House of Commons

International Development Committee

Investment for development: The UK's strategy towards Development Finance Institutions: Government response to the Committee's Ninth Report of Session 2022–23

First Special Report of Session 2023–24

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The International Development Committee

The International Development Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the Department for International Development and its associated public bodies.

On 1 September 2020, DFID and the Foreign and Commonwealth Office were merged to form the Foreign, Commonwealth and Development Office (FCDO). The Committee remains responsible for scrutiny of those parts of FCDO expenditure, administration and policy that were formerly the responsibility of DFID.

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First Special Report

The International Development Committee published its Ninth Report of Session 2022–23, Investment for development: The UK's strategy towards Development Finance Institutions (HC 884), on 15 September 2023. The Government response was received on 23 November 2023 and is appended to this report.

Appendix: Government response

Summary to response

The Government is grateful to the International Development Committee for the report on Investment for Development: The UK's Strategy towards Development Finance Institutions. We welcome the Committee's review and have considered the recommendations carefully.

The report highlights the important role Development Finance Institutions play in developing private markets in low- and middle-income countries by pioneering new and emerging industries, promoting positive change through investment activities, and stimulating wider private-sector investment to develop markets. We welcome the Report's recognition of BII's impact and approach to solving the biggest global development challenges by investing patient, long term, flexible capital to support private sector growth and innovation, while not losing money.

BII is a leader amongst DFIs in investing in the riskiest places with the highest development needs, including in fragile and conflict affected states, and has a unique focus on investing in the riskiest part of the capital structure. Over half of BII's portfolio (57%) is in Africa, compared to just 3% of UK Foreign Direct Investment, and approximately 70% of BII's portfolio is in equity investments. Over the last five-year strategy (2017–21), BII delivered substantial impact by making £7 billion of commitments into over 600 impact-led investments, mobilising approximately £2.5 billion of additional capital from the private sector. Over that same period, BII supported businesses that employed over 1 million workers, generated 277,000 GWh of electricity, and paid more than £10 billion in taxes. In 2022 alone BII made £1.27 billion ($1.56 billion) of new, impact-led commitments, invested £591 million of climate finance and generated 50 terawatt hours of electricity through investments in electricity – equivalent to 16% of all electricity generated in the UK in 2021. BII also boosted investment in women by committing £640.3 million to businesses which qualify for the 2X Challenge, a joint initiative to increase financing for women.

The Government is committed to ensuring BII continues to innovate in the pursuit of sustainable development impact and appreciates the Committee's recommendations to support BII becoming an even more effective organisation. The Government accepts or partially accepts all recommendations and will work with BII to implement relevant reforms, including as part of the negotiations for the next BII strategy period (2027–31). In particular, the FCDO has set BII the goal to become the most transparent bilateral DFI as measured by the Publish What You Fund DFI Transparency Index, and an ambition for over 50% of BII's annual investment commitments to be in the poorest and most fragile countries by 2030. The FCDO will continue to provide effective oversight of BII through ensuring its governance arrangements continue to align with best practice and will place a particular emphasis on monitoring the impact of BII's investments.

This response sets out our detailed views on the report's recommendations in the order in which they appear in the 'Conclusions and Recommendations' section of the Committee's Report.

Response to Recommendations

Governance

Recommendation 1. ***To ensure that BII's strategy and operations are consistent with the International Development Strategy and FCDO objectives, to protect taxpayers' interests and to ensure that BII's investments help the world's poorest people, FCDO should increase its oversight of BII and take a non-voting seat on the BII board.***

Partially Accept

The FCDO's governance arrangements for BII follow best practice guidance from the Cabinet Office and HM Treasury for the management of a public financial corporation. They ensure clear accountability for BII's activities and detailed oversight by the FCDO.

The FCDO agrees that BII's strategy and operations must be consistent with UK development policy. The FCDO already ensures this by:

- Undertaking a comprehensive Business Case for any new capital injections into BII, requiring Ministerial approval and aligning the use of funding with FCDO's development priorities.
- Setting BII's strategy, objectives, and operational parameters through the Investment Policy, Policy on Responsible Investing, Remuneration Framework and annual letter from the Secretary of State to the Chair of BII's Board.
- Aligning BII's investment policies with Government positions, for example, the UK's Fossil Fuel Policy.
- Assessing BII's performance in annual reviews conducted by FCDO (the most recent was published to Dev Tracker in September 2023).

The Government agrees that strong oversight of BII is essential. This is achieved through both: i) ensuring BII's Board has the correct mix of skills and experience to exercise effective oversight of BII's activities; and ii) direct reporting by BII to ministers and senior officials representing the shareholder. BII's Board is responsible for overseeing BII's activities and is fully accountable to the FCDO. The FCDO appoints 3 representatives to the Board with full voting rights - the Chair and two Non-Executive Directors – and is consulted on all other appointments. These Board members are appointed by Ministers for their specific skills and experience in overseeing the performance of a regulated financial institution, ensuring it delivers the strategy set by the FCDO. Ministers and officials hold the Board to account through regular formal reporting and engagement at senior levels as articulated in BII's reporting framework.

In addition to holding the Board to account for its oversight of BII, the FCDO's formal reporting framework with BII provides comprehensive access to information and assurances on BII's performance across a range of areas, including development impact, financial performance, portfolio composition, operational performance, and risks and incidents. This direct reporting to FCDO senior officials and ministers is delivered through regular engagement with the Chair and senior management of BII, principally through regular meetings – normally quarterly – with the Minister for Development, Quarterly Shareholder Meetings which are chaired by the FCDO Director-General, and an Annual Shareholder Meeting with the FCDO's Second Permanent Secretary. Alongside this there is an established process for escalating any significant risk events that occur within the portfolio or BII.

Other bilateral DFIs may have differing governance arrangements where this suits their specific circumstances, for example, because the DFI is a government agency and does not have clear reporting lines to one Secretary of State (e.g. US DFC) or where the DFI has other shareholders who influence the direction of the institution (e.g. FMO). In contrast, UK Public Corporations such as BII are the responsibility of the relevant shareholding department, with the Minister as sole shareholder accounting for all matters concerning the public corporation in Parliament.

The Government is committed to maintaining best practice governance arrangements and will continue to periodically review procedures. However, the Government does not agree that the specific proposal of appointing a government official to take a non-voting seat on BII's Board would enhance BII's governance arrangements. A non-voting board representative would bring additional risks, including potentially disrupting Board dynamics and blurring lines of responsibility between the Board and FCDO, with the representative duplicating existing oversight and current lines of accountability. The Government does not consider the benefits of FCDO holding a non-voting position to be clear or to outweigh the potential risks. The BII Board has already been assessed as effective in the latest external Board evaluation conducted by Chris Saul Associates in 2022, finding that the Board was positive, disciplined, collegiate and well managed with high standards and professionalism.

Recommendation 2. *The FCDO must work collaboratively with BII throughout its operations to deliver the International Development Strategy's objective of supporting countries to grow thriving economies by 31 March 2024. It should do this at both country office and regional levels by sharing institutional knowledge and ensuring that BII's investments complement the FCDO's bilateral programme. This should be built into the single country plan of each country where BII operates: the plan should outline operational synergies between FCDO and BII staff, identifying where the FCDO's bilateral programmes complement BII's investment activity and finding opportunities for further collaboration.*

Accept

The Government agrees that delivery on the International Development Strategy's objective of "supporting countries to grow thriving economies" requires effective collaboration between FCDO and BII.

Building effective collaboration between HMG and BII is an explicit aim in BII's current 2022–26 strategy. The FCDO works closely with BII to ensure complementarity between the UK's wider ODA portfolio and BII investments, with the FCDO shareholder team ensuring that BII's work is effectively communicated across its network. The FCDO and BII have produced formal collaboration guidance to support overseas posts to effectively engage with BII and seek out synergies related to policy and programming.

The Government also agrees that opportunities for collaboration and coordination with BII activities should be integrated into relevant FCDO Country Business Plans to ensure coherence. This practice is most relevant in countries where there are significant opportunities for BII investment. The FCDO shareholder team in London already works with posts to ensure BII's activities are understood and opportunities for alignment and cooperation identified. This practice is prioritised in countries where there are significant opportunities for BII investment. Ministers will explore opportunities to strengthen this practice, including ensuring opportunities for collaboration are included in country business plans in posts where there is both a UK Government presence and a reasonable likelihood of BII making an investment in this strategy period. There will be some countries where BII operates where opportunities for collaboration are minimal (e.g. where the FCDO has limited presence) and therefore including detail on collaboration in the Country Business Plans would not be proportionate or useful. The FCDO has also developed strategies for British Investment Partnerships focus countries which integrate how BII will contribute to BIP objectives in these countries.

Recommendation 3. ***The FCDO must incorporate SMART targets into its strategy documents that stretch the development impact that BII achieves, such as the number of quality jobs created through its gender lens investments. This must be done by March 2024 to achieve active governance over BII and to ensure that BII's investments are achieving greater impact for the world's poorest people.***

Partially Accept

The Government recognises the importance of actively monitoring impact to ensure that BII continues to help solve the biggest global development challenges, and FCDO has a number of arrangements in place to ensure appropriate oversight of BII's impact. As with all other areas of Government ODA spending, any approval for new funding for BII is subject to a comprehensive FCDO business case that aligns with FCDO's priorities and is approved by Ministers. The business case process sets out the outputs and outcomes that FCDO aims to achieve from new capital injections, and the indicators FCDO will use to assess BII's performance against such outputs and outcomes in the form of a log frame. The FCDO assesses BII's performance against these indicators in annual reviews which are made publicly available (the most recent was published to Dev Tracker in September 2023).

The FCDO's agreed reporting framework with BII also provides wider data and analysis on a set of both quarterly and annual core metrics. This formalised reporting is the basis for key performance indicators and other data discussed as part of Quarterly Ministerial and Shareholder Meetings between the FCDO and BII, ensuring effective real-time oversight of BII's impact.

BII has clear operational procedures in place to maximise the impact of its investments. BII's Impact Framework is designed to incentivise BII towards the most impactful investments aligned to its three strategic objectives. The framework has been reviewed and held up as an industry leader by BlueMark, a third-party assurance provider of impact claims and practices. All investments made under BII's current strategy will receive an ex-post assessment of their impact score biennially to measure performance against initial impact expectations.

In addition, FCDO and BII have agreed a longer-term Evaluation and Learning Programme which appoints independent evaluators to measure BII's development impact and recommend further improvements to BII's investment strategies based upon this learning. Independent evaluations have assessed BII's Infrastructure and Financial Institutions portfolios (two of BII's three sector groups), with a review of the remaining Industries, Technology and Services portfolio due for completion in early 2024. Building on these sector evaluations, further in-depth studies using bespoke primary research are being conducted to better inform FCDO and BII of the latter's development impact and what lessons can be taken into consideration for investments in the future.

To further strengthen oversight of BII's impact, Ministers will undertake a review of the BII log frame underpinning the annual review process to consider whether additional indicators can be included to capture BII's delivery of the 2022–2026 strategy in further detail. The FCDO will also review its SMART targets for BII as part of the next strategy period from 2027.

It is not appropriate for the shareholder to introduce multiple additional SMART targets within this strategy period. As a long-term patient investor of capital, BII requires clarity and certainty about its objectives over the course of a whole strategy period and has limited ability to alter its portfolio to meet new objectives in the short-term. Moreover, additional SMART targets could incentivise BII to undertake activities which would potentially trade-off against other objectives Ministers have agreed with BII. For example, a specific target for the number of jobs created risks providing BII with an incentive towards investments in more mature markets and sectors where large-scale job creation is more feasible.

Recommendation 4. ***The FCDO should have more oversight of the regional split of BII's funds. It should actively monitor the thematic and geographic split of BII investments and include this within its annual reporting of ODA expenditure. The profiling of BII investment activity should also reflect the FCDO's priorities, and this should be guided by the FCDO setting geographic and thematic handrails. The geographic and thematic areas of BII expenditure should be reported alongside the FCDO's annual programme expenditure so the UK taxpayer has true sight of how UK ODA has been spent regionally and across thematic areas.***

Partially accept

The Government agrees that it is important to monitor effectively the thematic and geographic split of BII's investments. The FCDO does so through the agreed reporting framework with BII, which includes information on BII's investment commitments and portfolio net asset value by geography, sector, and investment product, amongst other metrics. This information is provided on a quarterly basis to Ministers and discussed as part of the Quarterly Shareholder Meeting. BII also makes much of this data publicly available on its website and through its annual report.

The Government also agrees that it should guide BII's thematic and geographic investment activity. This is already done through the Investment Policy, which sets BII's geographic mandate, and the Impact Score which guides BII's portfolio construction to align with delivery of BII's three corporate objectives – to support productive, sustainable, and inclusive development. The Impact Score includes a prioritisation of countries, with more weight given to lower-income geographies, and incentivises investments in key priority themes. Ministers have set a target for BII investment in the Indo-Pacific region over the five-year strategy period of $500m of climate finance and will ensure the vast majority of BII's investment commitments over the current five-year strategy period will be in Africa and South Asia - FCDO priority regions. In addition, Ministers have set BII thematic targets for 30% of all new investments to qualify as climate finance, and for 25% of all new investments to qualify under the 2X Challenge as 'gender lens' finance.

As per the response to Recommendation Seven, Ministers have set BII a new ambition for over 50% of its annual investment commitments to be in the poorest and most fragile countries by 2030. The FCDO will consider setting further guidance on the proportion of BII's investments in particular sectors, regions, or categories of countries where relevant as part of discussions on BII's next five-year strategy.

The FCDO and BII report in line with internationally agreed ODA rules, set by the OECD. It is important to note that BII is distinct from grant ODA programmes. BII recycles capital and profits from existing investments into new investments, allowing BII to deliver greater investment volumes than the capital injections it receives from the taxpayer. BII annual investments are therefore not the same as the Government's provision of ODA to BII for a given year. Specific ODA allocations are therefore not directly attributable to investments made. Providing a thematic and geographic breakdown of BII investments alongside FCDO's annual programme expenditure for BII would confuse FCDO ODA and BII investments. Given these are not directly comparable, the FCDO will not provide this data together in the FCDO's ODA reporting. The FCDO will instead highlight where this data can be found on BII's website.

Recommendation 5. ***BII should articulate the work it strives to do to promote gender equality and target under-represented groups through its investee businesses by setting its own proposal for impact. This should set out the categories of people that are being targeted, the impact that the investments are targeting and the target outcomes and key metrics that will be measured to show the change created from BII's investments.***

Accept

The Government agrees that BII should articulate the work it strives to do to promote gender equality and target under-represented groups. For the Strategy Period 2022–26, BII has committed to focusing on two areas of diversity finance: i) gender finance (using the 2X Criteria) ii) promoting black ownership and leadership in Africa. BII's proposal for impact across both of these is set out in the organisation's 2022–26 Strategy document. Details on the specific approach that BII is taking can be found in BII's Gender & Diversity Position Statement.

BII is a champion of gender-smart investing and a founding member of 2X Global which is engaging investors, capital providers and mobilisers to work together to advance gender-smart investments and scale the field of gender finance. The 2X Challenge has raised $16.3 billion to support women's economic empowerment across developing country markets from 2021 to 2022, with BII having contributed $1.3 billion to this figure. The framework has assisted in mainstreaming gender into BII's investment decision-making processes, allowing BII to systematically assess all investments for gender gaps and opportunities. Under its current strategy period, BII will target at least 25% of all new investments on a cumulative basis over 2022–2026 as being 2X qualified. In 2022, BII invested £640.3 million in 2X-qualified businesses, 50% of its total commitments that year.

Recognising that the 2X Framework forms the global standard for gender-lens investing, BII will continue to use 2X as a starting point for reporting on gendered impact. BII already discloses all 2X qualified deals, which are published on BII's website and form part of BII's Annual Review. As part of the Transparency Roadmap (see response to Recommendations 13 and 14), BII will also begin disclosing the qualifying criteria for each new 2X investment. In addition, as part of the next phase of the 2X Challenge, BII will also align with the increased disclosure requirements for 2X qualifications being set by 2X Global.

In 2024, BII will publish a Gender Impact & Learning Report to set out where BII has made investments which are impactful for women and girls at the point of investment and investments where BII has worked with the investee to deliver impact for women once invested. The report will also cover impact realised within 2X qualified investments, where the remaining challenges for gender-lens investing lie, and analysis of what can be done to address this.

BII's Gender and Diversity Position Statement also highlights the organisation's BOLD (Black Ownership and Leadership for Development) investing framework. This aims to increase the representation of Black owners and leaders in BII's sub-Saharan Africa portfolio. For example, in Ghana, BII has invested in Growth Investment Partners, a Black-led SME lending platform, which has targets in place to direct a percentage of its capital to local Black-owned and -led businesses.

The Government recognises the importance of the FCDO-BII Evaluation programme (see response to Recommendation 3) considering gender, development impact, and environmental and social outcomes, having integrated these into previous evaluations. The FCDO will ensure these will also be a specified feature of future portfolio and individual investment evaluations.

Recommendation 6. ***A British Investment Partnerships strategy is urgently needed to drive effective co-ordination of actors within the BIPs and to ensure the International Development Strategy's objective of delivering development in partnership achieves maximum impact. The FCDO must create this strategy, outlining its expectations of all parties involved in those partnerships, by 31 March 2024. The strategy must define inputs, outputs and outcomes measured by entity and progress against these metrics must be publicly reported each year.***

Accept

Through British Investment Partnerships (BIP), the Government is developing a multi-faceted approach that addresses the complex set of barriers to investment and economic growth in developing countries and strengthens the link to development outcomes. The Government's vision is that BIP can anchor and join up HMG's financial instruments, technical assistance, and strategic partnerships, which otherwise largely operate in isolation. This is a long-term ambition that requires us to encourage increased collaboration and new ways of working. The FCDO agrees that publishing a strategy that sets out how we intend to deliver this ambition would be useful for driving further collaboration.

The effective co-ordination of actors within BIP is important to deliver development in partnership and achieve maximum impact. The FCDO is working closely with key partner countries in Africa, Asia and the Caribbean to ensure that the BIP offer meets their needs. We are also collaborating with strategic investment partners, including the G7, Australia and the Republic of Korea, to build a comprehensive and collective investment offer. We are planning further engagement with the multilateral system, the private sector and civil society to support our objectives.

The Government agrees it is important to measure and report the impact of BIP. BIP is a central pillar to the UK's International Development Strategy (IDS), one of the seven priorities outlined in the Integrated Review Refresh, and will be central to the ambitions of the new White Paper. The FCDO reports against BIP's delivery through IDS progress reports, most recently in August 2023. Programmes within BIP also publish detailed reporting against inputs, outputs and outcomes in their Annual Reports. The FCDO will draw on these metrics, including those published through our Development Finance Institution (DFI) reporting, to ensure consistent and meaningful reporting in this strategy.

Through the development of this strategy, the FCDO will consult and engage with relevant actors and partners to ensure their views are incorporated into our approach. While we appreciate that it is helpful to publish this strategy quickly, consultation with stakeholders will take time and is essential to developing effective co-ordination. However, in response to the Select Committee, the Government does feel able to commit to publishing by summer 2024.

Poverty Reduction

Recommendation 7. ***BII must better distribute its investment across countries with different development needs and income status by capping the proportion of investments that it holds in middle-income countries, at a percentage determined by the Minister for Development, by 31 March 2025. The rate should be defined within BII's investment policy and frequently monitored through BII's published reporting.***

Partially accept

The Government agrees that BII should have a balanced portfolio of productive, sustainable, and inclusive investments across a range of countries with different development needs. Ministers have already set BII a more concentrated and challenging geographic remit than any other bilateral Development Finance Institution, focusing BII on low-income and lower-middle income countries to deliver development impact. BII's Impact Scoring system prioritises investment towards the poorer countries within BII's geographic remit. FCDO monitors BII's investment commitments and portfolio net asset value by geography through Quarterly Shareholder Meetings to provide effective shareholder oversight of BII's geographic focus. BII makes much of this data publicly available on an annual basis on its website and through its annual report.

This approach has led to BII becoming the leader amongst DFIs for investing in low income and fragile countries. The majority of BII's portfolio is invested in Africa (57% at end of 2022) with BII being the largest investor of all European DFIs in fragile and conflict affected states (WB FCS) – having 30% more invested in fragile countries than the second placed DFI, and double that of the third placed DFI. BII has also led a number of cross-DFI initiatives looking at reducing the barriers to investing in fragile countries including establishing the DFI Fragility Forum and incubating the African Resilience Investment Accelerator (ARIA), which seeks to increase the number of investible opportunities for DFIs.

The Government also recognises that significant development challenges remain in middle income countries which development finance is an effective tool for addressing. These countries include 60 percent of the world's poor, are heavily reliant on fossil fuels for energy provision, and have limited sources of financing from under-developed capital markets. In countries such as South Africa and India BII takes a much narrower approach, limiting new investments to focus on climate finance and inclusivity, and placing a stronger emphasis on mobilising private capital alongside its own investment. A similar approach has been adopted in the Indo-Pacific where BII is solely targeting climate investments, including in Vietnam, Indonesia, and the Philippines.

To ensure BII continues to maximise impact, the Minister for Development has set BII a new ambition for over 50% of its annual investment commitments to be in the poorest and most fragile countries by 2030. As per the response to Recommendation Three, the Government has set this ambition as part of BII's next strategy period to ensure compliance with good governance practices. As a long-term patient investor of capital, BII requires certainty about its objectives over the course of a whole strategy period and has limited ability to alter its portfolio to meet new objectives in the short-term. Were it to do so, it would not be in the interests of the shareholder, taxpayers, or those we seek to help.

Recommendation 8. ***To ensure that poverty reduction is central to BII's investment decisions, BII must pursue investments that demonstrate a clearer focus on driving inclusive economic growth and reducing financial and social inequality.***

Accept

The Government agrees that BII's investments must support inclusive economic growth. The Ministers agreed three strategic objectives for BII as part of its current 2022–2026 strategy: to invest in *productive, sustainable, and inclusive* development. These objectives ensure that poverty reduction, inclusive economic growth, and reducing inequalities are at the heart of BII's approach. Moreover, these strategic objectives are integrated into BII's investment decision making through its new Impact Framework which assesses each new investment against its contribution to these objectives.

An important element of BII's Impact Framework is its portfolio-level Impact Score. Designed with FCDO and adopted as part of its new strategy, BII assigns each new investment an Impact Score as an objective, data driven assessment of its alignment with BII's strategic objectives. This enables BII to construct a balanced portfolio of impactful investments which meet its three strategic objectives. Investments which deliver higher impact across the three dimensions of productive, sustainable, and inclusive development are awarded higher scores. BII seeks to maximise the aggregate Impact Score it achieves each year with this being one of two main corporate performance measures set by FCDO for this five-year strategy period. BII's performance against the impact score is also directly linked to staff renumeration. As set out in the response to Recommendation 11, BII's application of its Impact Score methodology was independently assured in 2022 to verify BII's assessments were in line with its Impact Score Implementation Manual.

All three of BII's strategic objectives ultimately target poverty reduction. Productive investments that help to build critical infrastructure and drive business development are central to job creation and unlocking economic growth. Through its sustainable investments, BII supports the decarbonisation of economies to limit the harms of global heating and helps people and businesses adapt to the changing climate. Moreover, BII's strategic objective on inclusion incentivises BII to prioritise investments in poorer and more fragile countries, and those that reach low-income and marginalised groups within countries.

The Government will continue to monitor and evaluate BII's performance against the Impact Score, including the inclusion element of this which most directly focuses on poverty reduction. As part of this ongoing effort, in 2023 the FCDO requested an analysis of how implementation of the impact score was driving investment decisions, with a specific focus on the priority given to the inclusion element of the score.

Recommendation 9. ***BII must target nascent markets that struggle to stimulate investment from the private sector. BII must annually assess the value it adds to investee companies. Where BII has not proven its additionality to an investment or its case for additionality is no longer valid, BII should exit that investment.***

Partially Accept

The Government agrees with the importance of ensuring BII's investments are genuinely additional. When evaluating investments BII's Impact Framework incorporates an assessment of BII's contribution to the development outcomes of each proposed investment across three key aspects:

(1) Financial additionality: would BII be providing capital to an investee that is not otherwise available in sufficient quantity or on suitable terms?

(2) Value additionality: would BII be offering specialist expertise to investees in areas such as gender or climate?

(3) Mobilisation of additional capital: would BII be mobilising capital from others that would not otherwise be available to the investee?

The strength of BII's impact contribution in each proposed transaction is rated on a 4-point scale and investments are rejected if the threshold for additionality is not reached. This approach is aligned to the industry best practice Operating Principles for Impact Management, and BII has been rated as 'advanced' for its approach to contribution through independent verification.

Having set its expectations for the development impact it is seeking to achieve as part of its investment case, BII assesses the performance of its investments on a quarterly basis across different dimensions including development impact; environmental, social, governance (ESG) and business integrity; and commercial. Those investments that are potentially off-track against their investment thesis are escalated for discussion with the relevant Managing Director and the Offices of Chief Impact Officer, Chief Risk Officer and Chief Investment Officer. Specific actions are identified that BII should be taking in response. Those classified as higher risk or underperforming will be reported to Managing Directors and the CEO, with Board oversight.

For investments where BII has discretion over the timing of divestment, BII seeks a responsible exit once its presence as an investor is no longer contributing to impact, or where risks have materialised which may prevent impact being realised. BII undertakes a formal process for exiting investments which includes detailing the rationale for exit, its efforts to ensure the ongoing impact of the asset (i.e. selling to the right investor), and delivering value for money for the UK taxpayer (i.e. seeking to earn a fair return on its investments). The Government believe this is the responsible way to handle these matters.

Recommendation 10. ***To ensure that poverty reduction is central to BII's investment decisions and to prioritise investments that are critical to recipient countries' development needs, BII must:***

- ***a) take responsibility for where its money is invested by exerting greater oversight and control over the activities of financial intermediaries who invest UK taxpayers' money.***
- ***b) ensure that its investments reduce inequality by targeting investments that generate tax receipts in the country of operation rather than channelling money through low-tax jurisdictions that ultimately promote tax savings for those intermediary agents.***
- ***c) rigorously monitor all its intermediated investments to ensure that it can intervene before its money is invested in companies whose values are not aligned with the International Development Strategy.***

Partially Accept

The Government agrees that poverty reduction must be central to BII's investment decisions. BII contributes to poverty reduction by making investments that align with its three strategic objectives: to support productive, sustainable, and inclusive development. The objectives are translated into BII's investment decisions via BII's Impact Score. As outlined in response to Recommendation 8, all three objectives are aligned to the UN Sustainable Development Goals and support poverty reduction.

Investing through intermediaries is an important part of a DFI's ability to deliver impact. It enables the provision of smaller levels of financing; supports the development of local institutions; helps raise wider market standards by supporting funds to meet BII's requirements for responsible investment; and mobilises third-party capital into funds investing to support development.

The Government agrees that BII should have appropriate oversight and monitoring of its investments, including investments in intermediaries (Recommendations 10a and 10c). The FCDO already ensures BII has strong oversight of its investments by agreeing BII's Policy on Responsible Investment as part of the five-year strategy process. The Policy sets out the Environmental, Social and Governance and Business Integrity requirements for

BII investees which are based on legal requirements as well as guidance from international frameworks such as the IFC Performance Standards; ILO Core conventions; OECD and UN conventions on combating bribery; FATF and Basel standards on anti-money laundering; and draws from the UN Guiding Principles of Business and Human Rights. Where investees do not meet BII's requirements under the Policy on Responsible Investing, BII will either not proceed with the investment or agree a legally binding action plan for addressing gaps which are then monitored post-investment. The parameters along which a financial intermediary can invest BII's capital are set out at the point of investment in a legally binding limited partner agreement.

As explained in the response to Recommendation 9, BII monitors its investments into businesses, banks and funds by formally assessing the performance of its investments on a quarterly basis. BII also has a range of other formal oversight mechanisms, including a seat at - and often chairing – an investment fund's board, advisory committee or investment committee; receipt and review of regular reporting on the performance of the fund and its investments; participation in ESG committees; the right to review initial and high-risk due diligence undertaken by the fund on its underlying portfolio investments; requirements for the fund to report adverse events; and visits to the fund's portfolio companies to review implementation.

Ministers are therefore satisfied with the processes that BII has in place to ensure investments made through intermediaries comply with BII's key policies. For example, any intermediary BII invests in as part of the current strategy period must comply with the UK's Fossil Fuel Policy, which BII has also adopted. BII investees are legally required to comply with BII's policies relevant at the time BII makes its investment. It is not possible to apply new BII policies to historic investments made in previous strategy periods. BII has strong oversight of its investments through its regular engagement, including its investments in financial intermediaries.

The Government does not fully support Recommendation 10b). Ministers and BII recognise that tax receipts are fundamental to the ability of governments in development countries to fund public spending and stimulate sustainable development. BII monitors and publishes taxes paid and other fiscal contributions made by its investee companies as part of its development impact measurement programme. BII's investee companies paid $1.79 billion in tax in 2022 and have paid over $12 billion since 2018. BII's preference is to invest directly in a country or region where an investee company is located. BII uses intermediate jurisdictions only when it is needed to attract foreign investment or to ensure adequate protection of UK taxpayers' money (due to weak legal, regulatory and tax systems in some developing countries). BII only invests through funds that are domiciled in jurisdictions that are compliant with international tax transparency standards, as monitored by the OECD's Global Forum on Transparency and Exchange of Tax information.

Ministers believe that the IDC's recommendation would lead to less foreign direct investment flowing to developing countries, thereby delivering lower impact and potentially reduced tax revenues, and is satisfied with BII's existing procedures and safeguards. BII is committed to maintaining best practice of multilateral and development finance institutions in this area.

Recommendation 11. ***The FCDO must hold BII accountable for its due diligence and ongoing monitoring of its direct and indirect investments. To that end, FCDO must audit BII's investment portfolio over a rolling five-year period against a set of environmental, social and governance (ESG) and development impact standards to validate BII's internal assessments.***

Partially Accept

The Government agrees that it should hold BII accountable for its due diligence and ongoing monitoring of its investments. Ministers achieve this through existing corporate governance arrangements, with BII's Board being both responsible for overseeing BII's activities and fully accountable to the Government. BII is also authorised and regulated by the Financial Conduct Authority (FCA) with the Board responsible for ensuring compliance with its regulatory obligations.

To ensure BII is implementing best practice and to validate BII's internal assessments, many of BII's activities are independently verified. For example, BII's approach to development impact management is verified by BlueMark (a leading provider of independent impact verification) for alignment to the industry best practice "Operating Principles for Impact Management". BII is currently the only DFI on BlueMark's Practice Leaderboard demonstrating best-in-class impact management practices. In addition, BII's annual Aggregate Impact Score is externally assured by EY in line with ISAE 3000 international assurance standard.

BII's processes and investment decisions are also regularly scrutinised by independent reviewing bodies such as ICAI and the NAO. For example, BII worked with ICAI over a three-year period as it implemented a new Impact Framework. On ESG standards, ICAI found BII to be "*a leader among DFIs in assessing and supporting environmental, social and governance (ESG) issues*" (ICAI, 2019) and that BII "*is recognised as a thought leader by other DFIs in some areas, particularly on ESG issues*" (ICAI, 2019). In ICAI's most recent follow-up review it concluded that "*the extent of consideration of development impact in investment decisions is now much greater and that aspects of this consideration are often impressive*" (ICAI, 2021). In assessing BII's approach to active monitoring ICAI concluded that, "*we also found good evidence that all investments in our sample have been subject to regular assessment of development impact and that there was active ongoing management to improve impact or manage related risks*" (ICAI, 2021).

As referenced in response to Recommendation 3, independent evaluation is another important aspect of scrutinising BII's activities. FCDO and BII have an Evaluation and Learning Programme which appoints independent evaluators to assess BII's development impact and recommend improvements to investment strategies. Lessons from these evaluations are incorporated in BII's approach. For example, the Financial Institutions evaluation led to a shift towards financial sector investments which target support for specific customer groups and impact objectives (e.g. directed-lending for women owned and led businesses).

Given the existing oversight mechanisms in place, Ministers believe a full rolling audit of all portfolio investments would be disproportionate and not deliver value for money. However, as part of FCDO's commitment to ensure best practice oversight arrangements are maintained, Ministers will review in 2024 whether additional spot checks of BII investments by external experts to verify BII's internal ESG and development impact assessment are required.

Accountability and Transparency

Recommendation 12. ***To deliver accountability and transparency and to operate in lockstep with the International Development Strategy, BII must assess the impact of its portfolio under previous strategy periods and actively manage its portfolio. BII must perform annual assessments of the impact delivered by all of its portfolio investments, including those businesses that are invested in through financial intermediaries. BII must divest from those investments that do not have a clear development objective and do not align with the International Development Strategy. In conclusion to these concerns expressed by the Committee and some that submitted evidence, we recommend the Minister maintain closer scrutiny on the whole budget and the proportion of the ODA budget allocated to BII. At a time of limited availability of the development budget, the taxpayer needs assurance that Official Development Assistance is used to support the world's poorest people in the most effective way.***

Partially Accept

The Government agrees that Ministers should maintain scrutiny over the ODA budget, including allocations to BII. Ministers closely review the allocation of the ODA budget to ensure spending is aligned with Departmental priorities and approve all FCDO capital contributions to BII. Capital contributions to BII between 2015–2021 equalled approximately 4% of the UK's ODA budget and enabled a planned build-up of BII's activities over that time.

The FCDO closely scrutinises BII's activities to ensure effectiveness. As mentioned in the response to Recommendation 1, strong governance arrangements provide accountability and detailed oversight. FCDO's active role in setting BII's five-year strategy ensures BII operates in lockstep with the UK's International Development Strategy.

BII annually monitors the development impact for both direct and intermediated active investments made since BII's investment mandate was expanded in 2012. Investments made in the current strategy period are assessed under the new Impact Framework. The Impact Score assigned to each new investment, which forms part of the Framework, is also reassessed at 2-year intervals after BII's initial investment, in addition to annual impact monitoring. Investments made in previous strategy periods 2012–16 and 2017–21 are all subject to annual monitoring and assessed against the development impact metrics agreed at the time of the investment.

Ministers recognise the importance of the FCDO-BII Evaluation programme (see response to Recommendation 3) considering gender, development impact and environmental and social outcomes, having integrated these into previous evaluations. The FCDO will ensure these will also be a specified feature of future portfolio and individual investment evaluations.

Ministers consider BII's monitoring to be appropriate. However, as part of FCDO's commitment to ensure best practice oversight arrangements are maintained, the FCDO will review in 2024 whether additional spot checks of BII investments by external experts to verify BII's internal ESG and development impact assessment are required. Ministers disagree with the recommendation for BII to perform annual impact assessments of businesses invested in through financial intermediaries as this would require substantial additional resource and be disproportionate to ensuring a reasonable assessment of impact. BII already monitors these investments at the intermediary level as per the above processes.

As referenced in the response to Recommendations 3 and 11, FCDO and BII's Evaluation and Learning Programme, which uses independent evaluators to measure BII's development impact, has also published two independent evaluations of BII's Financial Institutions and Infrastructure portfolios. These found that 84% and 80% respectively of BII's investments in these sectors were on track to meet or had outperformed their development impact theses as defined at the point of investment. A review of the Industries, Technology and Services portfolio is due for completion in early 2024.

As referenced in response to Recommendation 9, where BII has discretion over the timing of divestment it seeks a responsible exit once its presence as an investor is no longer contributing to impact, or where risks have materialised which may prevent impact being realised. BII undertakes a formal process for exiting investments which includes detailing the rationale for exit, its efforts to ensure the ongoing impact of the asset (i.e. selling to the right investor), and delivering value for money for the UK taxpayer (i.e. seeking to earn a fair return on its investments).

Recommendation 13. ***BII must prioritise the monitoring and reporting of investment activity and transparently report its financial and impact data. This should include, but not be limited to:***

a) the number and type of jobs created,

b) types and value of capital mobilised,

c) the 2X Challenge assessment of its portfolio according to the five 2X Challenge criteria,

d) how the 2X classification has improved an investee company above employment levels currently found in the market for a given country.

BII must also adhere to publishing a full annual listing of its investments in coal, oil and gas so an external assessment can be made on its progress against its Climate Change Strategy and a net zero portfolio, as previously recommended within our 2021 report on UK Climate Action and International Development around COP26. The data should be complete for all BII's investments, published in a timely manner and allow for comparability over time. Where investments have not achieved their planned annual impact outcomes, BII should disclose the reasons for any short-comings and set out its plan for recourse. (Paragraph 116)

Partially Accept

The Government agrees with the importance of BII prioritising the monitoring and reporting of its investment activity and financial and impact data. BII ensures transparency by reporting all its investments on a public database available on BII's website. This includes the amount committed, details about the investee, and the anticipated development impact.

To further strengthen transparency, BII will publish a Transparency Roadmap before the end of 2023. This will articulate BII's ambition to be the most transparent bilateral development finance institution as measured by the Publish What You Fund transparency index, as well as specific short-term actions to deliver on this ambition.

At a portfolio level, BII already reports against subcategories a) and b) above. For example, in 2022 BII's investments supported 54,000 additional jobs and BII mobilised $1.35-$1.41 billion of private-sector capital. Moreover, 50% of BII's 2022 investments were gender-focused investments into 2X-qualified businesses and fund managers.

All BII's 2X qualified deals are published on an annual basis on BII's website and form part of BII's Annual Review which is also published online. Typically, 2X qualifications are also included within investment announcements on BII's website, including which criteria the deal qualified under in line with Recommendation c) above. As part of the Transparency Roadmap, BII will also begin disclosing the qualifying criteria for each new 2X investment.

For sub-category d), BII will continue to provide in its Annual Review and other publications examples of how 2X-qualified investments have created positive outcomes for women and girls – providing outline for best practice and learning for the industry. For example, BII's investment in Kashf Foundation, a microfinance institution that provides finance to female entrepreneurs in Pakistan, has enabled the business to expand its customer reach from 490,000 in 2020 to 639,000 customers by end 2022. Moreover, increased disclosure requirements for 2X qualifications are being set by 2X Global as part of the next phase of the 2X Challenge. BII, together with its 2X DFI peers, will adhere to these new requirements as they are introduced.

As part of its commitment to align with the Task Force on Climate-related Financial Disclosures (TCFD), BII already discloses the percentage of assets in its portfolio that can be considered climate finance and 'carbon-related' (i.e. in the fossil fuel value chain) as part of its annual TCFD disclosure in its Annual Accounts - and in line with the TCFD recommendations on metrics. In the future, BII will state on their public investment database, where applicable, whether investments in their power generation portfolio are renewable or fossil fuel. This will be included in the Transparency Roadmap milestones and make it easier to identify BII's fossil fuel investments.

The Government does not agree with the recommendation for BII to publish progress against planned annual impact outcomes. BII regularly monitors progress against the short-term impacts of its active investments made since BII's investment mandate was expanded in 2012 and publishes aggregated impact outcomes for its whole portfolio in its Annual Review. This approach was endorsed by ICAI who concluded in their 2021 review of BII that "all investments in the sample were monitored against the development impact thesis and RAG-rated (red/amber/green) for the quarterly portfolio reviews" (ICAI, 2021). However, as a provider of long-term patient capital, the full anticipated impact of BII's investments, including longer-term systemic impacts, often takes multiple years or even decades to deliver. As such, and as set out in the response to Recommendation 11, Ministers and BII believe the most appropriate and rigorous way of assessing BII's development impact is through multi-year independent evaluation. BII actively manages investments for impact against a long-term plan, course correcting where possible.

Recommendation 14. ***BII should use Publish What You Fund's DFI Transparency Index as a roadmap to increase the transparency of its operations and public disclosures. (Paragraph 117)***

Accept

The Government agrees with the importance of BII being a leader on transparency across the DFI system and ensuring BII is a transparent and open organisation. Ministers have set BII the goal to rank as the most transparent bilateral development finance institution in the next Publish What You Fund DFI Transparency Index. BII will publish a Transparency Roadmap to articulate their ambition to be the most transparent bilateral DFI, with specific short-term milestones for delivering on this goal. BII will also place greater emphasis on using data from improved transparency - alongside their wider monitoring and evaluation work – to become a more effective learning organisation, incorporating lessons into its investment decisions and future strategy, as well as sharing knowledge across the DFI system.