the lack of adequate compensations for land expropriation and other violations of EIB environmental and social standards in the context of the project; the outcome of this complaint is still pending. Similarly in the case of the Mopani copper mine in Zambia, one of the world's largest and where project contracts are being renegotiated, the local population still has several outstanding safety concerns after previous acid leaks into drinking water sources. These have to be addressed by the Zambian government, project sponsors and international financiers. For more information, see the Counter Balance website: www.counterbalance-eib.org

30. Available at: <http://www.eib.org/about/publications/environmental-and-social-principles-and-standards.htm>

31. Available at: <http://www.eib.org/about/publications/environmental-and-social-practices-handbook.htm>

The EIB declares that all projects financed through financial intermediaries are covenanted to comply with appropriate environmental legislation and – if finance is being provided outside the EU – national legislation, with reference to EU legislation. However, at the stage of ex-ante appraisal, a particular global loan is assessed from an environmental and social point of view (for example an assessment of the environmental risk management capacity of the financial intermediary) only if this is requested by the EIB's operations directorate. At its discretion and on its request, the EIB may also assess individual sub-projects under a global loan operation. Usually the specific appraisal and approval of individual allocations is the responsibility of the intermediary institution.

Therefore the EIB's environmental and social assessment is focused only on the environmental and social capacity of the financial intermediary, and this is supposed to be tracked over time and based on quantifiable evidence obtained from the intermediary itself. Thus the EIB seeks to check what is the level of understanding and competence of the financial intermediary in social and environmental issues. The EIB would, therefore, be expected to look into the financial intermediary's environmental and social management procedures, and check if the intermediary has a public policy on environment and social issues, as well as corporate responsibility, agreed by its board. The EIB also checks the intermediary's adherence to certain international standards such as ISO 14001, AA1000, Extractive Industries Transparency Initiative (EITI), the World Commission on Dams, Global Compact, Equator Principles as well as whether the intermediary has been audited for compliance with the above standards and whether it possesses enough expertise and capacity to implement its own policy. The EIB also looks into the track record of the financial intermediary and its own previous experience with this institution.

The EIB assists financial intermediaries to ensure that environmental and social standards are met through the "Guidelines for Financial Intermediaries handling EIB Global Loans outside of the EU", which are included in the above-mentioned handbook. The EIB assumes that the project in question does not require a formal environmental impact assessment (EIA), however in cases where an EIA is required by national or EU law, the project must be assessed independently by the EIB. For this purpose, the financial intermediary prepares a file with the project description as well as information related to its environmental impact and the proposed mitigation and/or compensation measures.

Therefore it is evident that, other than in exceptional cases, the EIB's environmental and social assessment of global loans is limited to the assessment of financial

intermediaries' capacity to deal with these matters. The financial intermediary is the one responsible for assessing the potential final project against its compliance with the EIB's environmental and social standards. It means that all the final projects, even those which may have a significant negative impact on the environment, are exempted from the EIB's direct scrutiny; the application of EIB standards, then, is only indirect and depends to a large extent on the financial intermediary's capacity to properly assess its projects. It should be noted that some of the intermediaries in question do finance operations in sectors that tend to involve high impacts, such as the extractives and energy sector.

Given that financial intermediaries, no matter their country of origin or where they are based, are usually commercial banks, it is not unreasonable to assume that their primary goal is not to ensure that projects conform with high environmental standards – they may limit their assessment to receiving all necessary project permits and formal consents from the final beneficiary. **However this does not often guarantee that the project is environmentally and socially sound.** In the case of EIB support for private equity funds, these concerns are only magnified.

It should also be noted that the EIB receives a list of final projects in advance of the loan tranche disbursement. Yet even for those final projects which require an EIA, the EIB refuses to take direct responsibility for their appraisal. The complete lack of disclosure of information about individual operations financed by financial intermediaries also prevents due public scrutiny over projects with significant environmental impacts and which require public consultation.

In the EU most public environmental and social concerns are mitigated by European standards which have been developed over time and practice, and usually involve – when necessary – public consultations and access to information. **For projects in developing countries, however, the lack of transparency that is so often a feature can easily result in situations where some projects in fact do not comply with the standards that the EIB claims it applies to all the projects it finances.**

Finally, there is persistent lack of clarity regarding the level and scope of the EIB's monitoring of results associated with its intermediated loans. The use of intermediaries disbursing smaller loans to SMEs necessarily includes the possibility that some operations might default or not perform as requested. All the same, the environmental, social and broader development performance of these operations remains unclear. The EIB has informed civil society that it checks some of the individual sub-loans disbursed by financial intermediaries. However the framework and scope of this monitoring remains vague and, overall, is inadequate if compared with the significant risks that are part and parcel of the use of financial intermediaries in countries outside of the EU.

A thorough corporate screening as part of ex-ante due diligence?

In reaction to the EIB's delegation of responsibility to the financial intermediaries to perform due diligence on each individual operation funded through a global loan, civil society has regularly challenged the EIB about the need to carry out a thorough "corporate screening" of the intermediaries, as well as of all other private companies benefiting from individual EIB loans. That would mean an ex-ante screening of the past record in terms not just of environmental damage, social problems, human rights violations, but also of corruption, fiscal and other economic crime allegations affecting corporations which are supposed to benefit from EIB support.

The EIB claims that most of these issues are already covered by analyses carried out by its corporate compliance office within the wider risk analyses performed by the bank, in particular where corporate governance and corporate integrity issues are concerned. However, as EIB president Philippe Maystadt admitted in June 2010 at a public meeting in London, the need to perform a comprehensive corporate screening, including screening of the past human rights records of corporations, is currently under discussion within the EIB. This suggests that more can and should be done on the side of the bank, including on financial intermediaries.

The EIB publishes a list³² of intermediary banks and financial institutions for credit lines both in countries within and outside the EU. No specific list is available for private equity funds, despite these funds in practice performing a similar function of financial intermediation, only on the equity side. It is unclear whether the institutions listed perform specific corporate screening – well beyond the specific context of individual credit lines – that is sufficient to make them eligible for EIB support.

As regards private equity funds, thorough corporate screening is even more urgent. In recent years numerous cases of aggressive behaviour by private equity funds have been denounced to oversight authorities and governments in developed countries, in particular when it comes to the asset stripping of listed companies that

these funds invest in with a "short-term and high return" attitude. More specifically, in the case of investments in developing countries, private equity firms tend to buy companies before they are listed and sold for a much higher value, and in order to make them more appealing they cut costs – in particular, labour costs are often among the first things to be targeted. Similarly, it is crucial to understand and get to the bottom of who screens other investors in these funds in which the EIB also participates: what is their corporate record, and what are the overall strategies pursued by these funds to generate sufficient and high returns for their investors?



Knocking on haven's door?

The request for a thorough corporate screening of EIB beneficiaries became particularly pressing in the context of the fight against tax avoidance and the abuse of tax havens by companies and banks benefiting from EIB support.

In order to respond to civil society concerns and pressure from the international community – and in particular from some European governments – as formulated in the recommendations of the G20 London Summit in April 2009, the EIB adopted in August 2010 an "Interim revised policy towards offshore financial centres"³³, that means tax havens and secrecy jurisdictions. Compared with its approach up to that point and with the practice of other IFIs, the EIB made – on paper at least – a significant step forward.

32. Available at: <http://www.eib.org/about/news/the-intermediary-banks-and-financing-institutions-for-credit-lines.htm>

33. Available at: <http://www.eib.org/about/news/eib-publishes-interim-revised-policy-on-offshore-financial-centres.htm>

In particular the bank decided to explicitly refuse to support operations linked with prohibited jurisdictions – besides domestic projects – and to request that operations practiced in monitored jurisdictions undergo an enhanced vigilance by complying with precise ex-ante requirements. For instance, the request of business relocation for some activities registered in offshore financial centres. The EIB also hinted at the possibility of developing a more stringent definition of offshore financial centres and prohibited jurisdictions if country lists developed by lead international organisations prove not to be adequate – if one considers that the black list of the OECD is once again empty today, these lists are indeed proving to be inadequate.

However, in spite of these improvements and public commitments, the whole architecture of the EIB's policy is primarily based on the OECD exclusion lists, which are proving to be ineffective for discouraging the abuse of tax havens by the private sector. This clearly emerges in the findings of our research concerning the 12 private equity funds supported by the EIB in 2007-2009.

The fund screening proved that more than 60 percent of private equity funds in which the EIB invests are registered in Mauritius, where, according to the EIB, "the comprehensive regulatory framework favors private sector development"³⁴. Moreover, two more EIB-backed funds are registered in Luxembourg. In short, it is no secret that most of the speculative funds, such as private equity funds and hedge funds, are incorporated in tax havens – and the EIB is willingly supporting them by taking on equity participation.

Beyond this, the corresponding intermediaries and fund managing companies of the funds screened are to be found registered in Mauritius as well as in Delaware (Africinvest Fund II LLC and Angola Capital Partners). Two of the companies funded through Agrie-Vie Fund – thus two ultimate beneficiaries – are not even registered in South Africa alongside the fund itself, but in tax-advantaged London (UK) and The Hague (Netherlands).

It is thus legitimate to reflect on how much the EIB's new policy against tax havens will be able to curb these perverse connections, connections which inevitably emerge when the EIB is willing to operate via private equity funds. Couldn't – and shouldn't – the EIB instead involve itself in equities in less secretive funds which, by actually paying taxes, contribute to the development of African countries?



These pictures are taken in the house of the former governor of Nigeria's Delta State, James Ibori is accused of stealing \$290 million from his own state.

A zero-tolerance fight against corruption?

Corruption – broadly defined as "the abuse of public or private office for personal gain" – takes many forms, from petty extortion to the amassing of personal wealth through embezzlement or other dishonest means. Its corrosive impacts on development and on democratic accountability have been widely documented³⁵. Moreover, corruption is not a victimless crime. As former UK Secretary of State for International Development, Hilary Benn, bluntly stated in 2006:

"In poor countries [corruption] can kill. Money meant for drugs for a sick child, or to build a hospital, can be siphoned off into overseas bank accounts or to build a luxury house".

34. EIB, 2009. EIB joins forces with international development organisations to provide technical assistance grants to African microfinance ventures, 21 April. See: <http://www.eib.org/projects/press/2009/2009-063-eib-joins-forces-with-international-development-organisations-to-provide-technical-assistance-grants-to-african-microfinance-ventures.htm>

35. See, for example:

United Nations, 'The Monterrey Consensus of the International Conference on Financing for Development: Leading Actions', 2002, http://www.un.org/esa/sustdev/documents/Monterrey_Consensus.htm

World Bank, 'Corruption, Poverty and Inequality',

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTANTICORRUPTION/0,,contentMDK:20222075%7EmenuPK:1165474%7EpagePK:148956%7EpiPK:216618%7EtheSitePK:384455,00.html#top>

Why Worry About Corruption? Paulo Mauro, 1997 IMF Publication

<http://www.imf.org/EXTERNAL/PUBS/FT/ISSUES6/INDEX.HTM>

36. Hilary Benn, Secretary of State for International Development, 'Governance and Development', speech at Holyrood, Edinburgh, 22 June 2006, <http://www.dfid.gov.uk/news/files/Speeches/governance-development.asp>



Worldwide, bribery and embezzlement have permitted billions of dollars to be amassed by corrupt politicians. Nigeria's former President Abacha is estimated to have embezzled between \$2 billion and \$5 billion; DRC's President Mobutu, an estimated \$5 billion. Kenya lost \$600 million in one scandal alone in the early 1990s, while in Angola an estimated \$4 billion went missing between 1997 and 2002³⁷.

It would be wholly inaccurate, however, to characterise corruption as a problem solely of the South. No country is immune³⁸. Corruption flourishes wherever the powerful are able to undermine the rule of law for personal gain. It is as common in the north as it is in the south. Moreover, much of the corruption that takes place in developing countries is possible only with the complicity – active or passive – of northern financial institutions, which enable bribes and other forms of corrupt wealth to be laundered through “legitimate” investments, often in northern economies.

Recognising the role played by northern companies and financial institutions in facilitating corruption, the EIB has made strong statements against corrupt practices

in recent years. Launching the EIB's revised Anti-Fraud Policy in 2008, EIB president Philippe Maystadt stated that, “It is our responsibility to ensure the proceeds of EIB loans are not misused and this policy therefore reflects our determination to be ever vigilant in seeking to combat fraud and corruption in EIB-financed activities.”

The Anti-Fraud Policy states the EIB's commitment to “‘zero tolerance’ of corruption, fraud, collusion, coercion [and] money laundering³⁹”. It adds too that: “The EIB is committed to ensuring that its loans are used for the purposes intended and its operations are free from prohibited practices,” and that, “the Bank will work to prevent and deter prohibited practices [and] money laundering⁴⁰.” However two specific cases investigated by civil society organisations raise concerns over the due diligence conducted by the EIB in its dealings with a private equity firm, Emerging Capital Partners (ECP), that the bank supported financially in 2006, and subsequently with a Nigerian private commercial bank, Intercontinental, which after being financed by ECP then received an additional loan directly from the EIB at the end of 2007.

ECP has invested in Nigerian companies that are 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. Mr. Ibori is currently under investigation by Nigeria's Economic and Financial Crimes Commission (EFCC) for alleged corruption. The EIB's failure to prevent these investments – see the Box below – points to major problems with the bank's due diligence process and anti-fraud procedures, as well as calling into question its increasing reliance on private equity investments as part of its development work.

What is more disturbing, however, is that the EIB lent again at the very end of 2007 to Intercontinental Bank of Nigeria, one of those financial institutions already investigated by EFCC in 2007.

37. The World Bank, Global Monitoring Report 2006: Millennium Development Goals – Strengthening Mutual Accountability, Aid, Trade and Governance, World Bank, 2006, p.177,
<http://siteresources.worldbank.org/INTGLOBALMONITORING2006/Resources/2186625-1145565069381/GMR06Complete.pdf>

38. “Foreword”, United Nation Convention Against Corruption,
http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf

UNCAC states: “Corruption is an insidious plague that has a wide range of corrosive effects on societies. It undermines democracy and the rule of law, leads to violations of human rights, distorts markets, erodes the quality of life and allows organized crime, terrorism and other threats to human security to flourish. This evil phenomenon is found in all countries – big and small, rich and poor – but it is in the developing world that its effects are most

39. EIB Board of Directors Approves Anti-Fraud Policy, 8 May 2008, <http://www.eib.org/about/news/eibboard-of-directors-approves-anti-fraud-policy.htm?lang=en>

40. POLICY ON PREVENTING AND DETERRING CORRUPTION, FRAUD, COLLUSION, COERCION, MONEY LAUNDERING AND THE FINANCING OF TERRORISM IN EUROPEAN INVESTMENT BANK ACTIVITIES, July 12 2007, Articles 3 and 4. See: <http://www.eib.org/about/documents/anti-fraud-policy.htm>

THE CASE OF INTERCONTINENTAL BANK, NIGERIA

THE EIB AGREED A €50 MILLION LOAN TO THE INTERCONTINENTAL BANK PLC LAGOS ON 28 DECEMBER 2007⁴¹, WITH THE AIM OF FINANCING SMALL AND MEDIUM SCALE HEALTH AND EDUCATION PROJECTS IN NIGERIA. APPARENTLY NO DISBURSEMENT HAS TAKEN PLACE TO DATE⁴².

IN AUGUST 2009, AFTER THE OUTBREAK OF NIGERIA'S BANKING AND FINANCIAL CRISIS, ERASTUS AKINGBOLA, AT THAT TIME MANAGING DIRECTOR OF INTERCONTINENTAL BANK, WAS SACKED BY THE CENTRAL BANK OF NIGERIA (CBN) AND FLED TO LONDON. AKINGBOLA HAD BEEN REMOVED FROM HIS POSITION BY THE CBN BECAUSE OF "POOR CORPORATE GOVERNANCE PRACTICES, LAX CREDIT ADMINISTRATION PROCESSES, ABSENCE OR NON ADHERENCE TO THE BANK'S CREDIT RISK MANAGEMENT PRACTICES"⁴³.

THE FEDERAL HIGH COURT IN LAGOS, ON 31 DECEMBER 2009, GRANTED AN INJUNCTION, FREEZING THE LOCAL AND INTERNATIONAL ASSETS OF ERASTUS AKINGBOLA, AMOUNTING TO £1,085,515. INTERCONTINENTAL BANK PLC HAD OBTAINED A SIMILAR INJUNCTION FROM THE HIGH COURT OF JUSTICE OF LONDON, DATED 24 DECEMBER 2009, TO FREEZE MR. AKINGBOLA'S ASSETS TO THE TUNE OF £10,500,000⁴⁴. THE INJUNCTION INCLUDED IN PARTICULAR: £8,540,134.58 AND £1,300,000, WHICH HAVE BEEN TRANSFERRED TO FUGLERS SOLICITORS; MONEY HELD IN AN ACCOUNT OF FUGLERS SOLICITORS; A PROPERTY ON 26, CHESTER TERRACE, LONDON, NW1 4NB; A PROPERTY ON 65, GROVE END ROAD, LONDON, NW8 9NH; AND A PROPERTY ON 8, CONNAUGHT STREET, LONDON, W2 2AH.

ON 1 JULY 2010, THE NIGERIAN GOVERNMENT SENT A FORMAL REQUEST TO THE GOVERNMENT OF THE UNITED KINGDOM FOR THE ARREST AND EXTRADITION OF AKINGBOLA TO NIGERIA. HE IS TO FACE TRIAL ON 28 CHARGES OF "FRAUD RELATED OFFENSES AT THE BANK": AMONG OTHERS, FINANCIAL MISAPPROPRIATION, MONEY LAUNDERING, FINANCIAL MALPRACTICES, CORRUPT PRACTICES⁴⁵. AKINGBOLA IS NOW BACK IN NIGERIA WHERE HE HAS BEEN BAILED PENDING TRIAL⁴⁶.

IF THE EIB HAD ANY EFFECTIVE MONITORING PROCESS IN PLACE, IT SHOULD HAVE BEEN AWARE OF THE EFCC'S AFFIDAVIT ISSUED IN OCTOBER 2007, WHICH WAS WIDELY PUBLICISED IN NIGERIA AND LINKED INTERCONTINENTAL TO IBORI'S CRIMES IN SEVERAL INSTANCES⁴⁷.

EVEN IF THE ARGUMENT COULD BE ACCEPTED THAT THE EIB COULD NOT HAVE FORESEEN AKINGBOLA'S INVOLVEMENT IN FINANCIAL CONTROVERSIES BACK IN 2007 (WHEN THE CREDIT LINE WAS GRANTED), A CLOSER LOOK AT AKINGBOLA'S ASSETS AND PARTICIPATIONS IN COMPANIES REGISTERED IN NIGERIA (AMONG OTHERS TROPICS SECURITIES LIMITED, TROPICS PROPERTY LIMITED, TROPICS HOLDINGS LIMITED, SUMMIT FINANCE COMPANY LIMITED, TROPICS FINANCE & INVESTMENTS COMPANY LIMITED, YANKURI NIGERIA LIMITED, REGAL INVESTMENT NIGERIA LIMITED AND BANKINSON NIGERIA LIMITED)⁴⁸ AND OTHER COUNTRIES (SUCH AS NIMBL CAPITAL BV ROTTERDAM) WOULD HAVE GIVEN THE EIB MORE THAN ONE REASON FOR CONCERN.

AN INVESTIGATION BY LAGOS BASED FINANCIAL ANALYST DAYO COKER, PUBLISHED BY SAHARA REPORTERS, HAS REVEALED HOW INTERCONTINENTAL BANK MISLED ITS CLIENTS, INVESTORS AND THE GENERAL PUBLIC BY CLAIMING THAT IT OBTAINED THE EIB'S €50 MILLION FACILITY IN 2009, AFTER THE ONSET OF THE FINANCIAL CRISIS. IN AN EMAIL TO DAYO COKER, CLIFFORD UNA, AN EIB PRESS OFFICER, CONFIRMED THAT THE EIB AND INTERCONTINENTAL BANK HAD SIGNED THE LOAN AGREEMENT IN 2007, WELL BEFORE THE NEAR COLLAPSE OF GLOBAL FINANCIAL MARKETS. MR UNA ALSO ADDED THAT "TO DATE, NO ALLOCATIONS HAVE BEEN MADE UNDER THIS LOAN AND THEREFORE, NONE OF THE AGREED LOAN AMOUNT HAS BEEN DISBURSED TO DATE"⁴⁹.

THE FACT THAT THE EIB DID NOT LOSE MONEY IN THIS CASE – INCIDENTALLY THE LOAN IN QUESTION IS ONE OF THE FEW CASES WHERE THE EIB LENT IN AFRICA WITH ITS OWN CAPITAL – IS NOT ENOUGH FOR JUSTIFYING THE EVIDENTLY FLAWED DUE DILIGENCE INTO THE CORPORATE GOVERNANCE OF INTERCONTINENTAL BY THE STAFF OF THE EIB, SOMETHING THAT THE BANK CLAIMS TO DO REGULARLY, AT LEAST FOR INDIVIDUAL LOANS, THROUGH ITS CORPORATE COMPLIANCE UNIT. AN OBVIOUS CONCLUSION IS THAT THE EIB'S PROCEDURE IN GRANTING THE LOAN IS JUST AS COMPROMISED AND LAX AS THAT OF A DUBIOUS AND OBSCURE PRIVATE EQUITY FUND, SUCH AS ECP. CLEARLY ECP INVESTED IN AND THE EIB LENT TO INTERCONTINENTAL BANK – BOTH WITH PUBLIC MONEY – WITHOUT LOOKING INTO INTERCONTINENTAL'S DEBT PORTFOLIO AND DUBIOUS RECORD. AND THE EIB HAD TO BE AWARE OF THIS EVEN MORE THAN ECP, GIVEN THAT IT LENT IN DECEMBER 2007 WHEN THE AFFIDAVIT AGAINST INTERCONTINENTAL WAS PUBLIC.

THIS IS AN ISSUE THAT DEFINITELY REQUIRES FURTHER INVESTIGATION BY COMPETENT AUTHORITIES, THIS TIME IN EUROPE.

IT CAN BE CONCLUDED, INDEED, THAT THE CHANCES ARE VERY LOW OF THE EIB'S OWN INTERNAL INSPECTION MECHANISM FINDING ECP GUILTY OF AN OFFENCE THAT THE EIB ITSELF MIGHT HAVE COMMITTED IN EXACTLY THE SAME COMPANY.

41. EIB, 2007. Intercontinental Bank, 28 December. See: <http://www.eib.org/projects/loans/2007/20070318.htm?lang=en&>

42. SaharaReporters, 2009. The lies of Intercontinental Bank, 01 April.

43. Next, 2010. Court freezes Erastus Akingbola's assets worldwide, 1 January

44. Ibid

45. Next, 2010. Nigeria asks for Akingbola's arrest, extradition, 8 July.

46. See http://234next.com/csp/cms/sites/Next/Home/5606659-146/akingbola_plays_not_guilty__csp.

47. <http://www.thisdayonline.com/nview.php?id=93870>

48. Next, 2010. Court freezes Erastus Akingbola's assets worldwide, 1 January

49. SaharaReporters, 2009. The lies of Intercontinental Bank, 01 April.

THE EMC AFRICA FUND II CORRUPTION SCANDAL

SERIOUS CONCERNS HAVE EMERGED OVER WHETHER OR NOT AN EIB-BACKED PRIVATE EQUITY FUND, EMERGING CAPITAL PARTNERS AFRICA FUND II PCC (ECP AFRICA FUND II), COMPLIED WITH THE EIB'S ANTI-FRAUD POLICY. ECP AFRICA FUND II 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) AND LAW ENFORCEMENT AGENCIES IN THE UK HAVE ALLEGED LINKS BETWEEN THESE ECP-BACKED COMPANIES AND IBORI AND/OR HIS ASSOCIATES. SPECIFICALLY:

- IN OCTOBER 2007, EFCC, NIGERIA'S PRIME ANTI-CORRUPTION ENFORCEMENT AGENCY, NAMED THREE COMPANIES – NOTORE, OANDO AND CELTEL – IN A SWORN AFFIDAVIT AS COMPANIES THROUGH WHICH FUNDS ARE ALLEGED TO HAVE BEEN CORRUPTLY MOVED ON BEHALF OF JAMES IBORI, THE FORMER GOVERNOR OF NIGERIA'S DELTA STATE. EMERGING CAPITAL PARTNERS (ECP) INVESTED IN THESE COMPANIES. THE AFFIDAVIT ALSO REFERRED TO A FOURTH ECP-BACKED COMPANY, INTERCONTINENTAL BANK, AS PARTY TO AN ALLEGED ILLEGAL PAYMENT.
- IBORI HAS A CRIMINAL RECORD IN THE UNITED KINGDOM AND IS CURRENTLY UNDER INVESTIGATION ON MONEY LAUNDERING CHARGES BY LONDON'S METROPOLITAN POLICE. IN 2007, A UK COURT FROZE ASSETS ALLEGEDLY BELONGING TO HIM WORTH \$35 MILLION (£21 MILLION). IBORI FLED NIGERIA IN APRIL 2010, FOLLOWING CHARGES BROUGHT AGAINST HIM BY THE EFCC FOR ALLEGEDLY SELLING OFF DELTA STATE ASSETS ILLEGALLY TO PAY OFF A PRIVATE LOAN FROM INTERCONTINENTAL BANK WHILE HE WAS STILL GOVERNOR. HE IS ACCUSED OF STEALING \$290 MILLION (£196 MILLION) FROM DELTA STATE. IBORI'S DEALINGS WITH INTERCONTINENTAL BANK (ON WHICH ECP HAD BOARD REPRESENTATION) ARE CENTRAL TO THE CHARGES. ON 13 MAY 2010, HE WAS ARRESTED IN DUBAI AT THE REQUEST OF THE LONDON METROPOLITAN POLICE. TWO DIRECTORS OF ECP-BACKED COMPANIES – HENRY IMASEKHA AND MICHAEL ORUGBO – WERE ALSO NAMED BY THE EFCC AS PART OF ITS 2007 INVESTIGATIONS INTO IBORI'S ALLEGED "CORRUPTION, DIVERSION AND MISAPPROPRIATION OF PUBLIC FUNDS, STEALING AND MONEY LAUNDERING". IN EFCC'S OCTOBER 2007 AFFIDAVIT, IMASEKHA WAS DESCRIBED AS "THE CHARACTER MOVING FUNDS IN CELTEL, OANDO AND NOTORE CHEMICAL INDUSTRIES." IMASEKHA HAS ALSO BEEN CHARGED AS A CO-CONSPIRATOR IN THE MONEY-LAUNDERING CASE AGAINST IBORI AND SEVERAL OF HIS ASSOCIATES THAT IS CURRENTLY BEING HEARD IN THE UK. IN MAY 2010, IMASEKHA WAS REPORTED TO HAVE FLED TO GHANA, FOLLOWING FRESH CORRUPTION CHARGES AGAINST IBORI.
- INTERCONTINENTAL BANK, IN WHICH ECP INVESTED, COLLAPSED IN 2009 AND HAD TO BE BAILED OUT BY THE CENTRAL BANK OF NIGERIA (CBN) – IN EFFECT, BY NIGERIAN CITIZENS TO THE DETRIMENT OF THE COUNTRY'S DEVELOPMENT. CBN SACKED THE BANK'S EXECUTIVE DIRECTORS AND ORDERED AN INVESTIGATION INTO A NUMBER OF NON-PERFORMING LOAN PORTFOLIOS, INCLUDING UNSECURED LOANS TO IBORI'S ASSOCIATES. THOMAS GIBIAN, ECP'S CURRENT EXECUTIVE CHAIR, HAS REPORTEDLY BEEN A BOARD MEMBER OF INTERCONTINENTAL SINCE 2007.

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.



Christian Bongo, Director of the 'Banque Gabonaise de Développement'

Looking for politically exposed persons: the case of Gabon Development Bank

Financial institutions are under a legal duty to ensure that they do not facilitate money laundering. Best practice requires enhanced due diligence to be undertaken where politically exposed persons (PEPs) are linked to financial transactions. James Ibori is a PEP because he was governor of Delta State, the oil producing state in the Niger Delta region, from 1999-2007. There is thus a legitimate expectation that the EIB and the funds in which it invests would have conducted in-depth investigations into the widely reported links between Ibori and Notore, Intercontinental Bank, OandO and Celtel.

Our own experience suggests that a cursory internet search reveals many legal documents and media reports going back over the past 19 years alleging that Ibori was convicted, investigated, and subject to legal orders on many counts from 1991 through 2010. This is something into which EIB and ECP staff could have easily looked into before any loan approval.

Many could surmise that doing business and helping Nigerians has always been tough and that the risk of making the wrong choice to whom to lend to is not only the EIB's problem. And many other institutions have somehow indirectly backed Ibori and his gang, whether aware or unaware of the EFCC warnings.

However, for the EIB, Nigeria is not the only minefield. On 7 May 2007, the EIB agreed to lend €7 million under the "Pret Global III" credit line in Gabon, with the aim of on-lending to private and public sector commercial operators, as well as microfinance institutions in Gabon. Declared beneficiaries of the loan were the Banque Gabonaise de Développement (BGD) and Financial Gabon Bank. The EIB's press release on the signing of this loan proudly proclaimed that "this is the third operation with BGD over the past 7 years" and "EIB's experience with both partners shows that they are particularly oriented at supporting SMEs and microfinance institutions⁵⁰."

BGD's general director is Christian Bongo, the youngest son of Omar Bongo⁵¹, who was President of Gabon for 42 years until June 2009, when he died. Christian Bongo is also brother of Ali Bongo, the current President of Gabon (and former Defence minister). The controversial Omar Bongo was one of the wealthiest heads of state in the world, his wealth attributed primarily to oil revenues and alleged corruption⁵².

According to a report by The African Executive, "Gabon's wealth was also siphoned off through the BGFI Bank, Gabon's biggest investment bank. (...) BGFI directors include Jean Ping (once married to Bongo's daughter) and Christian Bongo; Christian Bongo is also a director of the Banque Gabonaise de Développement⁵³".

Following a direct request to the EIB, it emerged that the credit line in question was cancelled completely on 23 July 2007, even though this was not communicated on the EIB's website. It is unclear whether the decision to cancel the credit line was based on a subsequent assessment of the risk associated with lending to an institution mainly controlled by local cronies. However this case raises the question of on which standards of enhanced due diligence, according to international best practices and requirements in the fight against fraud and money-laundering, does the EIB perform, given that the EIB has acknowledged having a seven year long relationship with this intermediary? Moreover, how effective is the EIB's operational structure in this regard?

In short, while it is worthy of note that the EIB appears to have grasped on this occasion that the decision to lend to these presumably dubious institutions was misguided, how can we be sure that new cases of this kind will not happen again?



James Ibori, currently under investigation by Nigeria's Economic and Financial Crimes Commission for alleged corruption

50. EIB, 2007. EIB provides EUR 7 million to two banks in Gabon to finance medium and long term projects, 29 June. See: <http://www.eib.org/projects/press/2007/2007-063-eib-provides-eur-7-million-to-two-banks-in-gabon-to-finance-medium-and-long-term-projects.htm>

51. Les Afriques, 2008. Christian Bongo: Directeur général de la BGD, 29 October. See: <http://www.lesafriques.com/100-africains/christian-bongodirecteur-general-de-la-bgd.html?Itemid=195>

52. Times Live, 2009. Bongo looted Gabon with impunity, 10 June. See: <http://www.timeslive.co.za/thetimes/article28629.ece/Bongo-looted-Gabon-withimpunity>

53. The African Executive, 2009. The Crimes of Bongo, Part V, 2 September



The background of the slide is a golden-yellow spiral that draws the eye towards the center. Scattered throughout the spiral are numerous musical notes and symbols, including treble clefs, bass clefs, and various note values. In the center of the spiral, there is a dark circular area containing the letters 'FIB' in a stylized, metallic font.

Chapter 3

The black hole of development

Small- and medium-sized enterprises are the backbone of most economies in Africa. Therefore the development community is increasingly discussing how to support innovative and creative entrepreneurial approaches that can help African SMEs adapt to global standards and realise their economic potentials.

SMEs in Africa undoubtedly face different social, ethical and environmental challenges, opportunities and dilemmas than do their counterparts in Europe or the US. Labour costs may be low but often not enough to offset the high costs of transport, raw materials, utilities, and other inputs. African businesses, therefore, find it difficult to compete in export markets, particularly in markets outside the region, and to compete against the importing of a range of goods from other developing regions.

This perspective is thoroughly endorsed by international financial institutions, such as the EIB, which sees the integration of Africa in the global economy as the main driver for the development of the poorest countries – an assumption which remains highly questionable if one looks back at the results on the ground of the last 25 years of economic globalisation that has promoted this approach.

Moreover, according to analysts, many African companies, especially SMEs, lack reliable financial data that allows financial organisations to scrutinise the health and prospects of companies. Most SMEs in Africa also lack assets that can act as collateral and mitigate the risks involved. As a result, capital in Africa remains too expensive for most entrepreneurs looking to build a sustainable enterprise.

In order to promote the development of the private sector, access to finance is thus regarded as crucial by the IFIs, including the EIB. Access to finance is without doubt a key issue in any development economics theory, but the ways of guaranteeing it, in particular to the poorest sectors of society, are different and may bring about very different economic and social implications.

On these grounds micro-credit practices have been promoted by civil society and alternative financial actors in the last decades as a means of addressing the wide demand for access to credit by the poor. Although some of these experiences have spread on a significant scale, the overall impacts and results remain limited. More recently

a wider approach to microfinance – including both credit facilities and other financial instruments to enhance access to credit – has been put in practice and the IFIs too have started exploring the possibility to back some of these initiatives. This issue is not part of the remit of this work, and would surely require additional investigation given the various critical threads which are already emerging vis-a-vis IFI involvement in this sub-sector.

It should be pointed out, though, that the IFIs have repeatedly downplayed the possibility to enhance a public controlled or led financial system in developing countries, by favouring the deregulation of banks, including financial markets liberalisation and the privatisation of local and rural banks. Public banks have always played an important function in terms of enhancing domestic savings and channelling resources into industrial development by enhancing access to credit, even when corruption and political interference has often made them work at sub-optimal levels. Yet simply ruling out the possibility of strengthening the domestic public financial system is a questionable assumption.

As said, access to finance can take many different forms, from bank loans to overdraft facilities. However, overall, Africa is still seen as a risky and expensive place to do business for major investors operating within the international financial markets. In fact, although a large number of agreements have been signed to liberalise foreign direct investments to the region, the amount of capital flows toward the poorest countries has not significantly increased in recent decades – comparing with what has taken place of late in the emerging economies – and has rapidly declined because of financial and economic crises, such as the one experienced in the last three years. Indeed, the IFIs report that the costs of transactions are often higher in Africa than elsewhere. Furthermore entrepreneurs actively working to set up their business find it a very lengthy and painful process to access loans from banks.

Why use local financial intermediaries then?

Therefore institutions such as the EIB tend to justify the use of financial intermediaries as a means to address these concerns. Direct lending by a bank such as the EIB to small entities would have high transaction costs, therefore 'bundling' the same resources together and lending these to a financial intermediary acting on private markets where ultimate beneficiaries operate too would allow for the reduction of these costs for various reasons. The intermediary may have better knowledge of the local context. It may also have the possibility to cross-subsidise some loans through higher returns generated by others, within the management of the same global loan. Furthermore, a large loan given to one single intermediary could help strengthen its business model so that it would then be able to leverage more private resources, including savings, thus enhancing domestic resource mobilisation which is a key lever for any local development.

In short, within a global loan a few operations may also turn out not to be successful, but as long as most of them do perform sufficiently then a large amount of resources would necessarily boost a better structuring of risk analyses, management and accounting procedures within the local intermediating institutions. Such an approach also reduces the financial risk for lenders, like the EIB.

Most of these theoretical arguments, however, are not confirmed by the practice in the poorest countries, in particular in Sub-Saharan Africa. Given the above mentioned deregulation of the banking sector enforced chiefly by the IMF and the World Bank in these countries in the last decades in the context of the structural adjusting of their economies, most banks and financial actors are controlled by foreign banks and investors, which are systematically draining local resources onto global financial markets to generate higher returns. And in any case, these types of foreign-controlled local intermediaries do not necessarily know well the local economic context and the needs of the poorest.

When it comes to the strengthening of local financial intermediaries, although the EIB identifies selected partners to work with in the long run in each country, it is unclear to what extent the EIB is able to transfer banking knowledge and experience to these financial actors, which tend to rapidly evolve not necessarily in the direction of becoming potential "local development banks", as clearly needed in the long run in any development process.

Furthermore, it is said that the EIB can impose quite strict fiduciary conditions on intermediated loans⁵⁴, which then set a relatively high interest rate across the board for all on-lending operations – when comparing with other development institutions – thus reducing the possibilities for cross-subsidisation. This can also have the effect of

forcing onto final beneficiaries loans with high interest rates when compared with those already available on the market in several cases, thus not particularly enhancing access to credit for the supposed ultimate beneficiaries in reality.

The case of the Malawi Global Loan III – already mentioned in chapter 1 – is telling in this regard.

Nat Bank, one of the three intermediaries identified by the EIB, gave the following reasons for their final decision not to take on the EIB loan, despite it having been approved by the EIB's board: "We felt the pricing was not competitive in terms of margin above LIBOR (London Interbank Offered Rate) and the fees applicable considering that we were going to on-lend these funds to customers. In addition, we felt some of the covenants were not competitive as we access several other credit lines with other International Banks which have no covenants⁵⁵."

When asked for details on the covenants and the average SME interest rates in Malawi, the EIB made clear that this always depends on the definition of SMEs: "In general I would say, SME borrowing for less than 1 million MK (Malawi Kwacha), that is ca. \$6,500, through the microfinance industry may be quoted the interest rates you have mentioned [33% and 36%, the conditions applied to SMEs by Malawian NBS Bank⁵⁶]. With the banking industry, a local currency loan for a SME would be priced at 21% to 25%, normally. Dollar borrowing or borrowing in foreign currency to the qualifying customers is relatively cheaper ranging from 7% to 10%. The facility that was being offered was a foreign currency facility⁵⁷."

International financial intermediaries to bypass local problems and uncertainties

Despite the interest in identifying and supporting local financial intermediaries, it is widely recognised that today several poor countries do not have adequate private financial institutions in place. Therefore, the EIB and other IFIs view as interesting the possibility to back international financial intermediaries registered abroad which can operate from the outside into these countries.



External knowledge faces challenges on the ground

54. See the Bankwatch study "Missing in action - The winners, the losers and the unknowns of the European Investment Bank's anti-crisis SME offensive in central and eastern Europe", November 2010.

55. Email, 2010. RE: FW: EIB - Malawi Global Loan III, 3 June.

56. NBS, 2010. SME Credit Facility, 7 June. See: <http://www.nbsmw.com/sme.html>

57. Email, 2010. RE: FW: EIB - Malawi Global Loan III, 4 June.

This option is deemed particularly attractive by many investors and financial actors which regard as highly inadequate and risky the investment climate in the poorest countries, including their legal and fiscal regimes. The use of international intermediaries which operate in multiple countries is considered by multilateral development banks⁵⁸ as the only option to channel resources toward the SMEs of specific developing countries in an effective manner, that means by reducing transaction costs and timing. Needless to say that several of these international financial intermediaries⁵⁹ are based in offshore financial centres – Mauritius is the most requested location when it comes to the EIB's funding of this particular sector, not to say that the EIB itself is itself registered in a well known European tax haven, Luxembourg.

By supporting this model the EIB generates additional concerns beyond merely the delegation to intermediaries of performing adequate due diligence of their on-lending to the ultimate beneficiaries. Acting via international intermediaries, whose specific knowledge of local contexts remains questionable, the EIB distances itself even further from the clearly defined development objectives of

its lending.

Given that, as seen in the previous chapter, procedures have not been sufficiently adapted to intermediary financing and that this part of the EIB's investment portfolio is extremely poorly monitored – being based almost exclusively on self-reporting – it can be easily argued that global financial intermediaries hardly have any development mandate or objectives and that their knowledge of local contexts in which to operate mainly relies on market-driven analyses motivated by the financial services industry.

Pausing to consider the roles of many of these intermediaries, that often operate through shadow banking arrangements in a highly liberalised global market of financial services, and within the unprecedented financial crisis we have experienced in the last three years, with severe impacts on economies and access to credit for the poorest countries in the world, it is deeply questionable why such institutions should get close to, let alone benefit from, public financial support that comes with a development tag.

The case of Banque de Dépôt et de Crédit Djibouti: a 'Swiss' local intermediary

Behind local names and set-ups, lest it be forgotten, local financial intermediaries are often structurally linked and controlled by actors operating in global financial markets. This is the case of a loan for €2 million agreed to by the EIB on 26 May 2009 for the Banque de Depot et de Crédit Djibouti (BDCD), to support the bank's growth and its financial capacity to provide credit products to SMEs and individual entrepreneurs⁶⁰.

The EIB reports that BDCD "started operations in the first quarter of 2008 to provide banking services and products to Djibouti entrepreneurs and small businesses which have been largely ignored until now by the country's two duopolistic banks⁶¹". Reportedly BDCD is part of the Geneva-based Swiss Financial Investments Group and opened its doors in 2007, gaining more than 4,500 customers by 2009⁶². SF Swiss Financial Investments SA, based in Geneva and managed by the French businessman Michel Torielli, created BDCD at the beginning of 2008. Before founding BDCD, Torielli had been co-founder of the Bank of Africa in Mali (1982), CEO of BICEC (Banque Internationale du Cameroun) and honorary consul of the Principality of Monaco in Cameroon.

In order to launch BDCD, Torielli put together a number of private investors, most of whom are French. Among the founders are also Fondazione di Piacenza e Vigevano, an Italian banking foundation chaired by Giacomo Marazzi (CEO of Cementirossi, a cement producer) and Pietro Torielli (an Italian businessman active in the shoe industry with interests in Africa)⁶³. Michel Torielli has also been CEO of Banque Internationale de Credit et de Gestion of Monaco, of which he has been the Africa Manager for a substantial amount of time⁶⁴.

As CEO of BICEC until 2001, Torielli would have helped privatise the bank, before being replaced following an inspection by the parent company (the French Banque Populaire). Under Torielli – according to a report by Africa Intelligence – Switzerland and Monaco have been the "destinations of a number of wire transfers of BICEC". In any case, BDCD – supported by EIB loans – seems to be merely a private bank, created by European businessmen to develop their private interests in Africa, even though they have no link to local industries and development processes.

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

59. Investments for Development: Derailed to Tax Havens: A report on the use of tax havens by Development Finance Institutions; Prepared for IBIS, NCA, CRBM, Eurodad, Forum Syd and the Tax Justice Network, by Richard Murphy, September 2010.

Is the International Finance Corporation supporting tax-evading companies? Tax Justice Network, CRBM, Eurodad, Ibis, Oxfam-France; December 2009.

Flying in the face of development; How European Investment Bank loans enable tax havens; Researched and written by Marta Ruiz for Counter Balance, July 2009.

60. EIB, 2009. Banque de Dépôt et de Crédit Djibouti, 26 May. See: <http://www.eib.org/projects/pipeline/2008/20080012.htm>

61. Ibid

62. Hiiraan Online, 2010. Djibouti sees boom in banking sector, 22 May.

63. La Lettre de l'Océan Indien, 2008. Une firme suisse crée une banque, 16 February.

64. Africa Intelligence, 2000. Who's who: Michel Torielli, 27 January.

Financial sector development, economic growth and poverty reduction

The IFIs and the developing countries themselves attach great importance to financial sector development and deepening in the pursuit of poverty reduction goals. By mobilising savings, facilitating payments and the trade of goods and services, as well as promoting efficient allocation of resources, the financial sector is thought of as playing a critical role in facilitating economic growth and, directly through broadening access to finance and indirectly through growth, contributing to poverty reduction. Supporting financial sector development has also been a key priority of development assistance in the past several decades.

Yet economists' views on the role of finance in economic development have not always been unanimous⁶⁵. There have been significant disagreements on the 'finance-growth' nexus. For instance, questions have often been raised over the nature of causality: whether financial sector development causes economic growth or economic growth generates a need for financial sector development. Economists have also debated the nature of the growth-poverty nexus: whether and to what extent economic growth leads to poverty reduction. Furthermore, there are deep questions hanging over whether financial sector development can bring direct benefits to the poor. **IFIs such as the EIB have, nonetheless, claimed to develop empirical evidence on many of these points and have sought to promote the emergence of a consensus on the vital importance of financial sector development in facilitating growth and supporting poverty reduction.** In particular, concerning the creation of economic growth as a sine qua non condition for development, it is believed that through all its functions financial sector development facilitates economic growth – not only by promoting private sector development, but also by supporting the public sector to invest in infrastructure and by enabling households to invest in human capital and consume more.

However, in the wake of several financial crises in the last decades, the central issue for most economists remains how to develop a financial system that facilitates and supports economic growth in the context of financial stability. And increasingly urgent attention is now, belatedly, being given to environmental and sustainability considerations, and how they are to be factored into the economic development equation. There are disagreements, too, over how to sequence financial sector development in developing countries, in particular the relative importance of developing domestic banks and capital markets and, in developing domestic banks, the relative importance of large and small banks.

Moving to the link with poverty reduction, there are two principal channels through which it is believed financial sector development can impact poverty reduction: one works indirectly through growth; the other works directly through the poor benefiting from having access to financial services.

It is fair to say that the link between economic growth and poverty reduction remains questionable, even though international institutions continue to promote economic growth as a sine qua non condition for any development. This explains why institutions like the EIB still back the trickle-down effect approach, believing that economic growth, even when mainly centred on private sector development, will in the long run always have a positive distributional impact, and thus contribute to reductions in poverty. **It may already have been declared dead by many – including the former British prime minister Gordon Brown at the G20 London Summit in 2009 and more recently the President of the World Bank Robert Zoellick⁶⁶ – but the 'Washington Consensus', and its theory, principles and practical application, remains popular among many EIB and IFI economists.**

Regarding increased access to finance for the poor as a direct lever for fighting poverty, there are, nevertheless, also sceptical views on whether financial sector development can lead to a broadening of access to finance by the poor, especially at early stages. Faced with evidence that improvements in the financial system may not automatically lead to the poor having greater access to finance, justifications can and have to be made for public sector interventions in the forms of various microfinance schemes and SME credit programs.

Some of the conventional wisdom about the poverty reduction potential of allowing greater access to finance by micro-enterprises and SMEs has also come under scrutiny recently. A recent Asian Development Bank study⁶⁷ on SMEs argues that access to finance is often only one of the major constraints to the growth of these enterprises, with other constraints including weak access to new technologies and to dynamic markets. Beyond this, if SMEs are to increase productivity and employment, they must innovate, including adopting new technology and diversifying into new markets. And finally governments should assist SMEs, and such assistance should include providing information services on technology and markets, vocational training, technical support services, and fostering linkages between SMEs and large enterprises, in addition to facilitating access to finance – that is, in sum, following an integrated approach.

65. For a literature review on the matter please consult: ADB Economics Working Paper Series No. 173; Financial Sector Development, Economic Growth and Poverty Reduction: A Literature Review; Juzhong Zhuang and others; October 2009

66. A cautious welcome to the World Bank's rejection of the old orthodoxies; Larry Elliott, The Guardian, 30th September 2010

67. ADB Economics, Working Paper Series, No. 173, October 2009; Financial Sector Development, Economic Growth, and Poverty Reduction: A Literature Review; by Juzhong Zhuang, Herath Gunatilake, Yoko Niimi, Muhammad Ehsan Khan, Yi Jiang, Rana Hasan, Niny Khor, Anneli S. Lagman-Martin,

In conclusion, what is believed by the EIB and others to be a monolithic and well-proven theory that private financial sector development will lead to economic growth and, all things being equal, to poverty reduction, in reality relies excessively on several dubious assumptions and a lack of sufficient evidence. On the contrary, key questions remain on whether supporting public financial institutions would not be a more effective way to foster development in the poorest countries, and on how much increased access to finance – even though not qualified and often through du-

bious intermediaries as we have seen in the case of the EIB – for SMEs without a comprehensive development strategy can in fact contribute to poverty reduction.

Until such time as there are better justified answers to these questions, it can be argued that the EIB's lending for private financial sector development in its present form should be seriously reviewed and possibly discontinued.

The abuse of private equity funds

These economic questions and non-economic concerns – as outlined in chapter 2 – take on an even deeper relevance in the case of EIB support for private equity funds. The fact that these intermediaries are often located in tax havens and secrecy jurisdictions, and their dubious positive economic impact also in developed countries, cast more doubts over the growing interest of the EIB in backing such funds in the name of development.

Supporters of the role of private equity in development processes claim that complementary to existing lending facilities and microfinance programs, there is a growing need for Private Equity and Venture Capital in order to fuel the development of the private sector in Africa. Equity investments can be instrumental in helping small enterprises grow into medium-sized enterprises and semiformal into formal businesses, it is argued.

Although the EIB has decided to strategically increase its support for private equity funds as key actors for supporting SMEs in developing countries, no specific reflections have been developed about whom or what are the ultimate beneficiaries of this support from speculative funds.

On 30 December 2009 the EIB agreed to invest approximately €8 million in the Agri-Vie Fund, a fund that invests

in agribusiness in Southern and Eastern Africa⁶⁸. The Fund is sponsored by Sanlam Private Equity, a division of Sanlam Investment Management; SP-aktif (Pty) Ltd; and Makotulo Agrifund Investments (Pty) Ltd⁶⁹.

The Agri-Vie Fund seeks investments in commercially attractive agribusiness projects with sound environmental and social practices in Sub-Saharan Africa. The Fund is constituted through a public cell company incorporated in Mauritius (the "PCC") and the South African En Commandite Partnership (the "South African Manager"). With an overall target of \$100 million in capitalisation, the Fund will be managed by AA Fund Managers (Pty) Ltd ("AAFM" or the "Investment Manager"), incorporated in Mauritius, which draws on advice from Agri-Vie Investment Services (Pty) Ltd (AVIA) incorporated in South Africa. Herman Marais, Izak Strauss, Avril Stassen, and David Douglas are the managers of the Fund⁷⁰.

Agri-Vie Fund has invested in AfricaJuice BV Den Haag⁷¹, and The New Forests Company Holdings Ltd London⁷². Izak Strauss is not only manager of the Agri Vie Fund but is also director of AfricaJuice BV Den Haag⁷³. AfricaJuice BV announced already in October 2008 that: "Agri-Vie will take a substantial position in AfricaJUICE" by investing in the company⁷⁴. This investment was completed in December 2008.

68. EIB, 2009. Agrie Vie Fund PCC, 30 December. See: <http://www.eib.org/projects/loans/2009/20090430.htm>

69. IFC, 2010. Agri-Vie - Summary of Proposed Investment, 26 May. See: <http://www.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/3746df99c5f30370852576fe005485dd?OpenDocument&Highlight=0,Mauritius>

70. IFC, 2010. Agri-Vie - Summary of Proposed Investment, 26 May. See: <http://www.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/3746df99c5f30370852576fe005485dd?OpenDocument&Highlight=0,Mauritius>

71. AfricaJuice, 2008. The African fund Agri-Vie confirms its intention to invest in africaJUICE BV, 24 October. See: http://www.africajuice.com/news_archive.html

72. ICC Information Group Limited, 2010. Profile on Avril Stassen, 5 May.

73. Dun & Bradstreet, 2009. Company Profile on AfricaJuice BV Den Hague, 14 December.

74. AfricaJuice, 2008. The African fund Agri-Vie confirms its intention to invest in africaJUICE BV, 24 October. See: http://www.africajuice.com/news_archive.html

Concerning New Forests Company (NFC), the manager Avril Stassen has been the director and investment principal of the company since 12 April 2010⁷⁵. However, on the NFC website, Avril Stassen is not mentioned as director in any of the board or management team categories. Neither is Izak Strauss on AfricaJuice BV's website. Therefore it is clear that the fund seems to generally take at least one board position in the companies in which it invests.

On 9 June 2010 it emerged publicly that the financial company Sanlam (Sanlam Private Equity is one of its subsidiaries) faces a claim of close to 2 billion Rand (or €21,5709,592.07 million) for grabbing various surpluses including its own staff retirement fund⁷⁶. Moreover, it is reported that a 700 million Rand "claim against Sanlam for its part in the retirement fund surplus stripping

scandal of the 1990s where employers, through complex schemes set up by now convicted fraudster Peter Ghavallas, managed to get their hands on surpluses to the detriment of members and pensioners⁷⁷". A recent settlement of the case recognised that Sanlam has been involved in surplus stripping of the Datakor and Cortech funds, as well as of the Picbel retirement fund, and agreed to pay 175 million Rand⁷⁸.

Given that the beneficiaries of this equity participation are in the end SP-Aktif Investments (Pty) Ltd Durbanville and Sanlam Private Equity South Africa, project due diligence from the EIB should have raised doubts about Sanlam, which seems to have a pronounced tendency to abuse its important position as one of South Africa's biggest financial service companies.



75. ICC Information Group Limited, 2010. Profile on Avril Stassen, 5 May.

76. Business Report, 2010. Sanlam faces bill for surplus stripping, 9 June. See: <http://www.busrep.co.za/index.php?fArticleId=5506512>

77. Business Report, 2010. Sanlam faces bill for surplus stripping, 9 June. See: <http://www.busrep.co.za/index.php?fArticleId=5506512>

78. http://www.fanews.co.za/article.asp?Company_News_Results;1,Sanlam;1055,Sanlam_Settlement_of_disputes_on_pension_fund_surpluses_;8462

'THE LOCUSTS OF CAPITALISM' – THE RISE OF PRIVATE EQUITY IN THE GLOBAL ECONOMY

PRIVATE EQUITY IS A BROAD TERM USED TO DEFINE ANY TYPE OF EQUITY INVESTMENT IN AN ASSET OR A COMPANY THAT IS NOT LISTED ON A PUBLIC STOCK EXCHANGE. THUS, THE PURCHASE OF SHARES IN A COMPANY IS PRIVATELY NEGOTIATED. THE SHARES OF A COMPANY COULD BE ACQUIRED THROUGH THE SALE OF EXISTING SHARES BY SHAREHOLDERS OR THROUGH THE PRIVATE PLACEMENT OF NEW SHARES.

PRIVATE EQUITY COVERS A WIDE RANGE OF INVESTMENT OPPORTUNITIES, INCLUDING EARLY STAGE INVESTMENT ('ANGEL INVESTORS'), TAKE OFF (VENTURE CAPITAL), MID-GROWTH INVESTMENT (MEZZANINE FINANCE), LATER STAGE (PRIVATE EQUITY), DISTRESSED DEBT FINANCING AND OTHERS. PRIVATE EQUITY ENCOMPASSES A WIDE SPECTRUM OF INVESTMENT VEHICLES FROM ANGEL TO LEVERAGED BUYOUTS. BECAUSE OF THE WIDESPREAD AND HEAVY DEPENDENCE ON LEVERAGED BUYOUTS TO RAISE MONEY, A PRIVATE EQUITY FUND AND A BUYOUT FUND HAVE ALMOST BECOME INTERCHANGEABLE IN THE US AND EUROPE.

PRIVATE EQUITY IS NO LONGER A SMALL BUSINESS. AFTER HAVING EXPERIENCED THEIR LARGEST BOOM BETWEEN 2005 AND 2007, PRIVATE EQUITY FUNDS UNDER MANAGEMENT TOTALLED \$2.5 TRILLION AT THE END OF 2008 (WITH A 15 PERCENT INCREASE COMPARED TO 2007, DESPITE THE FINANCIAL TURMOIL).

INTERNATIONAL FINANCIAL SERVICES LONDON FORECASTS THAT FUNDS UNDER MANAGEMENT WILL INCREASE TO OVER \$3.5 TRILLION DOLLARS BY 2015, STARTING FROM LESS THAN \$1 TRILLION IN 2003⁷⁹. WITH MANY BIG PRIVATE EQUITY FIRMS JOINING HANDS AND OWNING A LARGE NUMBER OF BUSINESSES ACROSS THE WORLD, A NEW TYPE OF CORPORATE CONGLOMERATE IS EMERGING WHICH IS RESHAPING THE WAY BUSINESS IS BEING CONDUCTED. BECAUSE OF THE DRAMATIC RISE OF PRIVATE EQUITY FIRMS IN THE PAST FEW YEARS, SOME PEOPLE WOULD CROWN THEM AS THE "NEW KINGS OF GLOBAL CAPITALISM" WHILE OTHERS WOULD LABEL THEM AS "LOCUSTS", DEPENDING ON POLITICAL PERSPECTIVES⁸⁰.

IN PARTICULAR, SEVERAL ACTORS HAVE RAISED STRONG CONCERNS ABOUT THE LABOUR, SOCIAL AND DEVELOPMENT IMPACTS ASSOCIATED WITH PRIVATE EQUITY FUNDS' OPERATIONS. TRADE UNIONS HAVE WARNED AGAINST MASSIVE LAY-OFFS CONSEQUENT TO TAKE OVERS AND THE RESTRUCTURING OF COMPANIES CARRIED OUT BY THESE FINANCIAL ACTORS IN A HIGHLY SPECULATIVE WAY⁸¹. INTERNATIONAL INSTITUTIONS, SUCH AS UNCTAD, HAVE RAISED CONCERNS ABOUT THE NEGATIVE LONG-TERM DEVELOPMENT IMPACTS ASSOCIATED WITH THIS KIND OF FOREIGN DIRECT INVESTMENT, WHICH REMAINS HIGHLY NON-TRANSPARENT⁸².

IN SHORT, PRIVATE EQUITY FUNDS NOT ONLY HAVE A SPECULATIVE BUSINESS MODEL, BUT ALSO REPRESENT A CONVEYOR BELT FOR SHAREHOLDER CAPITALISM FROM THE FINANCIAL TO THE REAL ECONOMY⁸³.

THE FINANCIAL CRISIS AND THE SLOW RECOVERY OF CREDIT MARKETS HAVE SLOWED DOWN THE PRIVATE EQUITY BUSINESS, AT LEAST IN AGGREGATED TERMS. THE REDUCED LEVERAGE CAPACITY – DUE TO THE LACK OF EASY ACCESS TO CREDIT FROM MAJOR PRIVATE COMMERCIAL AND INVESTMENT BANKS – HAS NECESSARILY REDUCED BUY OUTS AND ACQUISITIONS.

HOWEVER, WEALTH ACCUMULATION HAS CONTINUED, EVEN MORE SO IN THE PRESENT CRISIS CONDITIONS, AND MAJOR FUND MANAGERS HAVE PROMPTLY STARTED SCOPING FOR NEW MARKETS IN WHICH TO ALLOCATE RESOURCES. IN PARTICULAR, SINCE THE FINANCIAL CRISIS STARTED TO SPREAD AROUND THE WORLD IN 2008, THERE HAS BEEN A CONSTANT SHIFT FROM FINANCIAL ASSETS AND REAL ESTATE – CONSIDERED TOO RISKY AND ALWAYS LESS PROFITABLE – TO OTHER ASSETS, MAINLY COMMODITIES.

79. IFSL Research, 2009, Private Equity 2009, August

80. SPD (Sozialdemokratische Partei Deutschlands, 2005, Programmheft I. Tradition und Fortschritt, January

81. Where the house always wins: Private Equity, Hedge Fund and the New Casino Capitalism; International Trade Union Confederation; ITUC Reports; June 2007; Brussels

82. United Nations conference on Trade and Development, World Investment Report 2009, Geneva, July 2009

83. Superstars in the Emperor's New Clothes. Hedge Funds and Private Equity Funds. What is at Stake?; Peter Wahl; WEED-Briefing Paper, Berlin, 2008

Conclusions and recommendations



This report casts serious doubts on the development effectiveness of EIB operations outside the EU, in particular where the bank's loans are channelled through financial intermediaries or where it participates directly in private equity funds.

The recent moves made by the EU's bank, backed in all of its activities by a guarantee from the member states, towards more systematic use of private financial institutions and questionable financial markets' actors (such as highly speculative private equity funds) confirms and deepens civil society's critique of the structural flaws underpinning the development economics approach of the EIB in its lending outside the EU. In the very aftermath of the most serious financial crisis since the 1930s, the EIB appears eminently comfortable with advancing its approach to development via private financial institutions, some of whom are the same inhabitants and promoters of the so-called shadow banking system that has been centrally responsible for causing the most recent financial and consequent economic crisis. As, in some cases, they have benefited from the crisis, so they are benefiting from the EIB's unfolding approach to development finance.

In spite of the EIB's efforts in recent years to improve the environmental and social due diligence of its operations alongside positive advances in its policy on disclosure of information and in its accountability mechanisms, the greater emphasis being given to lending via financial intermediaries and by supporting private equity funds puts at serious risk the marginal improvements and achievements notched up to date on the EIB's road to sustainability and effective public accountability. The structural limitations posed by its clients' commercial confidentiality – which the EIB strenuously seeks to protect – as well as the longer and substantially more blurred accountability chain of lending through financial intermediaries or private equity funds, prevents necessary insights and understanding into how EIB money is being spent in reality and who is ultimately benefiting from EIB public support. This poses a serious risk in particular when the EIB lends in developing countries with weak governance and dubious democratic practices, in countries – and there are many of them – which systematically exclude the opportunity for domestic civil society to hold their governments and businesses to account for their use of international financing.

This is manifestly the case with those EIB intermediated loans that have been tainted by allegations of corruption on two occasions in Nigeria, as well as other dubious cases in sub-Saharan Africa examined in this report. Moreo-

ver, there is the systematic use of tax havens by private equity funds that are benefiting from EIB support: this is a practice that international observers and experts are increasingly viewing as anti-development, given that tax havens are the central mechanism for enabling capital flight from developing countries to donor countries.

Yet the EIB does not appear willing to rigorously improve the transparency and due diligence over these important lending instruments. In this context of widespread business secrecy, the EIB appears reluctant to encourage intermediaries to disclose at least some details regarding the global loans they have been allocated. This inflexible stance thus ignores the overwhelming public interest over commercial confidentiality in knowing how European public money is ultimately being deployed. At the same time, and as explained above, monitoring by EIB staff of intermediated loans and private equity funds remains sporadic and ineffective when set against the substantial risks that these chosen lending instruments pose.

In early 2011 the European Parliament will be asked to agree on the EIB's new external lending mandate up to 2013. The so-called mid-term review, which overlapped with the issuance of a new mandate as requested by the European Parliament, has offered the opportunity to involve all relevant stakeholders in discussion over the future of the EIB's external lending, within a wider debate on the reform of the EU's development finance architecture.

The unequivocal support by the EIB for financial intermediaries and private equity funds once more confirms that the bank cannot be transformed into a development finance institution, given not only its structural lack of expertise in development matters but also this strong bias in favour of pure investment lending and private finance sector development as a key engine for the development of the poor in the long run. Such a bias hinges on highly questionable assumptions as witnessed by the controversial empirical evidence that has accumulated in recent decades and the ongoing, far from resolved debate taking place in academic and political literature on this matter.

As a European public institution with clear obligations deriving from the Lisbon Treaty when it comes to the horizontal objectives of the entire external action of the European Union, that very much includes EIB lending, a great deal still has to be accomplished in order to make the EIB accountable for its development impact in the global South.

Even though the European Parliament and some member states have endorsed several civil society concerns and shared in the growing criticism of the EIB and its not being up to the development tasks and challenges of the day, this new trend of supporting financial intermediaries and private equity funds has still to come under sufficient scrutiny. Too often it is taken for granted by decision-makers that this is the only option for reaching out to small- and medium-sized enterprises in developing countries, or even individuals through micro finance schemes implemented by EIB-backed intermediaries.

This assumption has to be challenged given the failure by financial intermediaries to contribute to sustainable development and poverty eradication so far – these institutions, along with private equity funds, are not development institutions and clearly have no intention of developing adequate expertise and practice in this field. In short, transforming the EIB and its “trusted and experienced” financial intermediaries simultaneously looks like an impossible task.

Back to the drawing board: Other intermediaries, other expertise, other beneficiaries

It is legitimate for European taxpayers to speculate why, to support micro finance in African countries or the start-up of SMEs, EIB loans should go through obscure entities whose primary aim is not sustainable development promotion or poverty eradication. Couldn't these substantial lending volumes that run into the billions instead go directly to ultimate beneficiaries in a more accountable manner, or via local financial intermediaries whose growth would benefit the development of new and local financial services markets, as well as the local economy at large?

Similarly, it is of paramount importance to wonder why, when the EIB is making it possible for several important European banking groups to be financial intermediaries for disbursing intermediated loans through their subsidiaries in developing countries, the bank is not at the same time requesting these major financial actors – which have significant capacity and a high reputational risk – to adopt stringent and accountable safeguards policies that would ensure their lending is in line with environmental and social policies adopted by the EIB or that it derives from obligations under European law.

The Counter Balance coalition believes that the international private financial sector should not be used – and relied upon – as a primary vehicle for channelling development funding to local and indigenous private companies. Screening financial intermediaries both ex-ante and ex-post would absorb too many resources without

necessarily generating positive outcomes, and would divert capacity from trying to support directly local public and private sectors according to a development logic that aims to mobilise domestic resources and capacities. At the same time, support for locally established, but mostly foreign controlled, financial intermediaries easily leads to the repatriation of local savings and profits at any time, thus contributing to capital flight from poor to rich countries, against the intrinsic rationale of development aid.

Doing less, differently, transparently and better

Therefore Counter Balance recommends that:

1. EIB support for financial intermediaries should be restricted only to local financial institutions that do not operate in offshore financial centres and are knowledgeable about the needs of local SMEs, that have a substantial local ownership, that are equipped to implement a pro-development approach – in line with transparent and verifiable criteria – and that disclose in a timely manner all relevant information to the public in Europe and in developing countries.
2. EU public money should support – in some cases – the development of strong, locally owned financial intermediaries that are focussed on providing financial services to the poor in a responsible and transparent manner, or to supporting sustainable development more widely, i.e. micro finance institutions, rural banks, cooperative banks, and ethical financial mechanisms. The EIB should consider supporting the start-up of these institutions, possibly taking an equity participation in them for a limited time if needed. All of these local intermediaries should have sustainable development or the provision of services to benefit the poor as one of their core goals.
3. In all such EIB engagements, stringent environmental, social and development assessment and monitoring is needed, as well as cost-benefit analyses that take into consideration other possible interventions that may lead to the same long-term development goals. For example, does it make sense to support local banks issuing small mortgages for residential housing, or would it be more beneficial to directly finance public housing policies through local and national governments, thus avoiding the financialisation of the housing sector with negative long term consequences for the economy? In other essential services and social sectors there will be similar options to be weighed by balanced, objective cost-benefit analyses
4. EIB participation in private equity funds should be ended. All such funds operate via offshore financial centres contrary to any kind of development logic. The wealth management logic of these speculative funds is inherently against development goals and

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

European decision-makers have to open their eyes to these new trends in EIB lending and act swiftly and soon in order to prevent the situation deteriorating further on

a larger scale. By doing so, they can reclaim more public control and accountability over the most important European public financial institution.

Progress in this regard is achievable, and would represent merely a first step in the direction of making EIB lending outside the EU smaller and more selective and controllable. Political space can and must be opened to promote an alternative and more effective European development finance architecture – one that goes well beyond existing institutions and mechanisms such as the EIB.

www.counterbalance-eib.org
e-mail: info@counterbalance-eib.org

Counter

Balance
 Challenging
the European
Investment
Bank