Foreign, Commonwealth & Development Office

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Rt Hon Andrew Mitchell MP
Minister for Development and Africa

King Charles Street
London
SW1A 2AH
Tel: 0207 008 5000

Email:
fcdo.correspondence@fcdo.gov.uk

www.gov.uk/fcdo

Sarah Champion MP
Chair, International Development Committee
House of Commons
London

SW1A 0AA

25th June 2023

Dear Sarah,

I am writing in response to questions raised at the International Development Committee (IDC) evidence session on Investment for development: The UK's strategy towards Development Finance Institutions on 6th June 2023. I offered to write to you with more detail on several issues as below. As I stated in the session on 6th June, I look forward to receiving your recommendations and will consider them fully.

(Q265-267) Requested information on the proportion of the ODA budget going to BII and the proportion of BII investment spent on BII staff costs including senior staff.

From 2015 to 2021, annual ODA funding to BII has averaged around 4% of total UK ODA. Funding of BII as % of total UK ODA per year is as follows: 2017 (2%), 2018 (5%), 2019 (7%), 2020 (4%), 2021 (4%). In the context of recent reductions to the FCDO's ODA budget, we have reduced our planned contribution to BII by 30% over 2022/3-2024/5. FCDO determines the amount of additional funding to BII based on strategic ambition, needs assessment and liquidity position in the context of overall ODA availability, particularly the level of Financial Transactions funding determined by the Treasury.

As set out in paragraph 87-89 of our submission to the Committee, BII manages its costs to an agreed operating ratio (1.7% of Total Portfolio value plus unfunded commitments at the calendar year-end). An annual budget is prepared by BII to ensure that it is operating within its financial capacity, that the board and management understand the costs incurred in the business and to ensure that resources are directed towards meeting the company's objectives. The budget is reviewed, challenged and, ultimately, approved by the Board. Regular monitoring against operating costs ratio is provided to FCDO through quarterly reporting. Annual costs – including remuneration - are published in BII's Annual Accounts. Below is a table summarising the total employee benefits expense from the 2022 Annual Accounts. Total employee benefit expense in 2022 was £81m. BII's total investment portfolio value in 2022 was £6,888.6m, of which £1,273m was new commitments.

	Group		Company	
	2022 £m	2021 £m	2022 £m	2021 £m
Wages and salaries	**(55.2)**	(49.2)	**(49.0)**	(43.4)
Social security costs	**(9.0)**	(7.3)	**(8.9)**	(7.3)
Pension costs – defined benefit	**(0.8)**	(1.0)	**(0.8)**	(1.0)
Pension costs – defined contribution	**(5.7)**	(5.0)	**(5.2)**	(4.5)
Long-term Investment Performance Plan (LTIPP) accrual*	**(10.3)**	(11.7)	**(8.5)**	(10.0)
Total employee benefits expense	**(81.0)**	(74.2)	**(72.4)**	(66.2)

FCDO reviews and approves BII's Remuneration Framework which was last reviewed and agreed in January 2022 (available here). Salaries of Investment and Impact Teams, and the most senior corporate employees, are benchmarked against other DFIs, IFIs and impact organisations. FCDO wants BII to be able to attract and retain talent to ensure turnover is within manageable standards and comparable organisations. To support this the long-term incentive performance plan is directly proportionate to BII's mandate to incentivise investment for long-term development impact.

(Q287-290) Requested information on gender and disability-sensitive investment targets for BII and whether they are sufficiently ambitious.

BII has a target of 25 per cent of all new investments – on a rolling-average basis - to qualify as 'gender-lens' finance against the 2X framework, the now internationally recognised standard to boost financing for women. BII's ambitions are not static and over recent months they have led an alliance of DFIs to - in collaboration with 2X Global - strengthen the 2X framework.

2X is just one element of BII's wider approach to positively impacting women and girls. Since 2021, BII has consistently integrated additional gender targets into all 2X qualification MoUs to ensure qualifying investees continue to improve women's representation and inclusion over the course of the investment. Other investments may be starting from a lower base, and this is often where BII's opportunity to enhance gender diversity is greatest. In such cases, BII can provide advisory support or technical assistance to help investees increase women's representation and inclusion at all levels, and/or better target their products and services to underserved women and girls.

Under BII's 2022-26 Strategy, BII introduced an enhanced development impact framework. This includes BII's Impact Dashboard and Impact Score for each investment. The new 'Impact Score', is a robust tool for managing strategic impact on a portfolio basis, and places a greater emphasis on impacts across gender and climate change than previously. The Impact Score captures and scores each investment against three driving objectives aligned with the FCDO's vision for development. This includes:

- Productivity: raising the productivity of an economy and creating jobs,
- Sustainability: driving growth that reduces emissions, protects the environment and adapts to the changing climate
- Inclusivity: sharing the benefits with poorer and more-marginalised sectors of society.

BII has disability inclusion guidance for businesses which is designed to help companies familiarise themselves with the topic of disability inclusion and provides steps to become more disability inclusive. Disability inclusion is also included as part of BII's Environmental, Social and Governance Toolkit for all fund managers.

FCDO continues to engage with BII to ensure they are delivering the agreed corporate objectives on inclusion; this includes challenging performance at our Quarterly and Annual Shareholder Meetings as well as through day to day interactions at working level.

(Q294-296) Provide detail on how BII is benefitting the poorest. Is buying electricity from fossil fuels a benefit to the poorest.

As set out in our written evidence to the inquiry (paragraphs 11-16), development finance supports long-term poverty reduction through several channels including job creation, tax receipts, provision of goods, services and economic opportunities and longer term structural economic shifts. Our written submission also sets out examples and evidence which supports these methods of poverty reduction.

Evidence of the benefit of BII's investments is set out in paragraphs 24-29 of our written submission. For example, 50% of BII's average annual investment disbursements were in countries and Indian states with the highest level of investment difficulty. In addition, an independent evaluation of BII's financial institutions (FI) portfolio found that 78% of the FI portfolio was either on track or had outperformed the transactions' development impact thesis: the portfolio supported 178,300 jobs, 30% of investments were being invested in A/B countries (the poorest and most fragile geographies); 47 of the 88 investments were identified to have a clear offering to underserved segments; and across all investments, the share of female borrowers has increased 8-fold from 1,014,000 in 2013 to 8,188,000 in 2019.

How BII internationally targets its capital towards impact is set in detail in both our written submission (paragraphs 100-101) and BII's submission (paragraphs 20-23). An explanation of BII's new **Error! Hyperlink reference not valid.** and the measures used in that is set out as part of the our response (page 12 in response to Recommendation 15) to IDC's Extreme Poverty Inquiry.

With specific regard to the benefit of increasing electricity generation, 50% of sub-Saharan Africa's population – 600 million people – have no access to reliable power which also poses significant challenges for business growth and industrialisation and therefore poverty reduction. BII's role is to help provide access to reliable power in way that addresses these needs for people and economies and in way that is Paris aligned and hence consistent with their low-cost net zero transition paths. BII has committed over $1.7bn in climate finance since 2018. This includes investments including innovative utility scale renewable projects with battery storage (e.g. Kenhardt in South Africa and Cuamba in Mozambique) to provide the necessary power to support industrial development; and support for transmission and distribution (e.g. GridWorks Uganda substation investment) to enable the integration of more renewables; as well as smaller scale solar home system investments to support household needs for affordable energy (e.g Greenlight Planet).

HMG's (and BII's) Fossil Fuel Policy excludes new investments in the vast majority of fossil fuels. It also recognises that in certain — but not all — circumstances, gas power can play a transitional role towards net zero emissions. BII has developed a Gas Tool to assess whether a gas project is truly transitionary**.** An example of the type of country where BII might consider gas power is Mozambique where seven out of every ten people do not have access to electricity and 53% of firms report electrical outages. There are no viable renewable alternatives for Mozambique meeting its power needs and avoiding the projected shortfall in electricity production by 2024 and possibility of blackouts.[1] BII is supporting Mozambique in its transition through investing in renewables and battery technology (such as Cuamba[2]), as well as a Paris aligned gas project, Temane. The Temane project meets the criteria of Paris alignment. With a highly flexible design, Temane can provide essential baseload power and over time move towards a peaking role and thus supports intermittent renewables such as solar as they are added to the grid. Furthermore, the project anchors a 563km transmission line enabling greater energy access and enhanced renewable penetration. All of this underlines the role that projects such as Temane can play to a support rather than hinder the introduction of more renewables over time and provide reliable power to support economic growth in one of the poorest countries.

(Q309-310) Provide other country examples similar to Nepal to highlight FCDO programming and effective collaboration between BII and FCDO. Please can you also confirm whether the Committee's observations in Nepal were unique to how BII and the FCDO work together on the ground.

The FCDO and BII have a shared purpose in fostering economic partnerships that accelerate productive, sustainable, and inclusive economic development. To maximise the impact of the UK's collective effort overseas, HMG and BII recognise the role of effective collaboration which corresponds to each organisation's mandate, strengths, and processes.

While Nepal is a good example it is not unique in how BII and FCDO work together on the ground. Standardised guidance was developed in 2018 and a revised version for the 2022-26 strategy period was recently rolled out across the HMG network to strengthen the way strategic collaboration happens and to align FCDO and BII strategic and

[1] More information on this is set out in BII's follow up written evidence to the IDC as part of the Climate Change, development and COP' inquiry. here.

[2] The Cuamba project is one of the first solar PV and energy storage projects in sub-Saharan Africa, developed alongside Temane by Globeleq. The Cuamba Solar project will provide clean energy to 18,000 households and support job creation in Niassa, one of the country's poorest provinces with an electrification rate of just over 20 per cent.

investment priorities. This guidance was informed by pilot exercises which specifically explored how to deepen the FCDO-BII relationships in BII's markets and disseminated lessons from this exercise widely across the HMG network.

I recently visited Senegal where I saw first-hand the results of excellent joint working. Our Ambassador Juliette John and her team had worked closely with BII to unlock barriers to the construction of a new container port at Ndayane in Dakar – a critical investment for the development of Senegal. It is the largest onshore investment in the country which will enable the creation of over 20,000 new jobs and unlock new opportunities for local and regional businesses to trade and grow.

Another example, where BII and FCDO have strengthened joint development impact on the ground is with AgDevCo, an FCDO founded and funded programme specialising in support for African agribusinesses. BII's backing of AgDevCo is part of the company's graduation away from grant-funding. By supporting AgDevCo on this journey, BII is enabling the company to improve its access to patient growth capital including helping mobilise investment from the Norwegian and United States' development finance institutions.

(Q311-314) Justification from the FCDO to not sit on the board of BII

BII is a self-financing public corporation[3]. FCDO and BII have a corporate governance structure that aligns with best practice, including the UK Corporate Governance Code of the Financial Reporting Council. The arms-length governance model empowers BII to deliver the greatest impact through independent investment decisions whilst remaining aligned with the overall strategic direction set by FCDO. BII's arm's length relationship has a number of advantages for FCDO:

- **Robust and clear lines of accountability from the Board to the Shareholder**. The FCDO appoints the Chair, two Non-Executive Directors, and sets BII's strategic objectives and key operating parameters. The Board is then held to account for delivering this strategy. To have an FCDO official on the Board would confuse and blur these lines of accountability.
- **An effective and empowered Board**. Having an FCDO official on the Board, responsible for providing the Department's considered view on every decision, would undermine and potentially destabilise the Board and reduce its effectiveness.
- **Independence from political pressure.** The independence of BII's Board sends an important signal to the market. It reassures potential investee companies and co-investors that BII conducts its activities in a commercial manner – without political interference – and will be a reliable and predictable, long term business partner.

When the governance arrangements were last reviewed by the NAO in 2016, as part of their study of DFID investments through BII, they were judged to be "thorough". There are robust lines of accountability between BII and FCDO, including regular governance meetings where FCDO holds BII's Board and Executive Management to account for delivery.

A detailed assessment of FCDO's rationale has been set out in a letter from the former Department for International Development to the Chair of the Public Accounts Committee, available here.

[3] BII is entirely self-financing when in a steady state. Additional capital is required from the UK Government to increase activities.

(Q319-324) Clarify the use of intermediaries in Mauritius and BII's wider approach on tax havens.
BII preference is to invest in a country or region where an investee company is located. Where this is not possible, and whenever it is BII's decision, the vehicle through which such investment will be made will, by default, be domiciled in the UK. For investment funds that BII chooses to invest in, the decision of where to domicile the fund is one typically taken by the fund manager. In deciding such location, the fund manager will take into account which jurisdiction offers the legal and regulatory environment that best attracts this international capital for onward investment in our target markets.

BII will only invest in jurisdictions that are permissible under BII's Tax Policy. In particular, BII will only invest its capital through intermediate jurisdictions which successfully participating in the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes; is committed to implementation of international standard of automatic exchange of tax information; is a member of the Inclusive Framework on BEPs or is publicly committed to implementing BEPs minimum standards.

(Q337) Provide further detail on BII investments in PEP Technologies (personal care) in India in 2020
BII invested in Amicus Capital Partners Private Equity I (ACPPE I) in 2016. At the time, BII invested in India to build the domestic capital market, which is now, seven years on, significantly more developed.

The Indian-focused ACPPE I fund was established to target investments at small businesses and start-ups that needed capital. Start-up companies and entrepreneurs in India's healthcare, technology, consumer, and financial services sectors had struggled to access working capital to scale up, once their business model had been proven. BII's impact thesis for Amicus centred on access to those in towns that were underserved; a digital strategy to overcome limitations in physical infrastructure; and to support local manufacturing and sourcing. The fund invested in PEP Technologies in 2020 in line with these aims agreed in 2016.

(Q368-369) Investing in schools in Morocco & Tunisia and investing in primary education.
244 million children are out of school globally, more than half of which are girls. An estimated 70% of children in low- and middle-income countries are unable to read a simple text by age ten. The loss of lifetime earnings for this generation is estimated at $21 trillion. Education is a catalyst for progress on all other Sustainable Development Goals.

BII's investments in education make up 2% of the portfolio and less than 1% of 2021 new commitments. Historical education investments during 2017 – 21 aimed to improve learning and life outcomes, and to expand access, in support of SDG4. They also focused on providers who are improving workforce capability and reaching underserved parts of society. BII's education investments supported 20,940 teaching and support jobs, 39 per cent of them held by women.

As detailed on their website, BII have two investments in education in Morocco and Tunisia. KMR Holdings in Morocco which BII committed to in March 2014 and Holged Tunisie that was committed to in July 2019.

As set out in the 2022-26 strategy BII will not prioritise new investments in kindergarten to twelfth grade private education. Their investment activity on higher education is focused on technical education and education technology companies.

(Q340) Decision behind not having a cap against investing in Middle income countries.

BII's development impact framework, and in particular BII's country segmentation in the impact score, incentivises investing in poorer and more fragile states – with lower income countries receiving the higher score. In more mature countries such as South Africa and India, BII's investments are focused in the areas of climate and inclusivity and not in wider sectors recognising the specific challenges faced by countries. A similar approach has been taken in South East Asia – with BII restricted to investing only in climate finance in the countries such as Vietnam, Indonesia and the Philippines.

(Q351) What is the percentage of BII investment for Green Investment?

Over the current strategy period (2022-26) BII has committed to make at least 30% of its new investments in climate finance BII has delivered over $1.7 billion of climate finance since 2018, including $500m in 2022. In addition, BII assesses the climate impact of all its investments and has committed to Paris Alignment and reaching net zero emissions across its whole portfolio by 2050. Progress against this target is reported in BII's Task Force on Climate-related Financial Disclosure.

(Q374-375) Provide further detail on BII's investments into Feronia and Nairobi Women's Hospital

BII expect high Environmental and Social and Business Integrity standards from all investment partners and portfolio companies. These standards have been implemented for all new investments since 2012 and are outlined in BII's Policy on Responsible Investing. As part of the Policy, investees are expected to develop and follow a Stakeholder Engagement Plan, particularly for more complex (for example, infrastructure) projects. The nature and frequency of engagement reflects the level of project risks and impacts. Where such engagement plans are not adequate, BII would seek to improve it via Environmental and Social Action Plans (ESAP), which are legally binding and established at the outset of the commitment being made. BII also requires investees to develop and implement a 'grievance mechanism' aligned with the requirements of the IFC performance standards.

BII's Reporting and Complaints Mechanism allows anyone outside BII to report alleged breaches of the BI or E&S provisions of the Policy by BII, a BII Investee, or a portfolio company of a fund in which BII has invested. The Reporting and Complaints Mechanism can be used to report alleged or anticipated breaches of the BI or E&S provisions of the Policy. Any external party including individuals, community groups, non-governmental organisations, or other persons or entities may make a report under the Reporting and Complaints Mechanism.

Feronia

BII's mandate includes investing in hardest places to deliver development impact. Sometimes things don't go as intended because of the significant challenges in these markets – that is the case with Feronia.

There was and remains a compelling impact case for the original investment decision: it created better paid jobs for many and improved prospects in a remote part of the DRC. Despite its problems, some of the impact has been achieved. Since BII first invested in 2013, workers' wages have more than doubled, and protective clothing is now mandatory. Housing has begun to be renewed and restored and around $7 million has been spent on clean water provision, healthcare and educational facilities. 72 wells have been drilled or renovated, and restored medical facilities are helping thousands of workers and non-workers every year.

In 2021, BII sold its remaining interest in Feronia to Kurama Capital, an African firm. BII left Feronia more economically viable and having implemented our ESG Action Plan.

The lessons learned from the investment have been applied to BII's new strategy, including in the investment channels of BII's country segmentation.

Nairobi Women's Hospital

The challenges at Nairobi Women's Hospital (NWH) have been widely reported. In 2019, a new fund manager (Evercare) took control of the assets. They have put in place a new management team that works directly with NWH's board to continuously strengthen operational policies and procedures, enhance patient relations, drive cost-competitive pricing, and increase the overall quality of care.

BII reformed its investment approach to private hospitals in 2021. Any investment requires the hospital to support a significant proportion of users who are on government payment schemes or on low incomes. That said, they will still not be BII's focus. Rather, the next five years will see BII prioritise investing in the manufacturing of medicine, vaccines, devices and equipment; pharmacy; early-stage funding for health-technology.

(Q383) Clarify if any funding has been lost to fraud with specific reference to the CEO oral evidence on the matter. It was also asked how this had been disclosed and reported.

There has been only one recent incident of fraud directly against BII. This case occurred in 2017 and it is alleged that monies withdrawn from the Abraaj Growth Markets Health Fund by Abraaj Group entities were used for unauthorised purposes. BII's established monitoring processes alerted them to the possibility of unusual activity in the fund. Following intervention by BII and other investors, the improperly withdrawn monies were reimbursed to investors, without significant monetary losses.

On the 17 March 2023, I responded to a Parliamentary Question asking for the sum and proportion of investments that BII had written-off in the last ten years due to fraud. The answer was zero. This is consistent with the oral evidence given by the BII CEO. As explained in BII's supplementary written evidence (paragraphs 20 -21), in the case of Abraaj monies improperly obtained from BII were returned.

Since the transfer of the assets to a different fund manager, BII has revised valuations of the underlying assets to reflect a variety of factors, including operational challenges within those companies and prevailing market conditions. The current carrying value of those investments does not yet constitute an incurred capital loss.

FCDO have oversight of matters related to fraud through quarterly meeting with the Chair of the Risk Committee of the Board, quarterly meetings with the BII Chair and executive management team via Quarterly Shareholder Meetings; through the Significant Risk Events process and quarterly meetings with BII's Head of Compliance, Head of Business Integrity and Head of Environment and Social teams. In addition, the Department independently audits BII's fraud risk management processes ensuring that BII has effective risk management processes in place – reviewing BII's due diligence processes, contractual requirements, access to the investee to monitor compliance, legal redress in the event of non-compliance, and the need to have appropriate risk management processes and that these requirements are in place for sub investments.

(Q357): BII's investments to the China National Investment and Guaranty Corporation.

BII have exposure to the China National Investment and Guaranty Co through CDH China Fund III, LP, which is managed by CDH Investments. The investment in the fund was made in 2006 under a different investment policy, set by the Government of the time, when the requirements of BII were to invest in emerging market funds.

With every good wish
Yours ever
Andrew

Rt Hon Andrew Mitchell MP
Minister for Development and Africa

I believe the reformed BII is a great British success story which is making a quite extraordinary contribution to international development and the aims you and I share.