HOUSE OF LORDS

Select Committee on the European Union

External Affairs Sub-Committee

Corrected oral evidence
Brexit: sanctions policy

Thursday 20 July 2017

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Watch the meeting

Members present: Baroness Verma (The Chairman); Baroness Brown of Cambridge; Lord Dubs; Lord Horam; Baroness Manzoor; Earl of Oxford and Asquith; Lord Risby; Lord Stirrup; Baroness Suttie.

Evidence Session No. 2 Heard in Public Questions 10 - 18

Witnesses

I: Dr Francesco Giumelli, Assistant Professor in International Relations, University of Groningen; Mr Tom Keatinge, Director, Centre for Financial Crime & Security Studies, Royal United Services Institute; Dr Clara Portela, Assistant Professor of Political Science, Singapore Management University.

Examination of witnesses

Dr Francesco Giumelli, Mr Tom Keatinge and Dr Clara Portela.

Q10 **The Chairman:** I welcome our second panel of witnesses: Mr Tom Keatinge, Dr Clara Portela and Dr Francesco Giumelli. Welcome to the session. I remind the Committee that this is being broadcast and will be transcribed. You will have an opportunity to make any corrections to the transcript once the session is over and it has been sent to you.

I will ask the first question. What advantages and disadvantages does EU membership have for the UK with regard to its approach to designing and implementing sanctions? If you could provide some examples, that would be very helpful.

Tom Keatinge: Thank you very much for this opportunity. There is a risk that we will repeat some of what has been said previously, so I shall try to limit that. It is worth looking at the Iran negotiation and the Russia sanctions as a way of assessing the advantages and disadvantages of EU membership. Clearly, the economic heft of the EU is a tool that can be used as it relates to sanctions. It is the world's largest exporter and manufacturer of goods and the biggest export market for about 80 countries around the world. The bottom line is that we have more economic influence within than outwith the EU. The second thing is that sanctions should not be seen as a single tool. They are part of a broader foreign policy tool set. Clearly, having a larger, influential foreign policy front is more advantageous.

From the perspective of disadvantages, as has been mentioned, the UK's hands are somewhat tied by consensus when it comes to the use of sanctions. Decisions are made in Brussels that affect the UK as a financial centre. We still have the biggest financial lever in the European Union that the EU can use. We probably have to make sacrifices there when we would rather not. We all remember documents carried into No. 10 making statements about the City of London in the context of the Russia sanctions.

Lastly, although the EU passes sanctions—we see this in the Russia case—it is very poor at keeping them up to date. Those that are sanctioned are very good at changing their spots and stripes to avoid sanctions. Whereas in the United States, sanctions maintenance—keeping them updated and moving against the target—is a matter of course, it seems that all we can do in the European Union is renew sanctions every six months without necessarily changing them to track the activity of those that were originally the subject of sanctions. So there is greater flexibility outside the European Union, but certainly less influence.

Dr Francesco Giumelli: Thank you very much for inviting us. It is a great opportunity for an academic to be here and to be useful.

As has already been said, there are a few things that we will repeat from the first session, but in general terms the advantage from the UK's perspective is having greater flexibility and being faster—if one state can be faster; sometimes that is not granted. At the same time, the disadvantage is less impact. One of the things you need to know, building on what was said before and what we will say later, is that when we talk about sanctions we are talking not about what the UK does but about what companies do to implement what the state would like them to do. If you are outside the EU, what happens in the other Member States is very much outside your control, so companies have more freedom to change whatever you would like them to do. Being outside does not allow the UK to influence the process in which you can regulate. Nor can you get information from other Member States on how firms and companies behave in other states. That is very important. On the one hand, the UK can do whatever it wants. On the other, it may have no impact on its foreign policy.

Dr Clara Portela: I will briefly mention the disadvantages, given that other points have already been made by my colleagues. Operating through the EU framework meant that, as with all composite fora, agreed measures often got diluted in favour of consensus. However, there are two important advantages of operating through the EU. Operating via the Common Foreign and Security Policy (CFSP) framework has been advantageous for the UK because it served as a vehicle for the multilateralisation of its measures. It has been calculated that in about 78% of cases London was able to multilateralise its sanctions via the EU rather than enacting them individually or using alternative fora. This has obviously allowed Britain to benefit from the support of European partners, particularly since the evolution over time has been towards enhanced discipline and enforcement. I am happy to give an example afterwards.

The other advantage I will highlight is that European adoption of British sanctions has magnified the effect of the measures. As a participant in the CFSP, the UK has also benefited from the broad consensus bias that characterised this framework. The existence of a previous position to agree to sanctions is most clearly illustrated by the persistence of a number of sanctions regimes, despite resistance by certain Member States. This is particularly remarkable since sanctions regimes are endowed with a sunset clause that foresees an expiration date. If no agreement on renewal is reached by this expiration date, sanctions will collapse automatically. Still, we have never witnessed any such instance, so this shows that there is an intention to work together and to support sanction regimes even when certain Member States are suffering. To me, this is clearly one of the most important advantages.

Q11 **Lord Horam:** Can we now look to the post-Brexit situation and the independent UK sanctions regime that may exist? What effect do you think the fact that the UK will, I hope, have an independent regime, will have both on the UK’s ability to achieve its foreign policy goals and on the European Union’s ability to achieve its foreign policy goals?

Tom Keatinge: There has been a lot of fixation on what the UK will do with regard to sanctions. That is clearly important, but let us not forget that, as was mentioned in the previous session, the UK contributes considerably to the backbone—the lead in the pencil—of the EU's sanctions policy. The EU will miss the UK and the financial lever of the City of London that it can pull on. Separated, the ability of the bloc and the UK to pursue foreign policy objectives will clearly be reduced. That is not to say that we have not shown an ability to work together in other fora and with other countries. It is worth bearing in mind that sanctions are imposed not only by the EU. There are other nations around the world that we work with on things such as the Joint Comprehensive Plan of Action. It will have to work much harder at co-ordinating and at presenting a united front. That will not happen naturally, but I see no reason why sense cannot prevail and that the common goals that we as Europeans have cannot continue to be pursued with separate sanctions policies that are linked.

Lord Horam: It depends to some extent on our willingness to carry on this role.

Tom Keatinge: It absolutely does. It is always interesting to see how Europe reacts when there is discussion of sanctions in the United States. There has been considerable focus on additional sanctions on Russia in the US. If you look at the reaction in Germany and Austria to the comments about potential sanctions on energy pipelines and so on, it is clear that that is a situation where parts of Europe do not agree with the US. The UK might ally with the US position on that topic. There we would be fractious with the EU.

Lord Horam: Dr Portela, in your evidence you said that we can expect the European Union sanctions policy to diverge from that of the UK after Brexit. What lay behind the thought that it will diverge from what the UK might do?

Dr Clara Portela: The UK is one of the most important promoters of the use of sanctions at the EU level. After the withdrawal of the UK, few Member States would support the use of these measures. This leaves us in particular with the Netherlands, which is quite supportive of the use of these measures, but also with a large number of Member States that are unhappy about the use of sanctions, particularly when the regimes are quite protracted. Now that the EU is going to lose one of the most important advocates of the use of sanctions, I expect it to become less active in the use of these measures.

There is a second aspect that relates more to bureaucratic capacity. Most Member States have very small, understaffed sanctions units. Some of them have been created only recently and were put in place as a reactive measure, because they realised that the EU and the UN were quite active on sanctions, so they needed to create some sanctions units. However, they are quite weak in terms of bureaucratic capacity. At the EU level, bureaucratic capacity at the level of the institutions is also quite weak. It depends partly on seconded national experts. Now that the UK is going to stop sending seconded national experts, I am also worried about the institutional capacity of the EU. So on these two fronts it seems to me that the activity will decrease.

By contrast, there is no reason to believe that the UK will stop using and implementing these measures, particularly in the framework of its close relationship to the US, which is also quite an active user of sanctions.

Baroness Suttie: Do you envisage that the sanctions against Russia might be lifted post-Brexit?

Dr Clara Portela: Not necessarily, because in this particular case Germany is a big supporter of these measures, so as long as the current leadership continues to remain in place and as long as Germany, which is actually sustaining a significant portion of the damage which the measures are inflicting on the Common Market, is on board, and as long as this is also supported by Poland, Finland and other countries that are pretty close to Russia and that are also sustaining quite a lot of damage, I do not see the sanctions against Russia coming to an end.

So as far as this particular regime is concerned, I am not too worried. I am more worried about the mid- and long-term consequences.

Lord Stirrup: Just to widen that point slightly, we have heard people say that the UK is, as Mr Keatinge said, the lead in the pencil, but it has been suggested to us that there are quite a number of other members of the EU that feel similarly on the issue of sanctions but that are very happy for us to take the lead and for them to remain in the background. If we are no longer there to take the lead, would these people then step forward? My assumption from what you said earlier about divergence is that they probably would not, but I wonder why you would say that.

Dr Clara Portela: This question can only be answered on a case-specific basis. Certain countries will try to step forward. Countries such as Denmark or the Netherlands are quite supportive. Much of what was done in European foreign policy was the result of an agreement among the big three. This is a rather informal arrangement; it is not written in the treaty. If the UK, France and Germany supported the policy, it was also easier for them to obtain the agreement of smaller Member States. This constellation will change now that one of the big Member States is going to withdraw, because it might prove more difficult to find a consensus and to allow a consensus to crystallise in the Council. For certain foreign policy issues that are of lesser importance to countries such as Sweden, Denmark or the Netherlands, they might not be willing to step forward. If this issue is of importance to them and they have the agreement of France and Germany, it will be easier to mobilise support in the Council because the unanimity rule continues to prevail.

So when it comes to the rules, nothing will change, but when it comes to the constellation of power in the Council we might face a drastic change.

Dr Francesco Giumelli: Many things were said after the question, so I will try to be brief.

The academic answer is that nothing might change, in the sense that the UK was there before the EU, the Member States of the EU were there before the EU, and things can be as doable and as viable even after Brexit. There is one issue that I should mention. Most of the sanctions cases that we talk about—Russia, Syria, Iran—were dealt with in strict co-ordination between the US and the EU, which are not members of the same organisation. That means that if you want these sanctions to be effective—and this goes back to the point that I mentioned earlier—you need strong co-ordination. There is no way in which you can have effective sanctions on the ground unless you have wide co-ordination. Now it is the US and the EU. In the future, it might be the US, the UK and the EU.

At the same time, this is what you need. Think about Switzerland and Norway, which are often used as role models for the post-Brexit world. Many would argue that Norway and Switzerland are better at implementing EU measures than EU Member States are, even if they do not decide on those measures because they do not sit around the table. Of course they talk to each other, but in Foggy Bottom and the room where the decisions are taken, Switzerland and Norway are not there. Nevertheless, they enforce and implement the measures in better ways than certain EU Member States do. This could also be the situation in which the UK finds itself: that you do not take the decisions, but at the same time if sanctions have to be implemented and enforced and somehow have to be effective, the UK will have to align itself with the US and the EU.

Of course, I second the idea that the UK was and is one of the most active actors in the EU when it comes to sanctions, but I would also extend that to say that historically the UK has been more assertive than many other Member States on many issues, and not only on sanctions. Because of the way in which the EU was constructed, certain countries are more active in certain areas and other countries are more active in other areas, which is important. This can change, as we have already seen in the case of Russia, for example. We saw sanctions imposed after the MH17 crash, not before, and that was because of the Netherlands, not the UK. And we have seen the UK play a very important role in the case of Syria. At some point, an arms embargo was imposed on everyone in Syria, but one party of the conflict was still able to acquire weapons and the other party, which the party we wanted to help, was not given this ability. The UK pressured the EU to change the sanctions regime, and that worked.

There have been other cases in which the UK has been effective in persuading other EU Member States that had not felt as strongly. The UK's effectiveness in those cases might also be better from the UK perspective because you persuaded the others to sanction countries or people in countries whom others would not have sanctioned. At the same time, the result might be negative if you impose sanctions when you are the only member that wants to impose sanctions.

My last point is about disaggregation. Again, as I said, academically, nothing might change, because again you might have the very same regime imposed with the same level of implementation, but at the same time you increase the vulnerability of the system.

Think about what Russia did, allegedly, after sanctions were imposed in the summer of 2014. It started to target EU Member States with certain measures to make sure that support for sanctions was weakened. That is easier, of course, when you have more actors and players outside the European Union. The European Union managed to withhold pressure because everybody was within the same institutional architecture, but if you fragment it, the outcome might be less predictable.

To conclude on Russia, I do not think that we will see changes at all because the UK allegedly wants more sanctions, but the leading actors, which means the countries paying the price of sanctions, are in favour of sanctions. As long as we see that, that can also replace the role of the UK because things can change. Certain countries might become more assertive precisely because the UK is about to leave, which they were not before precisely because the UK was fulfilling that role. The fact that the UK leaves does not mean you will not sanction any more. Therefore, I disagree with Clara. It might even mean that the EU sanctions more, depending on which country in the EU steps in to fulfil the role of UK.

Q12 **Lord Risby:** We have heard quite a lot about Norway and Switzerland. We have just heard that they are rather stricter in their implementation than some other countries. I would like to understand the process involved. In other words, and we heard this in the previous session, when a sanctions regime is agreed by the European Union, how is the approach made to those two countries?

I have a supplementary question. Particularly in the RUSI report, Mr Keatinge, you mentioned that the "heft"—I think that is the word you used—of the United Kingdom has been impressive and powerful in the argument about a sanctions regime. At this point of the negotiation process, and given the value that has been attached to the United Kingdom's role, do you think there is some idea at this point that the United Kingdom can put forward for some process of continuing co-operation that would be efficacious to the overall European sanctions policy? Those are two somewhat related questions.

Dr Francesco Giumelli: This is a very important question. There are two issues. The first is for countries that are not members of the EU but that want to align themselves. Countries such as Switzerland and Norway are part of the Common Market and others are aspiring to be members. They very often align themselves with the sanctions regime. There is an issue of reputation, meaning that certain states want to make sure that they are stricter and implement the sanctions. But then I come back to my previous point, which we keep forgetting: that it is an issue that companies have to take up. A Council Decision is then a foreign policy decision. If there is Regulation and you join the Common Market, companies have to follow those Regulations because this is not a foreign policy decision; it is a Regulation. That is my first point.

My second point is that companies do not care too much about the EU, Switzerland and Norway. Most of them—the big, the small and the medium-sized companies—care about the stricter international regime, which usually comes from the US. Basically, companies align themselves with what they see as a risk of getting fined or having to pay money, and then they will follow the others. Assuming that one of the countries we have suggested decides not to comply, that does not mean the companies of Switzerland, Norway and other countries will not comply. They will comply because they have business to do in the EU and in the US. That is the real distinction. It is not so much a decision of states; what happens in the sanctions world is a decision of companies.

Briefly on your second question—what we would recommend the UK to do to approach the EU to deal with sanctions decisions in the future—there is not much that we can comfortably say because it depends on the political situation. If the EU wants to allow negotiation and informal discussion before the decision phase, my sense is that, at this very moment, it will be the other way around: the EU would like to make the point that it decides, then it will invite the others to join. Again, this will depend on the political environment in which the decision is made.

Dr Clara Portela: I will make a very brief point before handing over to Mr Keatinge. On the first question, the process is that first the European Union agrees on the sanctions package. Once this has been agreed, an invitation is extended to selected countries. For example, most countries of the neighbourhood policy, located in eastern Europe, receive an invitation, but those located in the southern Mediterranean area are normally not invited. First, they have to be invited to align with the sanctions. Then it is up to them whether they do so. But they are not consulted prior to the decision on the sanctions package. They can decide whether they want to align themselves with the measures and implement them in their domestic legislation, but that is it. There is no consultation prior to that.

Tom Keatinge: On the "heft" question, the fundamental issue is whether we can continue to take a position of leadership or whether we are going to follow. It is worth looking at the way the US leads sanctions around the world despite not being a member of the European Union. It does so fundamentally because, like the UK, it is a very large financial centre. As the previous panel mentioned, financial institutions' nervousness about re-engaging with Iran is nothing to do with the European Union; it is to do with the fact that they have branches and operations in the US and they do not want to get their fingers caught in the door again.

We will continue to have a large financial lever here in the UK. The question is how we want to use it. If the UK determines it wants to put sanctions on country X and the EU does not, and a financial institution operating in an EU Member State and in the UK continues to deal with country X, how will we react? The United States might well come after you in that situation; are we going to go down the route of secondary sanctions and that kind of broadening of powers? It is not necessarily something I would advocate but it is an option we would have because, for the time being, a great many financial institutions will have operations in the UK as well as their home country, which potentially links them to decisions made in the United Kingdom.

Q13 **Lord Stirrup:** I would like to understand more about the importance of information sharing when it comes to listings and enforcement. I say "information sharing", because although this clearly includes secret intelligence, it seems to me by no means confined to that. We have wider diplomatic and economic sources. Enforcement is a national issue, but we are talking about businesses, many of which are international in nature. To what extent is information and intelligence sharing a crucial part of listing and enforcement? To what degree it is likely to be impacted by Brexit?

Tom Keatinge: Information sharing is the buzz phrase of the era and is seen as the solution to many of the evils we try to grapple with. There is no doubt that where you have a fragmented decision-making and implementation process, sharing information is very important. You kindly mentioned our report. One of the things that is very clear to us is that if you ask the private sector to implement sanctions, you need to ensure that they understand the background to them, what you are going after and why you are doing it. You do not necessarily need to involve them in the construction of the sanctions, because that needs to be done confidentially, but you need to engage with them very quickly to ensure that the effect you are trying to have is delivered. Generally speaking, that does not happen. So from an implementation perspective, we can do much more.

From a partnership perspective, on the design and implementation of sanctions, it is interesting to look at how the United States operates because it is outwith the European Union. The US embassy in London and US government individuals in Brussels make a tremendous amount of effort to provide information that perhaps helps decisions to be made on sanctions. So information sharing will be important. I personally do not see that being a problem, because we will maintain diplomatic relations with these countries and will have to work hard to do so. The information-sharing challenge needs to be addressed in implementation and that is with the private sector.

Dr Francesco Giumelli: This is a key issue. I am trying to decide whether Brexit will necessarily affect this problem, because information sharing is an issue of co-ordination. Being a member of the same institutional architecture or not does not always determine whether you talk to each other. Think about the recent attacks in Brussels, where information intelligence was there in different Member States of the EU but they did not necessarily talk to each other. At the same time, we see situations in which the US is talking to and sharing a lot with members of the European Union.

So on the one hand, as I said before, the academic answer is that it depends on whether the different actors trust each other and on the political environment. If the political environment is good and they trust each other, information can be shared as much as it is now. At the same time, there is an issue of co-ordination. Sharing information when you design sanctions is a matter of getting the other Member States to share knowledge. Of course, the UK was and is very active, but at the same time there is a lot of intelligence in other Member States, depending on the regions in which you want to intervene.

At the same time, there is the second phase, which is implementation. In that case, you need to make sure that companies are working in an environment in which they, too, share information. Remember that many sanctions are written in such a way that we are delegating powers to businesses to make decisions that we cannot make because we do not know what happens on the ground. We say, "You have to freeze the bank account of that person and of people directly or indirectly related to them". We do not list them because we do not know who they are. We hope that the banks, companies and traders dealing with them will somehow see something and will share it with us. In a fragmented, institutional architecture it will be more difficult to cope with this challenge. If you find a way to be together, you might find a solution.

One thing, building on what Dr Portela said, is that we talk about bureaucratic capacity and enforcement—this is one of the points that have been raised before—but we do not have that now in the EU; there is something in the Commission, something in the External Action Service, and a lot is provided by the UK through seconded personnel. The fact that the UK is no longer in the EU might create an incentive for other EU Member States to centralise. Then the enforcement will be done in Brussels and no longer by the Member States. That is also a possibility, and if that happens there will be a lot of capacity in Brussels compared with the other 27 Member States. So we also need to consider this as an option. The world is not going to stand still when—if—Brexit takes place, but there might be a response and a different organisational structure on the other side, in Brussels.

Q14 **Baroness Suttie:** I turn now to the impact on businesses. Can you say a little about what you expect the impact of our independent UK sanctions will be on businesses in the UK, including foreign businesses operating here in the UK?

Tom Keatinge: It will depend on what posture the UK takes on sanctions. I am aware of companies setting up extractive industry joint ventures having learned lessons from the sanctions placed on Russia. They say, "Well, we might've set up our previous joint venture in the EU, but we're probably not going to set up our new joint venture in the EU because of the lessons we've learned from the Russia sanctions". I think the posture that the UK takes will determine, for inward investment, how the sanctions policy affects future investment in the UK.

As regards organisations that are already in the UK, obviously there will be another list to check and additional due diligence to do. I am not sure that I would necessarily overemphasise that challenge, for the simple reason that, as was mentioned, companies are already looking at sanctions regimes all over the world when they make their decisions. You might be based in the UK and you might want to interact with Syria, let us say, but you will have one eye on the Office of Foreign Assets Control (OFAC) listing. So I am not necessarily sure that it makes things hugely more complicated. It does make things somewhat more administratively burdensome, because there will be other lists to check. Ultimately, people will watch the UK's sanctions policy very closely: "What is the UK sanctions policy?" Are we going to be a weakness in Europe in the future, driven by a desire to do trade, or are we going to be tough on the issue as people perhaps expect that we are when we are sitting around the EU table in Brussels?

Dr Francesco Giumelli: This is something that we should talk about more, as I have said a few times. There are three things at least that I would like to say about businesses. First, it depends on the kind of sanctions regime that the UK decides to implement. If the sanctions regime is stricter than anyone else's, you might have UK companies looking at the UK regime and trying to comply, because if they do they will be on the safe side. Of course, a sanction is nothing more than an EU Regulation passed on an emergency basis. It is supposed to be temporary, but companies look at sanctions as the rules having changed. Once there are new rules, there will be those who want to comply with them because they are afraid of the reputational cost.

That is very true for big corporations. They have been there before sanctions, they are there during sanctions, and they are likely to be there after sanctions, so for them reputation is key; if they burn their reputation, they lose money, basically. They have the resources to comply with them, they have the resources to pay for offices, and for the capacity to make sure that they do not violate them, so they follow the regime. If the UK sanctions regime is stricter, they will follow the UK. The US has been more assertive in imposing fines. Many UK companies have been brought to the table by OFAC and have had to pay settlements.

At the same time, a regulation also creates a different market if you are already dealing with countries illegally. It is a regulation, and not everything is free trade. All the things that it is forbidden to trade in have a market: illegal weapons, narcotics, pharmaceutical products and so forth. Those networks make money whenever there is an extra regulation, because you can add whatever you ban to the portfolio of networks that deal with countries that we sanction.

So on the one hand you have big corporations that want to comply. They might even overcomply, which is a problem that you brought up with regard to Syria. They were so scared, especially by the US, that they stopped any transactions with Syria. Remember that we imposed targeted sanctions because we wanted to reduce the impact on the local population. By scaring companies we stopped them doing any business with Syria, so the targeted sanctions were turned into comprehensive sanctions. That was one of the issues: that we scared them.

At the same time, there are small and medium-sized companies that operate off the radar that want to make more money precisely because sanctions have been imposed.

Then there is the impact on UK businesses and it depends on how much these networks deal with the UK market or operate in the UK.

There is very little capacity on the global scale to monitor what happens, unless we talk about financial transactions, which everyone knows about. However, we talk very little about goods. Money is one side of the coin of illegal transactions; you need to pay for these goods. In many cases you are banning goods going from one place to the other. If we forget that part of the picture, we are forgetting what it means to impose sanctions and what it means for them to have an impact. It is roughly estimated that only 5% of global goods are checked in the shipments and containers. I was at the port of Rotterdam two weeks ago. They are great at what they do and have top-notch technology. The guy there told me that they check 5% of the shipments. So we should think about ports, where inspections are not as good as they are with regard to financial transactions. The best banks in the world check between 5% to 10% of everything, which is very little. If we fragment and waste energy when it comes to enforcement and implementation, the sanctions will lose power. The big businesses overcomply, while the small ones and the criminal networks make money. We need the resources to go after them if we want to implement sanctions.

Dr Clara Portela: As my colleagues have already mentioned, I see two possibilities, and they go in opposite directions. Some companies pay more attention to what the US does than to the European legislation that is adopted and implemented here. For these companies, Brexit will not make a big difference; it will not make a big difference whether they remain in the UK or relocate to continental Europe. Basically they are afraid of OFAC. They will make sure that they do not get into trouble with it. Then there are other companies that might not be working that much with the US or operating with the US market. They will find it more convenient to be based in continental Europe, because they might rely on the fact that European legislation on sanctions might be more lenient than British legislation.

My expectation is that most companies will fit into the first scenario: they will pay more attention to what the US is doing, as Mr Keatinge has mentioned. We cannot exclude the possibility that for certain companies that are not that interested in the US, continental Europe might become more attractive as a base precisely because of the prospective sanctions legislation. When applying for exemptions from sanctions regimes, it is up to the national authorities to decide whether to grant an exemption or not. Certain countries might be less interested in the strict implementation of the sanctions legislation than others. Those countries will be more attractive as a base.

Q15 **Baroness Manzoor:** We have already heard that the US has significant influence on EU sanctions policy for businesses. We have also heard from

Mr Keatinge that the EU will face significant challenges without the UK. Given the importance of the UK as a financial centre, there will be real issues for the EU in terms of leverage.

Would you expect there to be a change in the way financial sanctions are enforced in the UK after Brexit, and if so, what would be the impact on the UK financial sector?

Tom Keatinge: We already see large financial institutions deciding how they will operate after March 2019. I am not avoiding the question, but it will depend very much on the message that the UK gives as to how it will use financial sanctions in the future. If you look at the re-engagement with Iran, there are banks in continental Europe that are regional or domestic and are happily doing business with Iran because they are not concerned with what is going on in the United States.

Financial institutions may try to insulate themselves from decisions that are made in the UK if the view is that the UK is going to use the financial lever that it has more aggressively than in the past. It will boil down to policy, but one should not lose sight of the fact that a proportion of financial business that is done through the UK will move to other European centres. I am not saying that is because of sanctions policy, but banks might find that convenient because they can do their business from Frankfurt, Dublin or Paris rather than London.

Dr Francesco Giumelli: I have one quick comment. The US is playing a role in this because of the currency. Because most international financial transactions need to have clearance to use dollars, that is when the USA exercises its role, not because companies are based there, here or anywhere else. It has influence because most of the companies need US dollars to make international transactions and they have to go via the US. The fines that OFAC imposes on companies are not actually fines but settlements. OFAC picks up the phone and calls a bank or a company and says, "You have violated that", and the company says, "No", so the bank says "You can't use dollars any more". Then they negotiate how much they can pay to make sure that OFAC is happy.

I have a list of UK banks—Lloyds, Barclays, HSBC, Standard Chartered, Royal Bank of Scotland—which have all paid a settlement in the US. So where they are based is not so important. It does not give leverage to the UK. The leverage is provided by the fact that the currency is important, whether it is dollars, euros or the British pound. It boils down to the fact that a state needs to follow up. As Dr Keatinge said, if after Brexit the UK decides to go after the companies and say, "You need to pay us otherwise you cannot use the British pound any more", they can either say, "We will pay", or, "I have the euro, the dollar, the yen, the renminbi or whatever other currency, and I don't care". If they say that, the UK has no influence over businesses. If they want to pay a settlement and sit down with the UK Government, the Government can exercise leverage. That is what gives leverage to a country.

Baroness Manzoor: Do you think there would be greater leverage if the

UK financial institutions or the UK sanctions policy were more aligned with other multilateral organisations such as the G20 or the OECD? Would that help?

Dr Francesco Giumelli: The G20 does not co-ordinate often on these issues—quite the opposite sometimes. If the UK operates within a larger currency, which in this case is the euro, and the EU decides to be more assertive in doing what the US does, the UK will have a lot of influence, as much as the US would gain by having both companies based in London. If they split, then of course not. So the answer is yes, if they remain in the EU and if the euro becomes a more important currency.

Q16 **Baroness Brown of Cambridge:** I shall move on to government capacity and resources and ask all three of you very quickly to give me a view on whether the Government have the right kind of capacity and resources already for developing policy and monitoring compliance, or whether they will need to build up those competencies. In the previous session we had two very different views—one that we are already well positioned, the other that there might be a lot more litigation and enforcement—and that we would need a lot of strengthening.

Tom Keatinge: To keep it short, I agreed with both previous speakers. There is already good capacity in HMG. Clearly there are people in Brussels with expertise who we hope would bring that expertise back to London, but there will be legal challenges that we will have to deal with in the United Kingdom that we do not have to deal with today. That capacity will need to be created.

Dr Clara Portela: I will not comment on the legal side because I am not a legal expert, but as far as development, monitoring and implementation of policy are concerned, government capacity and resources are excellent in the UK, particularly in comparison with continental European countries.

Dr Francesco Giumelli: The question is very short and the answer will probably not do it justice. I will try to be brief. First, there is a huge difference between what OFAC does and what anybody else in the world does. That is big issue, because it creates an incentive for the others not to do anything. You have in the EU certain Member States with five to 10 people doing this, while in OFAC you have thousands of people. Any rational politician would say, "Why should I hire five extra people? They will never compete. Therefore I simply get whatever OFAC tells me, end of story". There is this implicit process of outsourcing the decision to OFAC. As much as OFSI is comparatively bigger than the other Member States, it will never match OFAC's resource allocation. Even if OFAC has thousands of people and millions of dollars, we still have a lot of evasions. The world is too big even for OFAC.

Pooling and sharing resources is part of the story, meaning that after Brexit the EU and the UK will be weaker in going after sanctions busters. At the same time, we need to stop thinking about sanctions as a world in which we have cops on one side and bad guys on the other. We need to create a system that is more resilient to sanctions busting, which means that you need to have better co-ordination, involve the primary and civic society actors, and make the violation of sanctions more difficult. It is a matter not of having more people checking the bad guys but of creating a system where companies know what to do and can share information with states, and states can ensure that the companies and people who do not comply are more under control and feel the check of the Government more. It is not a matter of how many people you have, but of how you use them.

Baroness Brown of Cambridge: Different sorts of people, perhaps.

Tom Keatinge: OFAC has a tremendous reputation, depending on how you look at it. It is not an enormous agency, but it has strong powers and it uses them. It punches way above its weight. If you look at how slowly it processes licence applications, you can see that it needs more people.

Another important point is that we no longer operate in a unipolar financial world. There is a whole world out to the East that has no interest in what is going on in the UK as it relates to sanctions, or the EU, or the United States. What is our strategy on sanctions? It has to be more alliances. If you go to places such as Singapore, they will tell you, "We look at one sanctions regime and those are the sanctions handed down by the United Nations. I do not want to hear companies in Singapore telling me that we are not doing business because of OFAC or the European Union". While there is no doubt that we need to figure out how we will operate outside the European Union, we should put much more emphasis on these broader alliances if we want what is no longer a unipolar world to comply with the sanctions and the ethos we would like to promulgate.

The Chairman: I am mindful that we are drawing close to the end of the allocated time. We have two questions left.

Q17 **The Earl of Oxford and Asquith:** Perhaps you could touch a little on the UK's membership of the Financial Action Task Force, which is obviously a function mainly of counterterrorism, finance and money laundering. Does it play a role at all in the UK sanctions policy other than as a sort of basic information analysis tool?

Tom Keatinge: Briefly, we will be evaluated by the Financial Action Task Force next year for money laundering and terrorist financing. We are a large financial centre; there is lots of money laundering here. It will be interesting to see what the Financial Action Task Force thinks of the UK. One of the issues that FATF will evaluate us on is the timely implementation of sanctions. We will score well on that one. Whether we will score well on all the other measures FATF looks at remains to be seen, but we will score well on that. We are an important voice at FATF in ensuring that countries around the world are measured for their speed of implementation of sanctions.

Dr Francesco Giumelli: I do not see a strong link after Brexit.

Q18 **Lord Dubs:** To your knowledge, what level of co-operation or exchange of information exists on the enforcement of sanctions between the EU, or the UK and other countries such as the US? How effective is this and how would you expect this to change after Brexit, if at all?

Dr Francesco Giumelli: I am more knowledgeable about the European environment. There have been different phases. My knowledge is that at the beginning, especially after 9/11, there was a high level of co-operation and willingness on the part of Member States of the European Union to share information with US authorities and with the UN. The problem has become bigger over time since we started to have litigation cases in which we had to show evidence in court of why certain people were listed. In that case, we had a few issues, because certain Member States were reluctant to share information. New rules were passed at the EU level to allow the sharing in court of classified information. I do not know whether this is going well—I am not saying that it is; I do not know—but this issue was dealt with in Regulations in the EU.

On information sharing, my knowledge is that a fair amount of information is shared, especially when listing individuals. Member States come to the others and say, "I would like to list these individuals". Then a statement of reason needs to be provided, unlike in the past. There is a big question mark with regard to what happens after Brexit, first in relation to whether the Court of Justice will have authority on issues that happen here—to my knowledge, that is still up for discussion—and, secondly, in relation to whether we keep thinking about sanctions in the way we do today. There has been a change over time. In the past we tended to list individuals more often. Now we emphasise more the type of people we would like to list. That becomes less important to information sharing. Overall, Brexit will rather undermine the information-sharing mechanism, but it depends on the political environment. If the actors trust each other, there is no need to worry. If they do not, there is something to worry about.

Dr Clara Portela: I will not comment on terrorist listings, because I am sure that has already been covered in the previous session and by Francesco in his contribution.

As for the extent of information sharing between the EU and the US, I understand that this is extremely active and takes place both in Washington and in Brussels. It is impossible to specify the regularity with which these exchanges take place, because they are constantly on the phone talking about sanctions issues. It takes place in a very informal manner. It is very active and very regular. In addition to the exchange that takes place in Washington and Brussels, European capitals often have visits from members of US authorities interested in explaining what sort of sanctions policies they follow. They are obviously also interested in influencing decisions by these European capitals in the framework of the Council. It is in their interests to keep this information sharing active.

The Chairman: Thank you very much indeed for coming in this morning and for giving us a very detailed view from three very different perspectives.