

Treasury Committee

Oral evidence: Russia: effective economic sanctions, HC 1186

Monday 7 March 2022

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Members present: Dame Angela Eagle (Chair); Rushanara Ali; Harriett Baldwin; Anthony Browne; Gareth Davies; Emma Hardy; Kevin Hollinrake; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1-93

Witnesses

I: Dr Justine Walker, Head of Global Sanctions and Risk, ACAMS, Natasha de Terán, former Head of Corporate Affairs, SWIFT, Tom Keatinge, Director of the Centre for Financial Crime and Security Studies (CFCS), RUSI, Neil Shearing, Group Chief Economist, Capital Economics.

Examination of witnesses

Witnesses: Dr Justine Walker, Natasha de Terán, Tom Keatinge and Neil Shearing.

Q1 **Chair:** Welcome to the Treasury Committee's evidence session on Russia and effective economic sanctions. Before I ask our experts to introduce themselves, let me just say that Mel Stride, our usual Chair of the Committee, sends his apologies that he cannot be here, but he has tested positive for covid, so in all our interests he is self-isolating and watching us on TV, I think, with some frustration. We wish him a very speedy recovery. I invite the witnesses to introduce themselves, starting from my left and moving along the panel.

Natasha de Terán: I am Natasha de Terán. I look at payments policy from a number of standpoints: I sit on the PSR Panel and the Financial Services Consumer Panel, but I suppose most relevant in relation to the discussion today is that I am the former head of corporate affairs at SWIFT.

Tom Keatinge: I am Tom Keatinge, the director of the Centre for Financial Crime and Security Studies, which we founded in 2014.

Dr Justine Walker: I am Justine Walker, the global head of sanctions compliance and risk at ACAMS. ACAMS is a global membership body of



HOUSE OF COMMONS

around 90,000 compliance individuals, and we have a global sanctions programme looking at thought leadership.

Neil Shearing: I am Neil Shearing, group chief economist at Capital Economics.

Q2 **Chair:** Thank you very much, and thank you all for attending what we think is an extremely important evidence session.

The Office of Financial Sanctions Implementation, which is run out of the Treasury, suggests that there are a number of reasons to impose financial sanctions, including to coerce a regime into changing behaviour. Since the ultimate aim of the sanctions that are being put on Russia now is to get it to remove Russian troops from Ukraine, I would welcome any observations on how you think the total package of financial sanctions matches up against that aim. Who wants to go first?

Tom Keatinge: I'm happy to dive in. I think there are three reasons why countries use sanctions: to deter action, to change behaviour, and to express opprobrium. Clearly, the rhetoric from western allies prior to two weeks ago was to deter action. That obviously has failed. We can discuss whether that was a realistic objective of sanctions initially, but that was obviously the initial objective: threatening massive economic consequences. Now, we are at a point where—well, we're in uncharted territory: using sanctions against a country that is so integrated with the west is unprecedented. Obviously, now what we are trying to do is to, I would suggest, make Vladimir Putin decide whether he wants to fund his country or fund his military. That is why focusing on trying to reduce the amount of finance going into that economy—I'm sure we'll come on to some of the areas that still fund the economy—has to be our focus. We have to make him make choices and to, at the same time, possibly—I think this is a very long shot—inflict, frankly, suffering on the Russian people that makes them feel as though they need to also force a choice, but as I say, I think that is a very long shot.

Dr Justine Walker: I concur with what Tom has just said. I would also really emphasise the point that we have never used sanctions in this way against another G20 country. We have used similar types of sanctions only against jurisdictions such as Venezuela, Syria, Iran and North Korea when looking at the targeting of central banks, so we are in uncharted territory. Also, we are already seeing the scale and impact expanding beyond Russia and Ukraine. One of the areas that we have been looking at is how these types of sanctions impact globally, in terms of the threat of secondary conflicts emerging, food security, oil prices and so on. In general, at that level around the response to sanctions, it is unprecedented.

There is also a point that this is not being discussed to a large extent at this stage. Tom talked about why you use sanctions, but there has to be a link to how they will help to de-escalate the conflict, because we are now in a conflict scenario. We moved so quickly from a deterrent policy to its now being a punishment and deterrent for future escalation. We have to look at these sanctions in relation to de-escalation and how we frame



HOUSE OF COMMONS

them and tie them to a de-escalation scenario. I am happy to talk about that in further detail later on, but this is probably going to be very critical for both this Committee and the Foreign Affairs Committee, and for the global economy as well.

Chair: Natasha, do you have any comments?

Natasha de Terán: Not at this stage.

Chair: Neil?

Neil Shearing: Nothing to add.

Q3 **Chair:** To what extent do you think that the sanctions now applied amount to the highest level of sanctions that we can get? We were talking about escalation, and a recent Government communication said: "The government will continue to ratchet up pressure and use sanctions to degrade the Russian economy on a scale that the Kremlin, or any major economy, has never seen before." How much more tightening of these punishing sanctions do you think is possible?

Tom Keatinge: There is a meaningfully longer way to go, because we have not yet touched the energy topic. There is no doubt that where we have come in the last 10 days is, as Justine says, unprecedented. Freezing the assets of the central bank has obviously had a massive impact. There are still banks that are untouched. We know that they are untouched because of the requirement for energy payments to continue to flow. I was pleased to see in the press overnight that the question of oil sanctions is now being considered, because that remains a major revenue generator. There is plenty of room to ratchet up, and I hope that that happens fast.

Neil Shearing: Yes, I agree with that. From an economic standpoint, if the objective is to hit Russia's economy, it is the energy sector that you need to touch. Clearly, there is a cost for the rest of the world that that entails. When news broke overnight of oil sanctions potentially being imposed, the price of oil spiked to just over \$140 a barrel, so there would be a cost to the rest of the world were we to go down that route. We can get into that, but, as a rough rule of thumb, energy is about half of Russia's exports and about 15% of its economy—more if you include all the associated services. I agree that the central bank sanctions are unprecedented for a G20 economy. They are principally what is causing the economic pain right now, but there is a meaningful way to go if we include energy as part of the sanctions.

Q4 **Chair:** What do you regard as the most impactful of the sanctions that we have seen so far, and why?

Neil Shearing: From an economic perspective, it is the central bank sanctions. It is perhaps helpful to break the sanctions down. There have been asset freezes, and clearly that will have an impact on the individuals concerned. There have been export bans on certain technologies to Russia's defence sectors and other parts of the economy. That will have an impact over the long term, too. The acute financial pain stems from the sanctions on the central bank. That affects the ability of the central bank



HOUSE OF COMMONS

to defend the rouble and provide foreign currency to banks and companies in Russia that are now shut out of foreign currency markets. That is the oil, if you like, that keeps the Russian economy—the trade side of things—going. It is the central bank sanctions that are causing the most acute pain.

Q5 Chair: Natasha, do you want to say something about how the exclusion from SWIFT will impact those affected?

Natasha de Terán: The communications layer of international transfers is only one of four parts to why and how an international transfer takes place. No one does an international transfer without an underlying economic incentive—in this case, trade or moving assets—so as long as trade can continue, there is always going to be an incentive to move money. What do you need to do that? You need willing counterparts. At the moment, there are still willing and able counterparts. At the moment, there are still unsanctioned banks in Russia, so that is still a possibility. You need an exchangeable currency or mutually acceptable assets. That is still in play, although it is somewhat compromised, and many of the nations that Russia might wish to trade with outside Europe and the United States might have complicated currencies for it to exchange the rouble with, which will increase the cost.

The communications layer is just one of those factors, but so long as there is the economic incentive and there are counterparts, you will sort out the other two things. That said, there is a question of scale. If I am a bank and I need to do a billion dollar oil transaction, I can make that possible by setting up a leased line and by sending a fax. It is problematic. It is risky, because clearly if I tell another bank to act on the receipt of a fax I am opening myself up to fraud and other risks. It is cumbersome. You cannot do an awful lot of low-value transactions that way, so it messes things up, but it only messes things up and complicates things in a terminal sort of way—if that is the aim—if that bank is subject to really multilateral sanctions. That takes us into the application of US secondary sanctions, which are probably the most exhaustive sanctions that there could be. We have not seen those exercised yet.

Q6 Chair: Justine, you were saying something about unexpected consequences of sanctions that actually hit the countries that are making them as well as the country that they are aimed at. Do you want to expand on that?

Dr Justine Walker: At the moment, because of the scale, the way and the speed that the sanctions are being imposed, we have very multifaceted sanctions. For example, on the Russian central bank, it is arguable that it is not an asset freeze; it is a “prohibition to deal with”, although in reality it works the same way. With respect to your previous question around enhancing sanctions, there isn’t a comprehensive trade ban with Russia, so there is a number of ways in which, as has already been indicated, it could go further.



HOUSE OF COMMONS

The issue that we are seeing is that, because we have such a quick speed of sanctions policy at the political level, the governance of sanctions is not keeping up with that. This is where we are seeing some of the potentially very major unintended consequences. On the VTB designation last week, the licences did not come out at the same time. What is really important in sanctions policy is that each time an entity or jurisdiction is subject to sanctions, the unintended consequences are managed. How does India, for example, purchasing fuel, grain or other commodities, because both Russia and Iran are global powerhouses in the agricultural as well as the energy sector, manage that risk?

This is where, in terms of the wider global impact, what is within the sanctions and what is not captured by the sanctions is actually very unclear at the moment. The US have been very forward leaning. They have been very clear. When they have imposed sanctions, they have been ready to issue detailed guidance and licences. We have not seen that in the same manner from wider G7 counterparts. There is just a whole lot of unknowns that everybody is trying to work through, but the unintended consequences will be very much around the trade that you wish to see continued for safety and security, either in this country or in Russia, Ukraine or other parts of the world. Given the scale of Russia, there are going to be lots of those trades.

Tom Keatinge: If I may, you cannot make up sanctions on the hoof, because you are relying on the private sector to implement them, and the private sector will need to know legal names and all those things. You cannot just simply say, "VTB." You have to give subsidiary names. You have to give enough detail for people to be able to figure out what it is they are actually meant to do. At the moment—Justine can disagree with me if what I am saying is wrong—the system to some extent is frozen. It is paralysed. No one is quite sure what to do, and at the moment most people are sitting there saying, "Okay—if it's got something to do with Russia, we'll put a red line through it," but that might not last, and we need details. We cannot continue to have generalisations; we must have details, and that is something that both the sanctions unit and OFSI need to really expedite if we want the private sector to do the job that I think the Government wants it to do, which is to implement sanctions against Russia.

Q7 **Chair:** How many people work at the Office of Financial Sanctions Implementation?

Tom Keatinge: I have absolutely no idea.

Dr Justine Walker: Probably not enough at the moment. I would imagine they are working 24/7, but I think that, like the private sector, they will just not be equipped to deal with a crisis on this level and scale.

Q8 **Chair:** So, just to sum up before we move on, what you are saying is that these sanctions have been applied very quickly and on the hoof and it is not clear, for those in the private sector who have to implement them, precisely what is included and what isn't.



HOUSE OF COMMONS

Dr Justine Walker: I think broadly that is the case. The exception to that, I would say, would be the US. I think it has actually been very good at mapping them out; it has signposted very, very strongly over the past two months what the sanctions packages should be. We actually hosted one of the assistants to the President at an event at the beginning of February, and he was very, very clear about the types of sanctions that we would see. So I don't know whether it is correct to say, "on the hoof". What I think we hadn't expected was just the turnaround, particularly by the wider G7 members—other than the US—and the EU, to come to the table with the package of sanctions that we have seen. Nobody expected that level of turnaround.

Tom Keatinge: Just to be clear, my comment on details refers to the UK. I absolutely would agree, from what I hear from the US, that it has been very ready.

Q9 **Chair:** So the US is the gold standard. Where would you put the UK?

Tom Keatinge: The US has been the gold standard on sanctions for as long as I think any of us can remember, in terms of details, guidance and all that sort of stuff. Obviously, the UK is faced with an unprecedented workload, and as I think we can all agree, OFSI was not set up to deal with what it is facing at the moment. We have to be realistic and, if you like, fair to it. The question is: how do we, as quickly as possible, ramp up capacity and ramp up guidance and everything that is needed? I cannot stress enough how important it is to understand that it is not the Government implementing sanctions; it is the private sector, and the way in which the private sector is effective is via clear communication and detailed information coming from Government. We have the situation, at the moment, where there are Saturday afternoon arguments on Twitter between the FCDO and Bloomberg and other organisations about what the right number of people we have sanctioned is. That should be a crystal clear fact for everybody to understand, because if you don't know what the right number is, how can you expect the private sector to sanction the right people? So I do think we need to get away from, "Who's got the biggest list?" and actually start focusing on: what are the details of what should be on that list?

Q10 **Chair:** If just one thing could be done to beef up effectiveness and enforcement, because we are quite bad at that in this country for economic crime and fraud—are we bad at it for sanctions as well? How can we make that better quickly?

Tom Keatinge: We need to do everything we can to leverage the capability of the private sector in this situation.

Q11 **Chair:** Are there any other comments?

Natasha de Terán: I think it would be unfair to say that Britain is bad at sanctions. It doesn't have as active a role as the United States; it has just come out of the EU, and sanctions responsibility was vested there. I think it's probably No. 2 to the US on a global scale. But this is massive. It depends on what you are trying to achieve. I would imagine there is



HOUSE OF COMMONS

massive over-compliance, which is making the sanctions bigger. If the will of the nation, the Government, is to put maximum pressure on Russia, the lack of clarity enhances the sanctions. There have been times when the Americans have deliberately been unclear about sanctions, to magnify their impact.

Dr Justine Walker: I would say the over-compliance is probably a potentially very true reflection, and that is partly because of the ambiguity of the situation. We shared earlier today an infographic about which banks are sanctioned and which aren't, and I have to say that that was incredibly difficult to do. It is just not clear what the precise legislation actually is in some scenarios, beyond certain asset freezes, so the compliance community are working very much in the dark. But in fairness to Governments, I think one of the ideas of sanctions is that this is a rapid response tool and so Government are looking at how they use this tool. I think there are two elements of conversation here: what can the tool do to actually change the crisis at the present moment, and how does that tool play out in the longer term? The other side of the coin is how we ensure effective implementation of both the sanctions and the exemptions if it is deemed that the Government wish to see oil continue, food continue or certain other types of humanitarian efforts continue.

Q12 **Anthony Browne:** I am just following up on your comments about de-escalation. We are clearly very much in an escalation phase, but what do you mean by "de-escalation"? Presumably this is the use of sanctions and negotiations to reduce conflict. Is that right?

Dr Justine Walker: Yes. In terms of de-escalation, what we have seen in other long-standing sanctions regimes is that it becomes very challenging to roll back. That is partly to do with the point that when people are imposing sanctions, it is at a time of crisis and you do not actually think about roll-back at that point. But in terms of having it as a tool for change of behaviour, it becomes really important. For example, if the sanctions that we are imposing now somehow get linked to the annexation of Crimea in 2014, does it mean that for any future roll-back, we have to see Russia remove not only from Ukraine's territory, but from Crimea? It becomes critically important what levers you see for roll-back.

The clearest of examples would be the Iran nuclear deal. We saw roll-back on nuclear sanctions, but those sanctions were so intertwined with human rights and terrorism sanctions that it actually became impossible to roll them back from a US and other jurisdiction point of view. It is about having clarity when sanctions are being designed, which I am sure will also be asked later around the rule of law on targeting oligarchs and other illicit wealth. How do you manage that in the longer term as well?

Chair: Thank you. I would like to bring in Julie now.

Q13 **Julie Marson:** Thank you, Chair. Justine, maybe I could follow up on what you are saying. I absolutely take your point about the implementation and guidance that you have been talking about—the effectiveness. Looking at the package that we have at the moment in the



HOUSE OF COMMONS

UK, what is missing? Is there anything missing that is currently blunting the overall package, and what would you add to add to its effectiveness?

Dr Justine Walker: Thankfully, I do not have to make the decision what to add—that is very clearly a matter for Governments. What I would say is there is still a significant amount of permissible trade. It has been deemed that that is not being targeted. The sanctions at the moment are not full-scale asset freezes from the UK's point of view, although there has been the intention from the Government that they will move more towards that direction. What we have is a jigsaw of measures, and it probably comes back to: if the Government chooses to escalate sanctions, what would that look like? That very much comes back to other comments from other experts today.

Q14 **Julie Marson:** Tom, is there anything else that you might pinpoint that would increase the effectiveness?

Tom Keatinge: No. We have talked about energy, but there is an important point in all this: what is very impressive is the clear co-ordination that is going on between the main protagonists in all this. We can only advance at a speed that will bring everybody with us. In the UK, we might think we need to go hard on oil sanctions now, but there may well be people in the alliance who would actually suffer from that fast movement. The important thing is just to keep up the momentum, identify where there are gaps, figure out how to fill those gaps and then move forward again. But the co-ordination is important, and we have to keep the co-ordination. I think that is critical.

Q15 **Julie Marson:** If we ratchet up sanctions, how do we assess what we also have to do to mitigate the costs to the UK and, indeed, its partners? How do we actually go about mitigating those costs over time?

Tom Keatinge: I wrote for RUSI back in December that we are not going to be able to put the sanctions on Russia that we are promising without creating self-harm. I was pleased to finally hear the Foreign Secretary and others recognise that this is going to be an issue, so I would hope that, somewhere in Government, there are people thinking about how we are going to deal with the impact that this has on energy. There will be people whose businesses rely on exporting to Russia, and that will be over. We hear already of the withdrawal of UK businesses and others from Russia. That will have a significant impact and we need to think about how we mitigate those risks, but we need to accept, frankly, that this is one of the costs that we have to bear to support the people in Ukraine, and by the way, it is nothing compared to what they are going through.

Q16 **Julie Marson:** What flexibility and potential are there for firms and countries to get around the sanctions? That must be a huge risk, presumably, particularly as we ratchet them up.

Tom Keatinge: Yes. Others will have views on that. Clearly, there are countries that are sitting on the fence at the moment—you just have to look at how people vote at the UN. Thinking about some of those countries, they clearly might play a role in resolving this conflict, so the



HOUSE OF COMMONS

last thing we want to do is antagonise them by targeting them with the secondary sanctions that Natasha was talking about, for example.

I would just like to say one thing, bearing in mind which Committee this is: I would like to hear the Chancellor's thinking about the impact of sanctions on the UK economy. I do not want to go as far as saying that they will have a kind of covid impact, but it is clearly a massive issue for the UK, so it would be good to hear the thoughts around dealing with the cost of living crisis and the impact on energy. How is that being thought through? Communicating that soon will be important.

Q17 Julie Marson: Thank you. Justine, is there anything you would like to add?

Dr Justine Walker: I echo Tom's comments, but I would also add the cost for global economies, because from what we are seeing, food security, energy security and other critical commodity security are not just UK issues. I cannot overstate just how significant those will be for all global elements of the economy.

Tom Keatinge: We will ask countries around the world to make very negative decisions for themselves on behalf of Europe, or on behalf of Ukraine. Again, we need to think about how, as Justine says, that will impact countries that rely on Russia as an export market, for example, or rely on Russia and Ukraine for their wheat supply. We need to think through all those sorts of things.

Q18 Julie Marson: Is it fair to say—particularly as we go through the process and potentially escalate—that sanctions are only as good as the weakest link?

Dr Justine Walker: I personally would not say that because it really depends on who your weakest link is. If your weakest link was a global economy, then potentially. So, I would not say that. It would depend on whether we are looking at global economies. Of course, the question for certain global economies—China would be one—is how that will play out in longer-term trading relationships. That is probably a whole Committee session in itself.

Q19 Julie Marson: Neil or Natasha, do you want to add anything?

Neil Shearing: There is lots that we can get into on the economic impact—I am sure we will in the course of the discussion. In essence, it is going to feel quite stagflationary. It is bad for growth, and it will push up inflation, so it will contribute to what is already being called the cost of living crisis. I think the increases in global commodity prices that we have already seen will push up UK inflation by perhaps another 1%, or something like that, compared with a pre-conflict baseline.

If you start to bring energy into the scope of the sanctions, and see further increases in commodity prices—clearly, it depends on how those are structured, which commodities are hit and over what timeframe—you can easily double that effect. At the moment, it could shrink the UK economy baseline by between 0.25% to 0.5%. That is the scale of the hit



compared with our baseline. The economy still grows, and the post-pandemic recovery continues, but it is a bit weaker. Again, you could potentially double that if you bring energy into play.

There is a cost to the UK economy, and there is a cost to the European economy, in particular. There are things that the Government can do to mitigate that, particularly through fiscal policy, by easing the effect on households, but it then really becomes a discussion about who bears the cost.

Q20 Julie Marson: Justine, as an adjunct or a follow-on from official sanctions, how important are the voluntary actions by individual firms that are not part of the official package but follow on from it?

Dr Justine Walker: There are soft sanctions, such as the sporting sanctions and the ESG considerations, where we have seen firms withdrawing. Personally, in my experience of sanctions, I think those sanctions are actually very important. In terms of messaging, they are very important. In terms of how they impact individuals in Russia, there obviously will be many ordinary citizens in Russia who will no longer have a job, and the company they worked for—Zara and others—is no longer operating and is withdrawing. The harm for individuals is something that Governments cannot control, but in terms of messaging and collective messaging, I have never seen a scenario like this, where we have had this level of soft-sanction response.

Q21 Julie Marson: Would you agree with that, Tom? Do you have a final comment?

Tom Keatinge: Yes. We were just talking outside. We started this programme at RUSI at the time of the last crisis when Russia annexed Ukraine. I remember saying at the time on the BBC, “We should be taking the World cup away from Russia.” I am kind of glad to see this time that people are actually taking these measures, because I could not agree with them more. These sorts of soft sanctions have an impact on a country that is trying to strut on the international stage, I suppose, so hear, hear.

Chair: Moving along to Anthony, please.

Q22 Anthony Browne: My questions are about SWIFT and payments more widely, so primarily questions for Natasha to start with. When countries announced their sanctions on access to the SWIFT system, it was often portrayed as being the most draconian form of sanctions there could be and that it would paralyse the Russian economy, but others have said, “Well, actually, there are so many workarounds”, and you touched on that a little bit earlier. What do you think the real impact of barring the, I think, seven Russian banks from access to SWIFT is?

Natasha de Terán: They are both right. They can be very impactful and not impactful at all. Just to clarify, I am not speaking on behalf of the organisation at all today. There are about 25,000 banks in the world. On SWIFT, there are somewhere between 9,000 and 11,000, so there are a lot of banks in the world that are not connected to SWIFT and, bar banks



HOUSE OF COMMONS

in Iran, North Korea and probably Russia at the moment, you can still send money to anyone at any bank anywhere in the world. How does that happen? It happens because the bigger banks act on behalf of the little banks and process their transactions. If you take off a small, private or internationally inactive bank from the network, or one that simply does not do a huge amount of business, it is limiting and costly for them. They bear more risk, and their customers obviously pay the costs, bear the risk and have slower transfers.

If you did it to a small bank, it is not particularly consequential. If, on the other hand, you took off a big international clearing bank, or a bank with big domestic capabilities in international clearing, that is very consequential. The effects of the measures are overstated but, on the other hand, we have seen both sides of this particular confrontation urging for, on the one hand, no action and, on the other hand, removals from SWIFT, so it is difficult. We were talking earlier about secondary sanctions, and my colleagues here mentioned that you have to be careful with secondary sanctions, because we have potential allies around the world who may bear the consequences of that. If you take a bank off SWIFT, it is off SWIFT for everybody. It is not off for Barclays alone or for the UK banks; it is off for everyone. It is a difficult thing to work with, and it needs to be treated carefully.

Q23 Anthony Browne: What are the opportunities for the banks to work around it? We mentioned faxes earlier, which are open to fraud, but there are obviously other payment and messaging systems. There is the Chinese one: the Cross-Border Interbank Payment System. There is the System for Transfer of Financial Messages, which is Russia's own system. Can the banks not just switch to another messaging system?

Natasha de Terán: Which banks? You would need to be a bank that is willing to do that. The information on both those systems is somewhat difficult to come by—at least here. I do not believe there is an awful lot of connectivity to those systems, but if you are an internationally active non-Chinese bank connected to CIPS, are you going to throw your lot in right now on Russian sanctions evasion, with all the risk that might bear for you? It is not a great prospect. If, on the other hand, more banks are taken off SWIFT and trade is allowed to continue, de facto either the Chinese system or the Russian system will have more attachment. The substitutability of any network does not just lie in the technological platform; it is also the end point. One of the things that the west will have to grapple with is how much the measures they put in place now encourage the development of those alternatives, which otherwise were quite difficult prospects.

Q24 Anthony Browne: Presumably it would spur the growth of alternative systems and could lead to a more fractured global payment system. SWIFT is not quite a monopoly, but it is a single-payment system around the world.

Natasha de Terán: That's right. It could do, but, as I said before, beyond the economic incentive, you need the end points, the banks, that are

happy to do this, and you need the currency conversions. Again, if this were to carry on over a sustained period of time, we could start to see much more liquid currency conversions and therefore much less trade through the US and the UK, which would diminish the power of the measures that have been applied at the moment. Those are important decisions.

Q25 **Anthony Browne:** Does anyone else have any comments on that?

Tom Keatinge: I would point out that the oldest money transfer system in the world is hawala and that never used SWIFT, so you do not need SWIFT to move money around the world—that is the first point. The second point is that at the moment when we talk about SWIFT, the elephant in the room is that we still want energy payments to go, and SWIFT is still operating for banks that have been allowed to continue to operate as part of that. In a way, SWIFT is belt and braces. Banks that are already sanctioned have been taken off SWIFT. Well, who was going to deal with those banks, anyway?

Q26 **Anthony Browne:** So it does not have much impact.

Tom Keatinge: To Natasha's point, there might be banks in other parts of the world that are not in the EU, the UK or the US who might go, "I don't care what they are doing in the west. I am going to carry on trading with one of those banks". That has now become more difficult because they can't use SWIFT.

Dr Justine Walker: The disconnection of SWIFT, when that takes place on 12 March, will in some ways ease the compliance burden for banks, because at the moment they are trying to manage all of that exposure, and not having to manage those payments will, in a bizarre way, make it easier. I would also say that the SWIFT disconnection is probably one of the most powerful messages that I have seen. SWIFT disconnection and the Russian central bank restrictions were the two most powerful measures that I have seen come out over the past week in terms of what that has meant for the global compliance community, but also leading on to things like ESG bank companies making decisions just to move out of Russia, because they are saying that it will become just so difficult. I think it is fair to say that that individual action has spurred a number of other actions.

Q27 **Anthony Browne:** Neil, do you see an economic impact from the sanctions through SWIFT, or is it just part of the whole and just another thing?

Neil Shearing: I think that all other things being equal, there would have been an economic impact on Russia from the actions on SWIFT, but it is dwarfed by the actions on the central bank at a macroeconomic level. That is the thing that has really made me sit up in the last week and think, "This is much more severe than I had anticipated" in terms of the economic hit.

Q28 **Anthony Browne:** Speaking of payments, Visa and Mastercard have



withdrawn from Russia. I think that was done voluntarily rather than as a sanction. What will be the impact of that? Is there a macroeconomic impact, or just an impact on Russian citizens not being able to use their Mastercards to go and buy things?

Neil Shearing: Yes, there will be a hit through that. On disentangling the scale of the economic hit of Visa's and Mastercard's decisions from everything else that is going on—the collapse in the rouble, the squeeze on real incomes as a result of that, the tightening of financial conditions in Russia's economy, the limited access to credit and everything else that is going on—it will be difficult to isolate exactly those effects. This speaks to a much broader issue: the self-sanctioning that we are seeing by firms operating in Russia. That could have some unanticipated consequences as well. We saw over the weekend Maersk, the shipping line, saying, "We are not going to run cargo between Russia and the rest of the world."

Q29 **Anthony Browne:** Maersk is the world's largest shipping line.

Neil Shearing: Exactly. As has been said by others on the panel, that will increase the magnitude of the economic hit.

Dr Justine Walker: I would add that yes, Maersk, but I think the three largest container lines have said that they are not going to continue new business with Russia. Again, that creates a difficult scenario for the commodities that we wish to see traded, for example grain.

In countries such as Lebanon, Egypt, even Nigeria and others, Russian grain is very important and bread prices are important for the stability of those economies. When you stop seeing any type of trade moving, either because you cannot get the payment, you physically can't get it to move or you can't get it insured, that becomes globally impactful in many ways that policy makers have not assessed at this point.

Q30 **Anthony Browne:** My last question is about enforcement; there will be more questions about this later. How easy is it to enforce the SWIFT sanction? Is it all centrally controlled? Would it be easy for Governments to detect whether it is being abused or not?

Natasha de Terán: A bank is either connected to SWIFT or it is not.

Q31 **Anthony Browne:** Is it literally plugged in or not plugged in and SWIFT would know if that were the case? Is it impossible to avoid it directly?

Natasha de Terán: Yes, once SWIFT is disconnected the bank is no longer connected. On Justine's compliance points, smaller banks will have their transactions processed by bigger banks. If I am a bank that has been disconnected, I might go the same way. That complicates the compliance burden, because you need to check inside to see whether you are processing for the bank that has been disconnected. It is by no means a panacea; it is a delicate instrument, and a blunt one at the same time, which is all of a contradiction.

Anthony Browne: Thank you all very much for your answers.



Q32 **Kevin Hollinrake:** You talked quite a lot, particularly Neil and Justine, about the impacts of the actions on the central bank. The French Finance Minister, Bruno Le Maire, said, "Of all the sanctions the west imposed on Russia last week, sanctioning Russia's central bank is by far the most fateful...We will cause the collapse of the Russian economy". Is that accurate?

Neil Shearing: That is close to accurate, I would say, and that is what we are seeing. In terms of how it works, what it has essentially done is frozen just over half of Russia's foreign exchange reserves. You may or may not be familiar that running up to this, and since the Crimea annexation in 2014, Russia has been running a programme that people have called fortress Russia in terms of the economy—running large external surpluses, building up large stocks of foreign assets and cutting external liabilities, therefore diminishing vulnerability to measures like this.

As part of that, we have seen Russia's foreign exchange reserves and the foreign assets held at the central bank increased to just over \$600 billion. They are parked in different currencies—dollars, euros, yen, sterling and so on. As a result of these sanctions, we have frozen just over half of those reserves, so those can't be used.

The central bank cannot process any foreign exchange transactions, defend the rouble when the rouble collapses, sell its foreign exchange reserves and buy the rouble to prevent it falling further, or help domestic companies access foreign currency for transactions. So it has completely frozen the financial system in Russia, with respect to external transactions. As part of the modern global economy—what was the 11th-largest economy in the global economy—that has a huge effect.

Tom Keatinge: In my last year at JP Morgan, I happened to have a client called the central bank of Russia. That was in 2014, so a long time ago. For the avoidance of doubt, a lot of people imagine that the central bank of Russia has all these dollars, euros and sterling in a vault in Moscow. That is not the case at all. They are all held in the Federal Reserve Bank of New York or big global banks in the relevant country. The flaw in the fortress Russia foreign exchange strategy was that those reserves are actually being held by people who were potentially your enemy, and that is what they have found out, to their cost.

Q33 **Kevin Hollinrake:** Fortress Russia—why did they do that? They must have seen that coming. Surely, they must have recognised that fortress Russia was a problem, or was it a solution to some of their problems?

Tom Keatinge: My understanding is that they significantly sold down their dollar portfolio because their strategy was to avoid the dollar, as opposed to avoid all foreign currency.

Q34 **Kevin Hollinrake:** Is that because, as you said before, the USA has been more effective in implementing sanctions against nations in these situations in the past?



Tom Keatinge: It is not so much effectiveness. Obviously, the US has been more aggressive in the way it has used sanctions, so if you had to roll the dice you would say, "I would rather reduce my dollar holdings." Things like Chinese Yuan have increased as well. The major flaw in their strategy was that the west has acted with such unity.

Dr Justine Walker: I agree with what has been said. I think one of the reasons particularly that they have tried to protect themselves from the US exposure is that they have seen the mood music from Congress over recent years. Certain elements of Congress, for example, were calling for Nord Stream 2 to be sanctioned, and were calling for much wider sanctions. They will have been mapping that, and managing and preparing for that scenario. They will have known that sanctions were going to be very rapid. There was a lot of signposting for that but, as Tom said, certainly the collective action has made that more impactful.

Q35 **Kevin Hollinrake:** Can you describe the effect on consumers and businesses directly of this? Are we going to see a run on the banks or something? We are seeing queues at ATMs and things. Is that likely to happen? Is that a good thing? Can we precipitate that?

Neil Shearing: We have seen some evidence of what I would call mini bank runs. I think that happened last week, and we are seeing less evidence of that this week, so that seems to have been snuffed out quite quickly. In terms of how this will be felt by ordinary Russians, there will be a variety of ways but principally there is going to be much higher inflation and a squeeze on real incomes as a result. It is going to be much more difficult to get access to credit because of what is happening in the financial system. On the cost of imports, to the extent that you can get hold of imports they are going to be much more expensive. Inflation is going to be much higher. Real incomes are going to be hit.

As I said earlier, I think on the order of magnitude the economy might shrink 10% as a result of what has been done already. If you start to wrap energy within that, it becomes substantially larger—maybe 15% or 20%, so substantial hits to the real economy. That spreads through the economy but obviously hits Russian consumers particularly.

Q36 **Kevin Hollinrake:** Will this affect Putin's ability to finance his war in Ukraine directly or indirectly in any way?

Neil Shearing: It depends to some extent on what happens with energy, because that accounts for about half of Russia's export revenues. A little more than half of the budget revenues come from energy. The ability to finance the war will depend to a large extent on what happens to the economy and the revenues generated by the economy, and that will depend to some extent on whether or not energy is wrapped into these sanctions. There is always a decision that could be made. The amount of resource that you divert to the defence sector you can just take from somewhere else. There is a decision that you can make. If you are willing to squeeze the welfare programmes, social spending and so on and so forth, you can take money from there and give more to defence.



Tom Keatinge: If I could just add one small footnote, it was very interesting to see a release from the US Treasury last week, which is already reacting to the risk of evasion. It made a comment about other organisations potentially accessing foreign exchange on behalf of the Russian Federation rather than the central bank. This is going to be a critical element, and we can see it playing out already. Are our sanctions tracking the targets as the targets adapt? The central bank is obviously already trying to figure out ways around the sanctions that it faces.

Q37 **Kevin Hollinrake:** Natasha, I was going to come to you on that. Sberbank has access to SWIFT still, doesn't it? Is that one way to do exactly what Tom just described? Is it a way to circumvent some of these sanctions?

Natasha de Terán: Any bank that remains connected does—but also, as I said before, banks that are not connected. If you were trying to do something away from the glare of the west, you might not want to do it over SWIFT in the first place. This information is anecdotal, but when there were oil waivers from Iran but all the Iranian banks were sanctioned, bilateral corridors were set up to allow for the waived oil transactions to take place, and we would have a leased line or a fax going from India to Iran, but there was also barter. If you were trying to avoid, I don't think I would use my biggest and most important bank to do the avoidance with—put it that way.

Q38 **Kevin Hollinrake:** Tom, do you have any ideas how we do that? How can we track what they are doing so that we can put a stop to it?

Tom Keatinge: When it comes to accessing foreign exchange, that is typically more trading companies, so it might be worth looking at some of the evasion tactics that Iran and North Korea used. All the ideas are out there; it is just a question of the extent to which, first, Russia can use them and, secondly, it can use them in the volume that is needed. This is not Iran or North Korea; this is the 11th-biggest economy in the world, or whatever the right number is, trying to finance a massive military machine.

Q39 **Kevin Hollinrake:** In the future, if fortress Russia learns the lessons of this, it will not leave its money in other jurisdictions. Is that right? Will this lead to a permanent change in how it organises its finance?

Neil Shearing: Possibly. There is a tension here. There is a school of thought that what this has underlined is the power that the US in particular, but also the western allies in Europe, can wield as a result of the dollar being the world's reserve currency. We have now unleashed that, and it is clear for other countries to see, so that might force and perhaps incentivise other countries to use the renminbi more. The renminbi might become more important to the global trading system.

There might be something to that. My strong suggestion—my sense—is that that is much more difficult to achieve in practice. It is possible that it might accelerate Russia to diversify holdings of foreign currency, to hold more renminbi and to build closer ties with China. I am sure that will be



HOUSE OF COMMONS

one consequence, but I do not see the renminbi supplanting the dollar as the world's reserve currency any time soon.

Q40 Gareth Davies: I want to focus on financial services, and to get to the bottom of how important Russian firms are to our financial services industry.

Today, we have discussed the combination of official sanctions by Governments on companies and voluntary sanctions. To take two examples, Gazprom was sanctioned by the United States, and its share price went down 85% and it accounts for 22% of the MSCI EM index; and BP sold its 19% share in Rosneft, and saw its share price go down 5%, which equates to about 3.5% of the FTSE 100. These are companies that are held by savers and investors in this country and around the world. I saw one report that international investors account for about \$170 billion in Russian assets. From your perspective, Neil, what has been the impact on savers, investors and in particular pension funds of the sanctions and the voluntary sanctions?

Neil Shearing: Yes. It is difficult to put a precise number on this. In essence, those are the kind of channels through which you would expect to see the impact. There is the impact on share prices, on the profits of companies and the dividends they pay out, and the extent to which that flows to savers and pension funds. It is also the case that, because this is going to push up inflation and because I suspect that normal interest rates will not rise by as much as inflation will rise, as a result real interest rates will fall further, so returns may fall further as a result as well.

This is really one manifestation of a much broader problem, which is that we are a net energy importer, so if the price of energy goes up, someone bears the cost. That can be the Government, the companies, households or, within households, savers. It can affect savers as well as through the inflation channel and the real income channel. It is just one way in which the cost of this is going to be felt in the real economy.

Q41 Gareth Davies: Justine, do you have a perspective? A lot of fund managers have sector limits and risk exposure limits in their portfolios. From a compliance standpoint, have you heard from the fund management industry and others how this is impacting on their investors and clients?

Dr Justine Walker: At the stage we are in at moment, it is because of the speed. Normally, in these sanction scenarios, there is a gradual escalation and people have time to prepare. This has just come on at such a speed that I think everybody has just—they are still rabbits in headlights. We are seeing a lot of divestment—people trying to offload their Russian exposure—so that is probably where we are seeing most of the energy at the moment. In terms of the longer-term elements that Neil has just spoken about, we haven't even got to that, to be honest.

Q42 Gareth Davies: Okay, thank you. Tom, we had a discussion earlier about who is winning the race, from a country perspective, as to how many people or companies have been sanctioned. You made the point that we



should not be looking at that but at the effect, but can I ask you about the co-ordination internationally? Do you feel there has been sufficient co-ordination between the US, UK and European Union, in particular, as we implement these sanctions?

Tom Keatinge: There has clearly been very intense co-ordination, as you would expect. I would congratulate those involved in the co-ordination—the co-ordination of ideas, if you like. I would have no beef with that.

Having co-ordinated, we then get on to execution. That is perhaps something that we ought to start to look at because, at the moment, I think that we all agree that there is quite a lot of self-sanctioning—I think I like that phrase, which Neil used. People are deciding not to trade with Russia, not because they are not allowed to, but because they are just not quite sure what on Earth to do right now. There will come a point where that stasis in the system will begin to melt, and we must ensure that people understand what is and is not allowed, very clearly, at that point.

Q43 **Gareth Davies:** In response to one of the questions, I think you talked specifically about the wind-down period for banks—it might have been you, Justine, apologies. My understanding is that in the US, the licensing is being granted more quickly than, or at the same time as, sanctions being announced, while that is not the case in the UK. That is causing a lot of problems for our derivatives traders. Can you expand a bit more on what that means?

Dr Justine Walker: Yes, a little bit more, but probably not as much as I would like to be able to. When we have seen the US come forwards with their asset freezes, for example, they have come out at the same time with the general licences, so, “You have 30 days,”—or whatever—“to withdraw and close out your positions.” In the UK, there was a bit of a delay. There was also quite a bit of ambiguity around what was permissible.

Tom will be able to add on a lot more information, given his background, but we have seen a lot of financial institutions, and others, trying to close out their positions—trying to offload their exposure. This is also an element that picks up on the financing side—we have talked about BP and others withdrawing—but when they close out, people are having to negotiate what the price is that they are closing out at and how they close that out.

In 2014, and in the context of Venezuela, we saw some people divesting their exposure, closing out, and getting rid of their exposure at actually quite preferential rates because they just wanted to withdraw. Previously, from the 2014 scenario, that actually benefited Russia in some scenarios. However, now, what we are really seeing is just the lack of trying to understand how to close out. This is really important; it is about closing out in a way that ensures that financial stability.

It is not about giving money back to the sanctioned entity—you are not making funds available to the sanctioned entity—but you have billions in flight. These financial institutions are literally WhatsApping each other



HOUSE OF COMMONS

about transactions, which are billions upon billions, going, “Do we think this is captured?” “Can we close this out?” “We want to actually get rid of it,” or “We want to freeze it,” or “We want to do something else with it.” They are trying to understand their legal basis for doing that, and, if they are trying to withdraw and reduce their exposure, how they can manage that in a way for their own financial stability. Tom, would you like to—

Q44 Gareth Davies: We have talked about the ambiguity. I just want to talk about the timing of this.

Dr Justine Walker: On the timing, we have seen specific scenarios where the wind-down licence period doesn’t actually reflect the required amount of time to wind down. There are some scenarios there where there have been requests to extend wind-down provisions by a number of days, just because of the mechanism for how that works.

We have also seen inconsistent approaches from allies on the type of timeline and how broad it is for winding down. One of the messages we have been trying to stress to likeminded partners imposing sanctions is that they ensure that the licences that they put in place—remember they are there either to protect critical business or to ensure financial stability—are consistent.

The worst-case scenario is when you have the US saying one thing and the UK and the EU saying another. It is partly to do with just the speed at which sanctions are being agreed. Policy makers are desperate, because the situation in Ukraine is desperate. Speed is of the essence, so people have been making those decisions very quickly, but not necessarily working through what needs to be done from the back-office point of view to ensure that all can be implemented efficiently.

Q45 Gareth Davies: That is really helpful. I only have a couple of minutes left so I want to ask one more question of you, Neil. In 1998, Russia defaulted on its debt, partly to pay for the war in Chechnya. How are you looking at that in this scenario? Do you think Russia will default on its debt?

Neil Shearing: There are several things to say, but I am conscious of time. Russia’s Government balance sheet is, in order of magnitude, much stronger now. There is much less debt in the system. It is running budget surpluses—partly because of the fortress Russia point that we talked about. The risk of an enforced default because they simply cannot afford to pay is much lower. There is a question of whether there is a selective default out of choice. Indeed, we have started to see some signs that that might emerge—among local currency bonds to foreign investors I suspect we will see non-payment, certainly of coupons in that area. It is a relatively small part of global financial systems. I do not think it would have major financial contagion. Obviously, in 1998, there was contagion. LTCM, a big hedge fund in the US, collapsed partly as a result of taking big bets on Russian debt. There is less of a big contagion risk this time around, but there is also potential for unanticipated consequences.

Gareth Davies: The credit rating agencies have already reduced them to



junk, as well.

Neil Shearing: They have already been reduced to junk, yes.

Gareth Davies: A lot of the firms will have sold out, pretty much. Thank you.

Q46 **Rushanara Ali:** Good afternoon. My questions are about Russian kleptocrats and oligarchs. For each of you, how effective do you think the current sanctions have been in terms of placing pressure on those groups? Could you compare the UK and other countries? Who has been the most advanced? Also, given where we are in the UK, with £100 billion, according to the NCA, of dirty money flowing through this country, and £1.5 billion in property, of which £430 million is in the City of Westminster alone, with connections close to the Russian regime, do you think the Government's announcements and actions thus far are adequate? Will the changes they are proposing be sufficient. Who wants to kick off?

Natasha de Terán: I really have nothing useful to contribute on this one.

Rushanara Ali: Okay. Tom, do you want to have a go?

Tom Keatinge: I will have a go. The first thing I would say is that it has been very unfortunate that in talking about Russia and sanctions, purposefully or otherwise, Government have allowed sanctioning oligarchs to become the headline. The result of that is that people like me have a look and say, "Well, what are you doing to meet the objective that you yourselves have set?" It is unfortunate that we have got so hung up on whether Mr X or Mr Y is subject to sanctions. In reality, as I think we all agree on this panel, what is going to crush—I use that word advisedly—the Russian economy, is not sanctioning Mr X and Mr Y.

The other thing we need to make sure we do not allow ourselves to get trapped into is thinking that sanctioning oligarchs somehow deals with the UK's dirty money problem. That is what the Economic Crime Bill and everything that goes with that is for. That is building the defences; that is not going after individuals with sanctions. That is not to say we should not be doing it.

So why are we doing it? We are doing it because these individuals, per the legislation, have benefited from or are supporting the Russian Government. They are probably in many cases stewards of Vladimir Putin's wealth. You do not get that wealthy without flipping a tip in the direction of the boss. We should be going after these individuals, but I repeat: it has become a very unhelpful metric by which to judge how the UK is progressing.

That being said, the UK is not progressing well in contrast to our peers. To go back to my earlier statement, it is extremely difficult to get clean data on this at the moment. The way in which information is being presented by the Government is not clear. As I have also said before, getting into a weekend argument on Twitter with the Foreign Office about how many



people we have sanctioned compared to everyone else suggests to me that we need to focus on the mission.

- Q47 **Rushanara Ali:** Of course, if you are looking at what makes the biggest impact, the early answers around central bank sanctions and so on are well made. There is a broader point here about corruption and the corrupting of our system, which has been going on for a long time, and the cosy relationship between Russian elites who are closely connected to the Putin regime and some people in political parties and Government.

We saw over the weekend that a Conservative-supporting newspaper ran a story about the involvement of our Prime Minister in the peerage that was offered to Evgeny Lebedev, owner of the *Evening Standard* and much else in this country, despite the warnings of the House of Lords Appointments Commission. It was informed by advice, which was based on the intelligence services, MI5 and MI6, and relayed to the commission by the Cabinet Office security officials, that this would damage international security. Despite that, our Prime Minister and those in charge decided to go ahead and provide a peerage. That is just one very serious example of the way in which the influence of people close to the Putin regime is at the heart of this Parliament.

Tom Keatinge: To be very clear, we should have dealt with this 10 years ago.

- Q48 **Rushanara Ali:** Just to probe you on this point, do you think that there is a contradiction in the objectives in Government, given these close connections and that we are trying to bear down on those who are laundering dirty money in our country? In this case, it is people close to the Russian regime, but there may be others. Do you think that the Government has not handled this well enough, that further barriers could be introduced and that too much time is being given, so that people can move their assets in this country? By contrast, other countries seem to be acting much more swiftly. What can be done to address this?

Tom Keatinge: Asset flight risk is clearly a risk. If you happened to have been sanctioned by the United States but not yet by the UK, you can imagine that it might happen to you soon in the UK. Therefore, you would try to avoid that. To be very clear, I am not suggesting that we should not be sanctioning these individuals. If they have benefited from or have supported the Russian Government, they are, per the law, involved persons and therefore subject to being sanctioned. As I say, we should not be allowing ourselves to accept that, by sanctioning people, we are fixing the problem.

- Q49 **Rushanara Ali:** That point is well made, but my questions are about these two groups of people. You make a very important, broader point that if we were having this session outside of this crisis, these questions would still be important and legitimate in their own right. Let's accept your point but make some progress on what can be done to prevent our Government and our system from being corrupted by these sorts of figures. In its own right, there are problems here.



HOUSE OF COMMONS

Tom Keatinge: One of the things I would like to see is this kleptocracy unit, which has been announced by the Prime Minister to be created for the National Crime Agency, properly funded so that it can properly investigate where this money is, how it is operating, to what extent it is undermining democracy in this country and to what extent it is being used to buy influence. These are all questions we cannot answer in this country. We have allowed for many years that corrosion to run through society.

- Q50 **Chair:** On this question of the kleptocracy unit, do any of you have any insight into how big it will be, or how it will be set up? I have just been told that the Treasury financial centre that is meant to be implementing sanctions has a full-time equivalent of 37.8 people in it, which is not really big enough, is it?

Tom Keatinge: The kleptocracy unit is going to be housed in the National Crime Agency. The National Crime Agency already has two units that are focused on exactly this kind of thing—in particular, the international corruption unit, which has been around for quite some time. Unfortunately, what has happened is that these organisations have not had the resources to do the kinds of work that is needed. I remind people that one of the issues—I am glad to see the cost-capping element in the Economic Crime Bill—that the UK has suffered from is fear of being financially outgunned in court by oligarchs and others whose illicit wealth we are trying to confiscate. We have not tooled ourselves up appropriately to deal with this dirty money. Our laws are not bad, but we simply have not resourced the issue. We need to be asking the Chancellor, the Home Secretary and so on to explain to us whether there is sufficient resourcing to deal with the challenge that we face. We cannot simply make more laws without providing the resourcing to enforce those laws.

- Q51 **Rushanara Ali:** That neatly takes me on to the point of funding for the NCA. It has suffered a real-terms funding cut over the last five years. Do you think that the Government are actually committed to tackling this issue, when they are making real-terms cuts to the NCA, and what sort of resources do you think it needs? You touched on some of these points in your previous answer. How much needs to be invested in an NCA, or an equivalent unit, to really get to grips with this problem, and to deal with some of the obstacles that these agencies face?

Tom Keatinge: Didn't the former DG suggest that she needed £2 billion to tackle serious and organised crime properly in this country? I have no idea where that number came from, but the point is that it is significantly more than we have right now. There is a proposed amendment to the Economic Crime Bill—NC24—which requires a review of the funding arrangements for enforcement agencies. Certainly, from our perspective at RUSI, we would want to see that brought forward. At the moment, I simply do not think that the magnitude of the shortfall is properly understood.

Dr Justine Walker: Specifically on the oligarch issue, given today's conversation around the Ukraine crisis, it is really important to make the distinction between whether these individuals are being targeted because



HOUSE OF COMMONS

of their connection and closeness to Putin, and their role in potentially influencing and changing the conflict, or because their wealth is derived from illicit origins. In my mind, those are two very different conversations, because the legal framework is very different. If you are trying to prove illicit wealth, and to seize assets on the basis of illicit wealth, you have to have grounds to prove that. However, if this is a sanction to do with proximity to Putin and closeness, it is a different type of conversation.

You asked about some of the differences that we are seeing. The ownership and control aspect has been quite a key one that we are seeing, because the way that ownership and control works across the US, the EU and the UK is quite different. We have oligarchs, for example, who have been sanctioned in the EU, but the EU does not do an aggregate ownership. Let's say that something is owned 25% here and 25% there. It is then not captured, whereas the US does. That is acting as a weakness in the system to very live decisions that are being taken in financial institutions at the moment. Certainly, industry is recognising that that disparity is potentially undermining the intent of the sanctions. To have ownership and control dealt with consistently in this scenario would be really helpful. It is the EU that is particularly problematic, because it does not do aggregate ownership and control.

The other aspect that we have seen over oligarchs and some of the actions that have been taken in the US is that the individuals have been sanctioned but, unusually, not everything that they own and control. It has been a much more defined measure. Normally, what would happen is that if an individual is sanctioned, everything that they own and control is subsequently sanctioned. The challenge for oligarchs is that, because they own so many legitimate businesses where there is not a concern over their legitimacy, the consequences can be quite significant. There may well need to be some really challenging policy decisions taken on whether you just target personal wealth or whether you target corporate wealth. That is in the context of the Ukraine crisis.

But if you are looking at this through an illicit finance lens, there is the challenge of tracking down and proving, following due legal processes, that this meets those requirements. I think it is very dangerous for us to decide at a particular moment in time that we are going to seize somebody's assets if there is not the legal basis to do that. It raises a number of global conversations that people have been grappling with for many years, and we have not seen huge success in the source of funds of dictators where we have tried to claim their finances back. Nigerian dictators would be one example. It is, and has been, a very challenging area to implement globally.

Rushanara Ali: Maybe this crisis will focus some minds. I did have other questions, Chair, but I will stop because my time has run out.

Q52 **Harriett Baldwin:** Justine, what role are cryptocurrencies playing in this crisis?



Dr Justine Walker: I think it is quite early to say the role that they are currently playing and that they will play in the future. Ukraine has been a much more crypto-friendly jurisdiction. It has been a jurisdiction that has been important for mining and for cryptocurrency, whereas the Russian regulatory framework and central bank have taken a very limited line. This was not an area that they really wanted to support and encourage. The presence of crypto in Russia itself is probably not as wide as it is, for example, in Ukraine, so it depends on what jurisdiction you are looking at here. One of my colleagues just issued a paper on this last week, which we have put up on our Ukraine rapid response hub. We are trying to get information out to help people navigate the way through this. The outcome of that was, yes, we are going to see a role for crypto. It may not be able to step into the level that Neil has been talking about in terms of whether you can pay for all your energy through crypto. Will it replace SWIFT? It will not fill that vacuum, but it is going to have an important and growing role.

Q53 **Harriett Baldwin:** Tom, do you see it as being used to evade any sanctions?

Tom Keatinge: To the point that Justine was making, the volume of financial access that the Russian Government will need to evade sanctions is not something that the crypto sector could support. I think it is something to watch. I am not necessarily sure at the moment that it is an area that I would be expending a huge amount of time on but, going back to an earlier point that I made, as things begin to settle down, crypto might start to play a role. Interestingly, if you look at the situation in Myanmar, the Opposition Government there has called for donations via cryptocurrency, and the military regime is saying, "We should be using crypto in order to avoid sanctions." There is a mini precedent there, but clearly what we are talking about here is on a massive scale compared with Myanmar.

Q54 **Harriett Baldwin:** What about the exchanges that are located here in the UK? Are you confident that they have the wherewithal to be able to implement the sanctions that are in place in the UK?

Tom Keatinge: Crypto exchanges are subject to regulation and have been the centre of tremendous scrutiny over the last three or four years, so I am sure that crypto exchanges in the UK will do what they are meant to do. But of course, cryptocurrency is a borderless product. Therefore, exchanges can operate anywhere in the world, and they operate in jurisdictions where perhaps there is not such focus on sanctions.

Q55 **Harriett Baldwin:** In the case where a sanctioned individual does a transaction that is obviously off an exchange, there is no way, is there, that the sanctions could catch that transaction? It is going to become quite appealing, isn't it?

Tom Keatinge: I think it will become appealing. I would not say there is no way that that can be caught, because obviously the exchanges are meant to understand who is using their services. They are acting as an interface between the fiat world and the metaverse. As I said, I think the



HOUSE OF COMMONS

crypto industry has not helped itself with some of the comments that it has made in the last couple of weeks, let's say, but I feel that the big exchanges will absolutely be across this, bearing in mind that some of them are in jurisdictions such as the United States, where you can be certain that they will be doing their best to comply.

Q56 **Harriett Baldwin:** Does SWIFT have a point of view on this, Natasha?

Natasha de Terán: I do not work for SWIFT, so I don't know. On your question about whether the exchanges could allow for the transfer of wealth, as soon as they hit the fiat system—whether it is the UK, US or EU fiat system—the banks would freeze the assets were that person or entity to be sanctioned. But as Tom said, you could either keep your wealth in crypto until things get better, or you could transfer out to a jurisdiction that does not have as much. That is possible, but by the same token, crypto could also be a useful means for Russian dissidents to do what they need or want to do abroad.

Q57 **Harriett Baldwin:** On that point, the Ukrainian Deputy Prime Minister has called for a block on all crypto transactions from Russia. Is that feasible?

Tom Keatinge: Again, it will depend entirely on what the exchanges decide to do. The other thing is that, frankly, an ordinary Russian citizen with a balance in a bank account who knows that their roubles continue to be worth less and less every day would have one option: take their money out of the bank. They probably will not be able to get dollars, so they have nothing to put under their mattress. I would try to buy crypto and put it under my virtual mattress, frankly. I can see a role for crypto in trying to help people in that country, with whom we have no beef, preserve their wealth.

Q58 **Harriett Baldwin:** Are you confident that that cannot then leak out and fund things outside the country?

Tom Keatinge: No. I do not think one can be confident of that. To go back to the point I made earlier, we need to keep an eye on the crypto ball, but I am not convinced that, right now, it is a major determinant of our objective—which is to crush the Russian economy and make Vladimir Putin think again or make him unable to fund his military—or that it will change that calculation.

Q59 **Harriett Baldwin:** Do you have a sense of how much crypto is held in Russia at the moment, Justine?

Dr Justine Walker: I am sorry, I cannot answer that—I have a colleague who probably could. I echo Tom's point: at the moment, that is an evolving area, and we will probably have a much better idea of it in two months' time, when we will really be able to map it out.

Individual citizens will look to crypto as a way to move or store money, as Tom said, because they are going to have to do that. If they are suddenly unable to access the banks or payments, that will be really challenging. There will also still be the need to get money into the jurisdiction. There will be a humanitarian need, a family need, a remittance need for workers



HOUSE OF COMMONS

who are overseas. Some 200,000 of the maritime sector—the crew—are Russian. All those people will need to move money and access services to pay money.

Q60 **Harriett Baldwin:** If your colleague does have an answer, could you follow up with a letter to the Committee?

Dr Justine Walker: We will follow up on that.

Q61 **Kevin Hollinrake:** I want to consider the impact on the Russian economy, which we have already discussed to some extent. I will come to you first, Neil. Capital Economics said that the impact in the next 12 months would be around 15% of GDP. You said 10% before, but it is 15% if we include energy, I think. According to the National Institute of Economic and Social Research, the net effect on the economy is expected to be around 1.5% to 2.5%, so somebody is out by about 10%.

Neil Shearing: To the Russian economy?

Kevin Hollinrake: Yes.

Neil Shearing: Okay, well, there you go. There are various jokes about economists—if you ask several economists, you will get several different answers. I can't speak to the national institute's estimate, when it was made, and under what circumstances and what assumptions.

Q62 **Kevin Hollinrake:** How do you get to the 10% to 15%?

Neil Shearing: There are several ways you can cut this. Let's assume that energy is excluded for the time being and where we are currently. There are several precedents. We can look at what happened in Iran. Back when Iran was sanctioned, that obviously included energy, and the Iranian economy was potentially a bit more vulnerable, from a balance sheet perspective. It had a peak-to-trough fall in GDP of about 15%.

Q63 **Kevin Hollinrake:** Over what period?

Neil Shearing: That was over the two years or 18 months following the imposition of sanctions. That gives you a kind of ballpark. You can look at other crises. We have talked about 1998 in Russia. You can look back at the global financial crisis. When you get extreme financial events, financial shocks, it's usual to get a drop in GDP of more than 5% and up to 10%. That can anchor your view. You can look at what is happening to financial conditions, access to capital and the need to roll over debt and have access to financial markets; and that can give you a sense, too. What doesn't tend to serve you very well is a big black box model, where you chuck in a number for oil prices and a number for what happens to your exports, and it spits something out. That doesn't tend to work in very extreme circumstances, so I think the lessons from history are probably the best way to anchor any view.

Q64 **Kevin Hollinrake:** So you couldn't do a guesstimate of how much impact the central bank measures had in terms of the 10%, let's say?



Neil Shearing: It is very difficult to do that, other than by looking at other economies that have been sanctioned, of which there are very few where the central bank has been sanctioned. Venezuela, which was in the midst of an economic and social breakdown much larger than what is happening in Russia, and Iran and North Korea are obviously different—

Q65 **Kevin Hollinrake:** Okay. Are there any other thoughts among those on the panel about how badly affected—obviously, the rouble has collapsed; it has lost more than 40% of its value. Interest rates have gone up from 9.5% to 20%. Are these short, medium or long-term problems for Russia?

Neil Shearing: I will let others comment, but I think that you're right; you have touched on something that I should have mentioned. I think it's right to split this into two phases. There is an acute phase of this crisis, where you will get a fall in GDP of more than 5%, I'm sure, and probably closer to 10%. There is going to be an acute period of pain over the next 18 months to two years in Russia. But then, I think, there is a second phase of the crisis. I think that, unless something changes, Russia is now set on a path towards long-term economic isolation; and in those circumstances, there is going to be a period of less acute but persistent economic weakness—stagnation, if you like—for a long period. So I think you have two phases of the crisis: first, acute pain, followed by a second period, which is essentially stagnation for many years.

Kevin Hollinrake: Are there any other thoughts? Justine?

Dr Justine Walker: I can't comment; I will leave that to Neil. I can comment on what we are seeing at a very practical level. We are just seeing people—as in, ordinary citizens—desperately trying to move money. We are hearing from colleagues in Russia about the challenges that they are facing now to access money: the interest rates and the impact. So I think the short-term impact that is having is very clear, but I will absolutely defer to Neil in terms of the medium to long-term impact.

Kevin Hollinrake: Are there any other thoughts? Tom? Natasha?

Tom Keatinge *indicated dissent.*

Q66 **Kevin Hollinrake** In terms of what has been done so far, we have seen different—this is not a sanctions race, necessarily, but it's interesting to look at international comparisons. The EU has not gone as far in terms of the sanctioning of some banks, for example. If it went further and did the same as—I think, looking at international comparisons, Canada has gone the furthest. If the EU stepped up and went further, with Sberbank and the like, would that make a big difference in terms of the economic impact?

Neil Shearing: I don't think it would make a substantial difference at this stage, because, as I said earlier, I think it's the central bank sanctions that have almost trumped everything else at this stage. The thing that would make the big difference—going back to the point we discussed before—is wrapping energy into these sanctions. That's the thing now that I think the



HOUSE OF COMMONS

markets are looking at and thinking about: if energy is involved and suddenly wrapped in, the hit becomes substantially bigger.

Natasha de Terán: Sometimes financial sanctions—in particular financial messaging sanctions—are easiest to talk about and they sound very compelling, quick and effective. Sanctioning Sberbank while also keeping energy open to Europe is not necessarily an option, and it wouldn't be a very clever one. Certainly, if you were to remove Sberbank from financial messaging while expecting energy to carry on working, it would be compromised.

Dr Justine Walker: I would agree with that. It has to go hand in hand. It is very clear the reason why Sberbank is not included in the more stringent EU measures; it is because of energy. If energy were to be targeted, it would give you a broader scope for wider targeting of financial institutions. I would also stress the difference in the G7 countries' exposure to Russia. For some jurisdictions, it will be easier to impose border sanctions than for others, because they are less reliant on energy and commodities, and will need those banking channels there to be able to process payments.

Q67 **Kevin Hollinrake:** What about the effects on Russia's ability to service its debt? I think it has announced it is going to pay all its interest in roubles now, which would not be particularly attractive to a lot of people who are expecting to see those payments. Is this going to be a problem for Russia, when it comes to paying what it owes?

Neil Shearing: There are several strands to that. One is that Russia does not have a great deal of external debt now, certainly relative to the size of its economy and compared to its recent past—we talked earlier about the experience of 1998. I do not envisage there being a problem with its capacity to pay. The other point is that, for as long as energy is not targeted, Russia will continue to own a current account surplus and generate foreign currency earnings there, for which it can service debt. If energy is targeted, we should expect there to be a wide-scale default on Russian debt. Its ability to earn a foreign currency to service its debts has just been exhausted. Again, it comes hand in hand with the energy sanctions. I think you would expect there to be a debt default then.

Q68 **Kevin Hollinrake:** We have mentioned the loss of foreign exchange reserves. It has lost 50% of its foreign exchange reserves by the sanctions imposed on it. How key is that, in terms of its ability to operate and service its debts and so on?

Neil Shearing: What has essentially happened is that a lot of the transactions are running through the commercial banking system rather than the central bank. Russia is continuing to export oil and gas. The price of that has gone up, in fact, as a result of the sanctions. The Government have instituted a rule saying that you have to convert 80% of your foreign exchange earnings into roubles. That gives it a mechanism to, essentially, tax the foreign exchange earnings of Russian exporters in the oil and gas sector, so rather than these foreign exchange transactions running



HOUSE OF COMMONS

through the central bank, they are running through the commercial banking system. For as long as Russia continues to earn oil and gas export revenues, I would envisage there being a capacity to pay foreign exchange debts and to be a source of foreign exchange earnings.

- Q69 **Kevin Hollinrake:** On the impact on the euro area, if there were a sanction on oil and gas, which would be nuclear, if I can put it that way—the toughest sanction we could put on Russia—would that bring about a recession in the euro area?

Neil Shearing: Quite possibly. I would not rule out a quarter or two of economic contraction. It is important to state that there is a big difference in the dependence of EU members on Russian gas. Gas is a particular issue, because oil can be bought from anywhere. You can put it on a tank and ship it around the world. Gas tends to be transported through pipes, so it is more difficult to move it between countries. There is a big difference in individual countries' exposure. France and Spain are not particularly exposed to or dependent on Russian gas, but Germany is. Some EU members on the eastern border of the EU, such as Slovakia and Hungary, are extremely dependent on Russian gas and would be much more exposed if the taps were to be turned off. Every country will pay a price if global energy prices go up. Russia is a net energy exporter. That is just the way that it works.

- Q70 **Emma Hardy:** Afternoon, everyone. My questions are all related to the impact this will have on the UK economy. I apologise, Neil—most of them are directed at you, but everyone else should feel free to come in as well. I know you've already touched on this a bit, Neil. I've written down some of the comments you made: you said there will be a cost for the rest of the world. Tom, you said we're not able to put sanctions on Russia without self-harm. To start off, Neil, what impact is the conflict having on the UK economy in general?

Neil Shearing: I will start by saying that we have never sanctioned an economy as large as Russia in the way that we have sanctioned Russia, so we should prepare ourselves for the fact that there will be some unanticipated consequences of these measures. That being said, it runs through three channels: there are the impacts on trade, financial linkages, and commodity prices and inflation.

Our trade linkages with Russia, in a direct sense, are not particularly large—our exports of goods and services to Russia make up about 0.2% of GDP. I think you can expect those to pretty much dry up all together, at least for the foreseeable future—for the next quarter or two. That is an economic hit. Those costs might be concentrated in one or two sectors, or on one or two firms, so there might be some pain there.

I should also say that there might be some indirect effects through supply chains. We have spoken about Russian energy; Russia also supplies 40% of the world's palladium, which is used in catalytic converters in cars—we all know what's happening to auto supply chains at the moment, as a result of the pandemic. It also produces important gases that are used in



HOUSE OF COMMONS

the production of semiconductors. Although Russia is not a major manufacturer, it produces raw materials that go into manufacturing supply chains, so we might see further problems arising on that front.

On the financial front, an awful lot has been made about Russian oligarchs owning prime central London property and the impact on the UK housing market if we freeze those assets and there's no Russian purchases—I think a lot of that is overblown. I don't foresee there being substantial economic risks from that.

Typically, at a macroeconomic level, when you get big problems from financial linkages, they run through the banking system. Our banks are not particularly exposed to Russia as a whole—we don't have large banking exposures. However, some European economies have significant, if not large, exposures to Russia, such as Austria and Italy. If some of those banks were to run into trouble, it could possibly be an area of risk. I'm not suggesting this is a base case, but it could then ripple through the eurozone financial system and affect us.

That is one area I would look at. However, far and away the most significant hit to the UK economy at the moment will come through the effect on energy prices and the cost of our imports. That is not because we import a lot from Russia, but because global prices have gone up. As a result of everything that has happened so far, since the start of the conflict, I would estimate that it has added about 1% to inflation versus our pre-conflict baseline. All other things being equal, that will mean another 1% hit to real incomes. Then, the pass-through to the size of the economy depends on what the Government do to take steps to mitigate that effect. If they don't do anything, it could shave about 0.25% to 0.5% off GDP, compared with where we were before. That is not to say that the economy is going to shrink; it just won't grow by as much as we had anticipated.

Clearly, if it escalates to the extent that we include energy within sanctions, those effects will get much bigger. As a broad rule of thumb, I would perhaps double the size of the hit to the economy and the increase in inflation.

Q71 Emma Hardy: Wow, thank you. How do you think the Bank of England Monetary Policy Committee should respond to this?

Neil Shearing: The first point to make is that it has got a challenging enough job as it is, at the moment, in the current circumstances. This makes it much more challenging for a number of reasons, but the most important one is that there is almost nothing that a central bank can do about global energy prices.

There is nothing that they can do about that—central banks set monetary policy, and that will not affect what is happening in the global oil market. Even if it did, there are lags between changes in interest rates and any effect in the real economy.



HOUSE OF COMMONS

There is nothing that central banks can do in a direct sense, so what they need to do—what they will be doing—is think about the extent to which this crisis and the subsequent impact on inflation is affecting broader wage and price-setting behaviour and inflation expectations. Counterbalance that with the fact that, because you have an additional squeeze on real incomes, further ahead demand might be weaker than would otherwise be the case. There is quite a lot to think through there.

My sense at the moment is that the Bank of England should press ahead with steady interest rates hikes and continue to wind down QE and shrink the balance sheet, but do so at a steady and gradual rate. It makes sense to remove some of the pandemic-era stimulus and support that was put in place. Clearly, however, if there was to be an even greater squeeze on real incomes and more demand destruction, then they should go more slowly.

- Q72 **Emma Hardy:** You mentioned stagflation. Given your comments about the actions that the Bank of England Monetary Policy Committee might take, is stagflation more likely or less likely?

Neil Shearing: I think it probably does not make a great deal of difference, frankly. I am suggesting that the Bank of England proceeds with relatively steady interest rate hikes, so that does not make a great deal of difference.

What might possibly make some difference would be what the fiscal response is. There is potential for fiscal policy to offset some of this pay and real-income squeeze. Someone somewhere in the economy will have to wear the cost of this—it could be the Government, consumers or companies—but if it is a one-off hit through higher energy prices, which we think is likely to be short-lived because in time energy markets will adjust and prices will come back down again, there is a case for fiscal policy absorbing some of the cost. That would prevent some of the pass-through to inflation and some of the hit to real incomes, and it would take some of the pressure off the Monetary Policy Committee.

- Q73 **Emma Hardy:** I am pleased you said that, because I was going to ask you what those fiscal policies will or could look like. What would your recommendations be for what the Government could do?

Neil Shearing: It depends on the extent to which the Government would wish to offset the cost to households, fully or partially. If it is a full offset for everything that has happened so far, it might cost between 0.5% and 1% of GDP so, say, 0.75% of GDP or something like that—a significant amount, but not a huge amount in the context of the public finances or the room against the fiscal rules at the moment. Again, you could perhaps double that if we were to wrap energy into the sanctions, and energy prices were to go up, and there would be a more substantial effect on inflation. That is a full offset of the hit to real incomes and to households.

Then there comes the question of how you design that. I do not think that you can do things like cut VAT on energy, for example—it will not be big enough—so it would have to be direct transfers of one form or another to



HOUSE OF COMMONS

households. You might then want to think about how that is structured—whether it is means tested or universal—because clearly the ability to pay those higher prices depends on where people sit on the income distribution.

It is possible that if energy companies are making large profits as a result, there might be a role for windfall taxes, but do not forget that wholesale gas prices have shot up, so the costs to energy companies are going up as well, so it is not necessarily the case that we will see large profits in energy companies as a result of the higher prices.

Q74 Emma Hardy: Those are some good, concrete examples. Does anyone else on the panel want to come in with some suggestions for what the Government can do to help people with the cost of living?

Dr Justine Walker: No, but I will make one comment. We are discussing the energy sector, but if we look at sanctions policy, a number of key energy-exporting countries are now under sanctions, so that could play out, in terms of Iran, Syria and Venezuela. I just make the observation that, looking at this in the long term, we cannot look at it in isolation. It really depends on what also happens with those jurisdictions.

The other point that I would make, again looking at this in the long term economically, is that in the awful situation of Ukraine falling to Russia, and Russia then basically having control over all of Ukraine, we would be getting into another conversation around how critical Ukraine is as a global exporter—not just of energy, but across the board for commodities and other important aspects. We are moving into a very different global territory, which will impact UK fiscal policy.

Q75 Emma Hardy: Neil, you mentioned that, if the Government tried to fully offset these costs, it would be 0.75% of GDP. Earlier on, you mentioned that if the Government did not act it would be 0.5% of GDP. Do I have that right?

Neil Shearing: Yes. Obviously, these estimates are exactly that: estimates. They are hugely uncertain, and they are subject to the various different assumptions that you make on exactly what is going to happen to energy prices, but that is essentially the case. Some of the fiscal offset will leak into imports, so it will not necessarily boost GDP. If you transfer money into households, they will spend some of that on UK products and some of that will leak into imports, which is why typically the cost of the fiscal offset will not be matched one-for-one in GDP.

Q76 Emma Hardy: Basically, there is going to be a cost either way, and there is going to be a cost to GDP either way. It is whether that cost means greater income for people. Is that right?

Neil Shearing: That is essentially right, yes.

Q77 Emma Hardy: That is really interesting. What is your view of consumer confidence in the UK at the moment?



Neil Shearing: At the moment, we have not seen much evidence that this is having a big effect. We do not have much data yet that postdates the war. We are going into this crisis, obviously—this war—on the back of the cost of living crisis and inflation having already increased.

I suspect that the first quarter of this year might look pretty good because the back end of last year was quite soft, so we are going to get a bit of a rebound anyway. That is mainly to do with the effects of omicron more than anything else, but there are going to be two pinch points. One comes in April, when the energy price cap is going to go up. Another potential one is coming in October, when there will be another decision on the energy price cap coming into effect. I think that there are potentially two pinch points—one in the spring and one in the autumn—when things will start to feel quite tight.

Q78 **Kevin Hollinrake:** You said that windfall taxes might not be appropriate because wholesale prices have gone up, but as I understand it a windfall tax would not be on British Gas or its suppliers; it would be on people like BP who are selling into the wholesale markets.

Neil Shearing: Yes, exactly. It depends on whether you are taxing the supplier or the producer. The other point is that we have spoken a lot about gas and oil prices but there are other forms of primary energy as well: solar and wind are another cost base here.

My point was more of a general one: just because prices are high, that does not necessarily mean that profits are going to be high.

Kevin Hollinrake: No, but profits have risen exponentially for the likes of BP and Shell because their operating costs have not changed but their income has increased massively.

Chair: It is almost like we should have a windfall tax coming on.

Q79 **Alison Thewliss:** I have some questions, topically, around the Economic Crime (Transparency and Enforcement) Bill, which we will be starting in about half an hour's time. Perhaps I could ask Tom Keatinge this first. You said earlier that the UK is 10 years too late, and that the sanctions proposals will not tackle the dirty money problem that we have in the UK. I wonder whether you could tell us a bit more about the consequences of not requiring overseas entities to be transparent when they were purchasing properties in the UK, and how that has contributed to the situation that we have today.

Tom Keatinge: The reality is that, as we all know, you can buy property in the UK through a company with nobody knowing who is behind that company. Of course, that has been a boon for those who want to bring their money to a jurisdiction with the rule of law and a stable asset price, and to invest it without anyone knowing who is behind them. So it is an extremely important development.

The question is whether the system is able to deal with that kind of new requirement. The Economic Crime Bill, as it stands, does not deal with the



HOUSE OF COMMONS

issue of Companies House reform, which we all accept needs to be addressed. We have spent too long admiring the garbage that is in Companies House and not enough time getting on and dealing with it.

I find it extraordinary that there is one gentleman, Graham Barrow, who I am sure you all know, who is able to point out the peculiarities in Companies House on a daily basis, yet Companies House itself is not able to do that. While transparency around who is purchasing property in the UK is absolutely critical, we need to ensure we have the system in place to respond to that transparency, once it is provided, whenever that might be.

Q80 Alison Thewliss: Are the proposals in the Economic Crime Bill today enough to do that?

Tom Keatinge: I gave evidence to the Bill Committee I don't know when—2018 or something. Had that proceeded as expected, we would now be at the point where that register would be operational, and we would not be having this conversation. Depending on who wins the arguments, we are going to have to wait six months, 18 months or whatever it is in order to find out whether this actually works.

It is an important building block, but there are other things that need to be done, of which we are all aware. The verification issues at Companies House are a major issue, but by themselves they are not enough. We need the full package, and we need to ensure that we are collectively relentless in ensuring that the full package comes forward.

One of the things we lack is any one person who stands or falls on the progress made on illicit finance in the UK. I, and others, would like to see some kind of commissioner who is responsible for holding the Government to account, in the same way as we have on modern slavery and on terrorism legislation. At the moment, successive Governments have not been able to follow through on this and we need somebody who is appointed by the Government to hold them to account. I thought I would take the opportunity to say that.

Q81 Alison Thewliss: That is a good suggestion to give somebody responsibility for that; I would agree. You have talked about the Government amendments to reduce the transition window from 18 months to six months; the official Opposition suggests four weeks. How much does this reduce the risk of kleptocrats moving their funds outside the UK?

Tom Keatinge: I am all in favour of things happening sooner rather than later, but the question that many people have is: do we have the resources to react? Do we have the resources to react to asset flight occurring? Do we have the resources to identify asset flight occurring?

While sooner rather than later is a good mantra, we shouldn't lose sight of the fact that what we are talking about at the moment is primarily changes to legislation around structure and architecture. If we don't resource the authorities that we are looking to in order to police all this effectively, then we can have as many laws and regulations as we like, but



HOUSE OF COMMONS

we won't achieve the success that we would all want to achieve, which is to identify, freeze and confiscate dirty money that is in the UK, and ensure that dirty money that might be thinking of coming the UK no longer sees it as a light touch.

- Q82 **Alison Thewliss:** Absolutely. There are penalties suggested within the Bill for failing to register an overseas owned UK company. The Government amendments over the weekend have increased these to £2,500 a day. Is that enough?

Tom Keatinge: There may be people for whom that is the cost of doing business. We need to look at which sort of individuals are we trying to identify and deter, and what is going to identify and deter them. Frankly, it is as simple as seizing assets and, if they happen to try to come and use that asset in the UK, then a custodial sentence. I don't think we can underestimate how important this is. Therefore, we should not hold back on the penalties that we propose.

Alison Thewliss: I am happy to bring in other panellists who want to come in on any of these issues.

Dr Justine Walker indicated dissent.

- Q83 **Alison Thewliss:** I think only nine unexplained wealth orders have actually been used since they were introduced. Do the proposals within the Bill make these more effective, and will they actually work?

Tom Keatinge: There is definitely a welcome improvement. I think the unexplained wealth orders have not really survived contact with reality. The impact assessment suggested that there would be 20 issued a year, and obviously that is not what has come to pass. The unexplained wealth order has not advanced in the way that people hoped for.

I hope that all the lessons that the NCA have learnt from their experiences over the last two or three years are factored into the Bill, and that some of the failures that we have seen previously will be avoided in the future. Expanding to include directors and those sorts of things—I think that is really important, because it clearly reflects one of the problems that we have found with using unexplained wealth orders in the past. I would say that unexplained wealth orders were never going to be, and are never going to be, the panacea that we would like them to be. None the less, we have the tool. Let's make sure it works properly.

Dr Justine Walker: In the context of today's conversation, unexplained wealth orders will probably not be the tool in the case of Russian oligarchs. I think it is pretty clear where their wealth is from. It is about making a determination on whether the original wealth was legitimate original wealth. I just wanted to make that observation.

Tom Keatinge: But that is an important point. It comes back to the point that I was making earlier: we should not conflate dealing with the crisis in Russia and Ukraine with solving the UK's illicit finance problems. Those are two separate issues.



HOUSE OF COMMONS

Q84 Alison Thewliss: Are there more things that you would have liked to see within the current Bill, and what else would you like to see within the Economic Crime Bill too, whenever it comes?

Tom Keatinge: I have sent to the Committee a list that civil society has put together, so I will not go through that in detail. I have mentioned Companies House, and I think one of the other areas that is certainly important from our perspective at RUSI is just thinking about the current supervisory regime in the UK. We all know that that is very fragmented. We all know that it is divided between statutory bodies and professional service bodies. We need to have a long, hard look at that. As an author and journalist who everybody is very familiar with likes to point out, is it really right that the Archbishop of Canterbury's office is supervising notaries? It is anachronistic, to say the least.

Q85 Alison Thewliss: It certainly is. You talked about OFSI earlier. Are they going to have the sufficient teeth and resource to enforce sanctions? Enforcement seems to be the big gap in a lot of legislation at the moment.

Tom Keatinge: OFSI is obviously a relatively new body, and this is clearly a massive challenge for OFSI, so we need to make sure that it has sufficient resources. I think there is an important issue here, which we have touched on during the conversation: the private sector is required to implement, and OFSI clearly needs to have the capacity to ensure that the private sector knows what it is meant to be doing. Then, of course, there is the question of enforcement and punishment thereafter. The Economic Crime Bill tries to help with that.

Q86 Chair: On that point, there are 37.8 full-time equivalents in OFSI. Is that enough?

Tom Keatinge: If we had had this conversation two weeks ago, I would have said that is absolutely fine, but they are facing a mountain now. There is an important point on this. I have not seen any statements on OFSI, but I have heard the Foreign Secretary say there has been a tripling of capacity in the sanctions unit in FCDO. The question I have is: does that tripling of capacity have the expertise to deal with the challenge that is ahead? I think we need to make sure that whatever OFSI does to expand—

Q87 Siobhain McDonagh: Does tripling mean there are now three?

Tom Keatinge: Whatever OFSI does to expand in order to meet the current challenge, we need to make sure that that expansion is not just people, but people with the necessary expertise.

Q88 Chair: So there is a quantity and a quality issue.

Dr Justine Walker: Can I come in? There is one challenge the Government face that was sitting in the Treasury. Treasury officials inherently move around quite quickly after a couple of years, and that was very much the reason for establishing OFSI. It was to have a more permanent unit where you could give a civil service career, and that is



working to an extent. We are seeing people staying in post longer, and that is helping significantly. With the move to an independent sanctions regime we have seen the UK take more responsibility for their sanctions decisions.

In terms of numbers, I completely echo Tom's point. Nobody was prepared for this scale of response, and I think we still don't have any real insight on what the scale of response is going to be.

On the quality aspect, it is not a quality aspect around the individuals there, but more about where the gaps are, particularly on the legal side and bringing in real levels of expertise that the team have not needed before. There might well be a gap in expertise, but I would say that is to do with the current crisis.

Chair: Last but not least, over to Siobhain.

Q89 Siobhain McDonagh: My questions are about the adequacy of the Treasury's public bodies that supervise sanctions and compliance and bring enforcement action for sanctions breaches. I know that there has been some crossover in this, but can I start with you, Tom? In a recent article, you described the Government's response against illicit finance as "anaemic". You said the way forward "requires leadership, prioritisation and resources, all absent from the UK government's response when it comes to genuinely confronting the UK's illicit finance vulnerability". Could you expand on your comments?

Tom Keatinge: I will start by saying I am really glad you didn't mention the peashooter, because that has followed me. What I meant—in some ways that summarises most of what I have said this afternoon—was that there is no shortage of desire within the civil service to fix the problem. There are lots of ideas and lots of hard-working people. What is clearly happening is that that energy, when it goes up the chain, is not being met by the kind of ministerial pick-up that would then say, "This is something we need to move forward on."

Just as an example—I can't remember whether it was stated in that article—when Ben Wallace was the Security Minister, he was the Security and Economic Crime Minister. We now have a Security and Borders Minister. I am not saying that makes a huge difference, but it gives you a sense of emphasis. As I also said earlier when I mentioned the point about having a commissioner on illicit finance, there is no one person who lives or dies on how the UK performs in addressing illicit finance. It is fragmented across Government. Whenever a question is asked in the House about illicit finance, you never quite know who is going to turn up. It will be BEIS, HMT, FCDO. It could be any number of different people. That is what I mean by the lack of leadership.

Resourcing we have talked about—I think everybody accepts that—and then there is prioritisation. How much do we care about this? If we care about it to the extent that perhaps the integrated review suggests we care about it and it is a national security issue, then let's treat it as a national



security issue and prioritise it accordingly. I don't think it would take a lot to fix the system, but it takes somebody to want to fix the system.

- Q90 Siobhain McDonagh:** Susan Hawley, executive director of the campaign group, Spotlight on Corruption, has accused the Government of being "toothless" when it comes to sanctions enforcement, highlighting that the Office of Financial Sanctions Implementation has only ever issued six fines worth a combined £21 million. Do you share her concerns?

Dr Justine Walker: One of the things to emphasise is that the powers of enforcement at the moment come within the existing framework, so there is a bit of a challenge in respect of applying fines retrospectively. Nobody can argue that enforcement action absolutely shapes compliance priorities. It is very clear that there has been a long-standing conversation and question around UK enforcement action. In comparison with the US, we see a lot less enforcement action. We are obviously a smaller country. I would also say that if you are comparing numbers, as people are looking at numbers here, the Treasury—the OFAC side—has hundreds upon hundreds of staff, and it is only covering the OFAC element, not the wider Treasury aspect. We do not have the comparable resources, so it does really depend on who you are comparing us against.

If you compare us against somewhere like the US, we do not meet that. If you compare us against many of our European partners, we look quite good, so it depends on what you are looking at. Yes, I would accept that there is maybe a reason to look at the enforcement numbers. Enforcement does focus compliance thinking.

The other aspect is that the types of sanctions frameworks we are now seeing are so complex. It is becoming difficult to actually manage permissible versus prohibited payments that that actual distinction is not as clear, particularly when you look at complex regimes. What you will see is someone like OFSI and, indeed, OFAC and others having a lot of no-action letters. There will be a lot of types of private communication that do not end up in enforcement action. When you are looking at just enforcement action, you also need to look at the number of cases that OFSI has opened and the number of no enforcement-type actions that it has issued. Looking at enforcement action alone probably only gives you one element of the true picture.

- Q91 Siobhain McDonagh:** You anticipated my next question, so maybe Tom can come in. How does enforcement for breaches of sanctions in the UK compare with the US, for example, and what are the barriers preventing UK law enforcement from being more robust in this area?

Tom Keatinge: I will take the second point because it is really just a copy and paste of what I said earlier. It is capacity and resource. It was a while ago now, but we held a workshop at RUSI on Russia sanctions when there was the annexation of Crimea, and I remember someone from the NCA saying very honestly, "Of course, one of the problems we have is there is nobody involved in sanctions enforcement who speaks Russian". It is basic things like that.



HOUSE OF COMMONS

One thing I would say, and to echo what Justine said, is focusing on bar charts of who has done what and all the rest of it might be informative, but right now what we want to help OFSI do is to ensure that sanctions are being effectively implemented. It is not about trying to identify, "You're busted"; it is more, "We want to help you enforce these sanctions as effectively as possible." That is where we should be focusing our questions to OFSI.

- Q92 **Siobhain McDonagh:** I think you both might be reading my questions over my shoulder. Maybe to you, Justine, what is the overall level of compliance with sanctions in the UK? Are smaller firms without large in-house compliance teams as aware of their sanctions obligations and how to meet them? How does compliance vary between sectors?

Dr Justine Walker: I live and breathe sanctions. This is what I do every single day, and I find it really difficult to comply with sanctions knowing what the law says. I think it is really important for that just to be there on the table. How an organisation that does not have that same capacity actually manages sanctions compliance, and I am sure that they are complying, is very difficult. There is one element about wilful circumvention of sanctions and that is one conversation, but there is another element about awareness of sanctions and actually being compliant with them.

In the latter case, we will see, for example, the global financial institutions being very aware of sanctions, but their complexity and global reach is phenomenally difficult, particularly with competing legislation. It is a sanctions arena, particularly when you have blocking regulations, where what is prohibited in one country is permissible in another. The sanctions tool is very political at the moment. If you are an entity in the UK, but you have operations in Russia, in China and a footprint in the middle east, you are going to have to look at what is your global group compliance, and that can be very difficult to navigate.

If you are a small firm in the UK and you are exporting to someone in the UAE, you may or may not be looking at whether that is going on to Syria, and whether you have a US footprint. There are so many elements; I cannot emphasise enough how complex compliance with sanctions is, even for those of us doing it full time. My answer is, I do not think our compliance is probably very good, because the level we ask people to comply to is so complex. However, what I would say is that the investment that is going into sanctions training and compliance—there is a whole professional group of people. Certainly, for major institutions—not just banks, but global corporates—there is an awful lot of time put there. At the board level, in many ways, sanctions compliance is seen as a more critical issue than some of the other wider financial crime elements, because if you get it wrong from the US side in particular, it is very significant. You see a real variation. I am sorry, that is a long answer, because it is not straightforward to give you the exact picture.

- Q93 **Siobhain McDonagh:** It is a good answer. Could I ask you, Tom, a last question? The FCA is responsible for ensuring that financial services firms



HOUSE OF COMMONS

have the right systems and controls to identify and prevent sanction breaches. How robust is the FCA's approach to this issue? Could it do more?

Tom Keatinge: I guess I would copy and paste what Justine said. I do not think the people who put the names on the list have any idea of the requirements that then triggers, particularly in big global financial institutions. It is incredibly complex. I absolutely would expect that the FCA could do more to understand what goes on within a financial institution when sanctions are listed. I come back to my previous point that, right now, we have to do everything we possibly can to help those we are delegating responsibility to, i.e. the private sector, to understand the sanctions and to execute the sanctions. We can have a wash-up later about whether they are being implemented properly or not, but right now, what they need is help. That requires clear communication when the sanctions are issued, details that allow them to understand precisely who or what is being sanctioned, and for them to be able to process that. At the moment, we do not have that to the level we need to have it.

Chair: Thank you very much. It has been an extremely informative session. I thank all our expert witnesses for the time they have taken to come and give evidence. Obviously, we are in unprecedented times, and you have said that we are also in uncharted territory. You have tried to give us at least a road map to some kind of coherence. We will continue to look at this issue, as I am sure the Government will. I hope they will get someone who can speak Russian involved in it and perhaps beef up some of the enforcement mechanisms that we have been talking about. I thank you very much for coming. We are all going to dash down and deal with the economic crime Bill. That concludes the Treasury Committee's evidence session.