

WEDNESDAY 13 MAY 2009

Present

Faulkner of Worcester, L
Garden of Frognal, B
Harrison, L
Henig, B
Hodgson of Astley Abbots, L
Jopling, L (Chairman)
Marlesford, L
Mawson, L
Richard, L

Witnesses: **Mr Sean McGovern**, General Counsel, **Ms Louise Shield**, Head of Communications, and **Mr Andy Wragg**, Senior Manager, International Regulatory Affairs Team, Lloyd's, examined.

Q506 Chairman: Good morning and welcome. Perhaps, Mr McGovern, you would like to introduce yourself and your two colleagues.

Mr McGovern: Thank you. I am Sean McGovern, I am General Counsel at Lloyd's. This is Louise Shield, who is Head of Communications at Lloyd's, and Andy Wragg, who is Senior Manager at Lloyd's who deals with money laundering and financial crimes issues for us. I would like, if I may, to begin with a brief opening statement to set the context for the comments I wish to make but also for answering the questions the Committee may have for me.

Q507 Chairman: That would be most helpful.

Mr McGovern: Lloyd's is the world's leading specialist insurance market-place covering some of the largest, most individual and complex risks around the world, and we can trace our history back some 300 years to Edward Lloyd's coffee house. It is important to understand, however, what the structure of the Lloyd's market is. Lloyd's is not an insurance company

but an insurance market where 86 syndicates compete to provide insurance and reinsurance solutions to clients from all over the world. Together the syndicates underwriting at Lloyd constitute one of the largest insurance and reinsurance markets in the world. Each syndicate is made up of one or more members of Lloyd's. Historically, members of Lloyd's were individuals, but today there are less than 800 individual members of Lloyd's who are actively participating, providing less than five per cent of Lloyd's capacity. The remainder of Lloyd's capacity is provided by members who are backed by private and public shareholders, investment funds and specialist insurance investors. Each syndicate is managed by a managing agent. It is the responsibility of the managing agent to employ underwriting staff and manage the syndicate on the members' behalf. All managing agents are regulated by the Financial Services Authority. The Corporation of Lloyd's oversee the activities of the market, admitting new members and new managing agents, approving business plans and ensuring solvency. The corporation does not carry on insurance business itself but supervises the market's activities. We, the Corporation of Lloyd's, are also regulated by the FSA. I am the General Counsel of the Corporation of Lloyd's and I am responsible for its legal and regulatory affairs. With that as background to the structure of the market, I would like briefly to comment on the areas I believe the Committee would like me to address this morning and then, of course, I will be very happy to take any questions that you may have. First, money laundering. The general insurance sector is regarded as being subject to a low risk of money laundering. To reflect this, general insurance activities fall outside of the money laundering regulations. We are, however, covered by the Proceeds of Crime Act 2002. My views and comments today will be limited to the general insurance sector as, other than a relatively small amount of term life assurance, the Lloyd's market does not write much life business. Notwithstanding the relatively low risk of money laundering, Lloyd's takes the management of the risk very seriously. Each managing agent has its own money laundering reporting

officer, and the Corporation issues guidance to the market regularly on legal issues and best practice. With regard to suspicious transactions, as a practical matter it is the managing agents in the market who would usually be the first to identify suspicious transactions. However, once identified, the most common method for reporting that suspicion is for them to pass the report to Lloyd's, who will then pass it on to the Serious Organised Crime Agency. Receiving this data centrally allows us to monitor the risk more broadly within the market and to spot emerging trends. The Corporation will also handle any consent requests on behalf of the market, although, for reasons I can explain, those are a relatively rare occurrence. Second, the payment of ransoms. I understand you would like me to address the question of the role of insurers when ships are seized and ransoms are demanded. It is obviously topical with the escalation of incidents in the Gulf of Aden. There are two points I would like to make at the outset. First, at the risk of stating the obvious, the issue needs to be approached with some care. It is a very complicated situation that has its roots onshore. Piracy is a symptom of a much broader problem in Somalia, and, ultimately, there are lives at stake. Whilst the payment of ransoms is unpalatable, to date the human cost has been relatively small. Second, in light of some of the evidence that I have read that has been given to the Committee, I would like to clarify the role of insurers in the payment of any ransom in these circumstances. As a general principle, whether insurance is provided through hull coverage, hull war-risk cover, cargo cover or, in relatively rare cases, stand-alone kidnap and ransom cover, insurers do not get involved in negotiating with pirates and do not get involved in making payment. Insurers stand behind the insured and provide, after the event, indemnification for the insured's loss. That concludes, My Lord Chairman, my introductory comments and I am very happy to take questions.

Q508 Chairman: Thank you. That is most helpful. Before I ask the first question, perhaps I could say, for the record, that many years ago I was a name at Lloyd's but have not been for

a long time. The annual SAR (suspicious activity report) for 2008 states that in the year 2007-08 the insurance industry made 1,434 suspicious activity reports. I wonder if you could give us examples of the sorts of matters on which the insurance industry makes reports. In what circumstances does the industry have to seek consent for transactions?

Mr McGovern: It is likely that the majority of the SARs filed by the insurance industry relate to whole life assurance, and, as I said, that is not necessarily an area that the Lloyd's market write. The risk of money laundering around the sale of general insurance is, as I said in my opening remarks, considered a low-risk. That is principally because, once a criminal has successfully disguised the proceeds of crime, they will want to reintroduce those funds back into the legitimate economy, and in general insurance, which does not have the investment aspects that you often find with life insurance products, that is quite a difficult thing to do. The way in which you could introduce those funds back into the real economy, the legitimate economy in general insurance, tends to be either through making a claim or through requesting a return of premium. That added dimension, particularly given the additional scrutiny that the insurance industry would place around the validity of a claim, generally, in our assessment, means that a criminal's flexibility to use general insurance as a means to launder money is quite restricted and they often look for easier routes to bring money back into the economy. Having said all of that, in 2008 Lloyd's filed 70 suspicious activity reports. The majority of those reports were where managing agents had suspicions around the reasons as to why an individual or a company was seeking insurance cover, and in all cases the cover was declined. A large proportion of those related to international fine art, jewellery, gemstones, cash in transit and those kinds of things, and underwriters are generally suspicious about the criminal either seeking to use the existence of a Lloyd's policy to gain legitimacy with third parties or to inflate asset values within the company by claiming they had assets that they do not have. To give you an example: we often find that we will have approaches

from individuals to insure a gemstone, and trying to get clarity over the existence or otherwise of this gemstone is often difficult. That is a fairly regular attempt that is made by criminal entities. The other aspect that we see is trying to buy a Lloyd's policy to cover an asset and either inflate its value or the asset does not belong to the company or individual who is seeking the insurance, and then they will try to use the existence of a Lloyd's policy to go to a financial institution to raise finance off the back of a fictitious or inflated asset. In our experience, seeking consent is relatively rare in general insurance, but we have sought consent from SOCA on a couple of occasions in relation to paying a claim or paying a return premium. To give you an example of one of those: we had a claim for a stolen car, a very expensive car, a Ferrari, and the investigations around that claim led to concerns as to how that individual had come to be able to afford such an expensive car, and also it was clear that the individual had made various misstatements at the point at which the policy was purchased. The insurers wanted to avoid the policy because of those non-disclosures and misrepresentations at the point at which the policy was taken out. In the case of avoidance you would pay the premium back to the policyholder, and so we sought SOCA's consent to return the premium to the individual concerned. Those are examples of where we have seen it. It is pretty rare. I hope that is helpful.

Q509 Lord Hodgson of Astley Abbotts: When you say Lloyd's get the SARs from the managing agents, does that mean managing agents are relieved of a duty to make a report to SOCA?

Mr McGovern: This is something we have talked to SOCA about. They can, if they wish, make a report directly to SOCA. If they choose to make a report through Lloyd's, theoretically there is an issue. If Lloyd's did not pass that referral on to SOCA, then it does not necessarily satisfy their obligation to make a suspicious activity report. As a practical matter, SOCA quite like the consolidated role they play because it helps to funnel suspicious

activity retorts through to them. But we do not do any filtering, we pass them straight on to SOCA, so the risk to managing agents concerned is very low.

Q510 Lord Hodgson of Astley Abbotts: What is the position where the underwriting is technically done offshore? It might be done in the Channel Islands. Where they have a money laundering agency. Do you liaise with that? Or it might be done, perhaps, in areas which have less heavily policed arrangements.

Mr McGovern: All of Lloyd's underwriting is either done in London or where it is done offshore it is done on an agency basis. A responsibility that we expect managing agents in London to discharge is that all of their activities, wherever it happens, complies with any relevant legislation, whether that is in the UK or any local legislation, and we take steps to give them guidance on that.

Q511 Lord Hodgson of Astley Abbotts: Do you have any evidence of insurance brokers and clients using the system in any way to avoid/evade/minimise their tax?

Mr McGovern: I cannot speak on the part of insurance brokers. Obviously the relationship that should exist between a client and their insurance broker means that brokers should be in a far better system than the insurers to come to a determination about the whys and the wherefores of a request for insurance and any suspicions that may be aroused in that context. However, we have very little experience of notifying to SOCA in relation to potential tax evasion, but we would expect that both the insurance brokers and the managing agents, if they had a suspicion that the purpose of the insurance policy was to evade tax, would file a suspicious activity report, but we do not have much direct experience of that.

Q512 Baroness Garden of Frognal: We have heard from the Law Society, the British Bankers' Association and the Institute of Chartered Accountants in England and Wales that

they would like more feedback from SOCA to persuade them of the value of the effort they put into making the SARs, which take quite a lot of work and effort together. What is the position of Lloyd's? How do you rate the feedback that you get from SOCA?

Mr McGovern: I think it is fair to say that we would share those comments. We do not get feedback from SOCA. We are not sure why that is. It may be that because the international dimension of a lot of Lloyd's business means that SOCA is passing that information on to other financial investigation units, but we have no transparency around what they do with the information once they receive it. Feedback would be quite helpful because it would justify the effort that has gone into it, but also may help in preventing further cases in future.

Q513 Baroness Garden of Frognal: Does that cause you any difficulty with the managing agents in circumstances where you are being the transit, as it were?

Mr McGovern: No. As I said, because the managing agents are expected to do this as a matter of best practice, they all have money laundering reporting officers. It is something to which we attach a great deal of significance from a reputational perspective, albeit we would agree that general insurance is a low-risk environment for money laundering. We have not had any feedback from our managing agents that would suggest that they are in any way irritated by the lack of feedback from SOCA, but I think it would be helpful to know whether the information we are providing and the effort we are putting in to file those suspicious activity reports is useful in the fight against financial crime.

Q514 Lord Marlesford: I think I should also declare that I was a victim of Lloyd's, until rescued by Equitas in 1993, since when I have taken no part. I understand, thanks to Mr Buffet, I have no further liabilities. I would like to ask about the consent regime, and whether or not you feel that the Home Office's refusal to change the consent regime was acceptable to you or whether you share the disappointment of the British bankers and others

at the failure to do so. In particular, one has had the impression that you have been given a sort of nod and a wink that you do not have to comply. Would you prefer to have the consent regime that other people do? Would you prefer that the regime was changed so that it was clear what your position was?

Mr McGovern: As I have said, we do not find ourselves in a situation where we have to apply for consent that often. That is because, rather than us having a nod and a wink around compliances, the nature of the environment means that we are at low risk for this kind of activity. The concerns that have been expressed by the Institute and by the BBA, I suspect are particularly linked to the automation and expectation around speed of payments within the banking sector. Without being pejorative about my own industry, insurance does not have the automation that banks do around payments, and so, in particular, where we have sought consent, it is part of the claims process, and generally the claims process requires a period of adjustment, analysis and settlement. In our experience there is plenty of opportunity to build in time to request consent if that is necessary as part of that claims process, so the fact that the consent regime has not been changed is not a particular problem from our perspective. I can understand that when you get into the banking sector, trying to stop automated payments or, at least, an expectation around the speed at which payments will be made, will cause different issues. Our experience, where we have consent with SOCA, has been reasonably good. We have had no consent that has taken any longer than four days to be approved. I understand their concerns but we do not share them.

Q515 Lord Faulkner of Worcester: How burdensome is all this for the private regulated sector? We are getting different views. The Law Society says it is a disproportionate burden, but the British Bankers Association and the Institute of Chartered Accountants, whilst admitting it is quite large, say that it is necessary in order to preserve the reputation of the City. What view do you take about it?

Mr McGovern: We would agree that a robust system of anti money laundering is necessary to protect the reputation of the City. At Lloyd's, although not subject to money laundering regulations, we have said to our market that, as a matter of best practice, we expect them to comply. There are obligations within the FSA handbook around systems and controls for money laundering which do not apply to the general insurance sector, but, again, we have said to managing agents, "We want you to be able to satisfy those requirements, as a matter of best practice". I think that is a measure of how important we take the issue as a matter for Lloyd's reputation but also for the reputation more broadly. The regime is, in our view, proportionate. I think it is proportionate in the way in which the money laundering regulations do not apply to insurance, so there has been an element of a risk-based approach in defining the scope of the regulations, but, notwithstanding that, I do think that having a robust system of anti financial crime in the City is very important.

Q516 Lord Faulkner of Worcester: You think the Law Society is wrong, therefore?

Mr McGovern: I cannot speak for the Law Society. I would agree that I do not have any issues at all in terms of the corporation compliance activity around money laundering or the managing agents' activity around money laundering, and, as I have said, we have had no complaints from our market-place at all around the proportionality of the regime as it stands but, also, the extension of that regime that Lloyd's has applied to the market as an issue of best practice.

Q517 Lord Harrison: Mr McGovern, the payment of ransom is not currently a criminal offence in the United Kingdom law and no-one has suggested to us that it should be. However, the ransom, once paid, becomes the proceeds of crime and may well be used to finance terrorism. Do you believe it is right that shipowners and others collecting ransom money should be obliged to seek consent from SOCA for this? In your answers heretofore

you have made mention about seeking consent and you have offered a couple of occasions, but do you think the shipowners and the others ought to have a responsibility there to SOCA?

Mr McGovern: I have been interested to read and listen to the evidence that has already been put before the Committee around the application of the regime to this situation, and it is obviously a bit of a vexed areas. There does not seem to be any dispute around the fact that the collection and preparation of money for the onward transmission to meet a ransom demand is not a criminal offence. The question is whether or not in doing so they should seek consent. I note that the Government's position is that it is possible that the shipowners may be under an obligation to seek consent under the terms of the Act but that a prosecution in that context would not be in the public interest. I think that is probably the right outcome. I think we would have to think very carefully about the imposition of a consent regime and the extent to which that might hinder the ability of a shipowner to secure, in particular, the safety of crew in what can be quite delicate and time-sensitive negotiations. My assumption is that shipowners, if faced with this situation, whilst they may not be formally seeking consent from SOCA, would be in contact with the police and other relevant authorities to inform them that the situation is arising, but that is just an assumption that I have. There is a very clear distinction between criminal acts such as piracy and where there is evidence of terrorism or terrorist involvement. In that context, I imagine the shipowners would be looking to the Government to give them a very clear steer as to whether or not there is a risk that the activities are funding terrorists. We are, as I said, slightly removed from the situation because any payment we make indemnifying a shipowner is an after-the-event payment to a legitimate party, so from our perspective the issue of consent would not arise.

Q518 Lord Harrison: Do you think it is too mechanistic to have a regime where there would be an obligation, as such, to report to SOCA, given that you have given a very good example of why there ought to be some subtlety in terms of this.

Mr McGovern: I think that would be something that would have to be looked at. Clearly it would be unfortunate if shipowners felt constrained by a timetable that was too rigid. My perspective would be that one would not want to see the shipowners' hands tied in any way in trying to extract themselves from a situation that nobody wishes to be in.

Chairman: That is the sort of issue on which, if you have reflections over the next few days, you might like to come back to us.

Q519 Lord Faulkner of Worcester: Have you ever had any suspicion that a shipowner who is insured with Lloyd's has colluded with a pirate and has effectively organised his own act of piracy so that he can then claim on the insurance?

Mr McGovern: That would be a suspicion that would arise in the payment of the indemnification. Absolutely, if during the course of dealing with that claimant there was a suspicion that there had somehow been some collusion.

Q520 Lord Faulkner of Worcester: Have you had any examples of that?

Mr McGovern: No.

Q521 Lord Faulkner of Worcester: None at all.

Mr McGovern: No.

Q522 Lord Hodgson of Astley Abbotts: If there was a still more rigorous scrutiny what would the impact be on the competitive position of the London insurance market and Lloyd's in particular?

Mr McGovern: Do you mean more broadly?

Q523 Lord Hodgson of Astley Abbotts: We are talking about seeking further consents. How would this impact the competitive position impact? Are we concerned about how scrutiny is carried out in other countries?

Mr McGovern: As I said, I am not concerned about the impact of the current consent regime because of the nature of the general insurance market. I do not think that if the consent regime is left where it is or is somehow made more onerous, that would have a particularly significant effect on the general insurance sector.

Q524 Lord Richard: Mr McGovern, one of the things which has been with us throughout the whole of this inquiry – and this is, after all, a sub-committee of the Select Committee on the European Union – is the extent to which there is co-operation within the EU on these matters, and particularly, since we have been looking at it, in relation to piracy. The British have one way of dealing with it, the French presumably have a different way, the Germans have a different way, the Italians have a different way. Can you give us some idea of the way in which other countries tend to deal with this situation? Are there any attempts that you know of by Lloyd's or, indeed, by the insurance world generally, to try to produce a more concerted European policy to this problem?

Mr McGovern: Of course the situation is a matter of great concern and of great interest to governments around the world and to the industry, both the shipping industry and the insurance industry. I have had conversations, for example, with the US Treasury, who have been asking exactly the sorts of questions that you have been asking this morning around piracy and the role or otherwise of insurance in dealing with it. I would say that quite a lot of work has gone on and is still going on amongst governments and industry, and indeed navies, to try to come up with ways of dealing with the threat of piracy in the Gulf Aden, short of bringing the Somali pirates within terrorism legislation. I will give you an example of that. There has been a great deal of work done amongst governments, the shipping industry and the

insurance industry, about giving advice to shipowners around how to travel through the Gulf of Aden. There is a very lengthy document, a best practice guide, which essentially has been compiled with advice from naval authorities, security experts, the insurance sector, which is all about trying to make passage through the Gulf of Aden safer. It is advice around navigational channels and advice around techniques that could be used to evade capture, et cetera – all of those things short of arming the vessels, which I do not think is something that the shipowners or the insurance industry would necessarily support.

Q525 Lord Richard: I was rather more concerned with the position where the piracy has taken place and where there is a ransom demand. We deal with it in this country in a certain way. How do the French deal with it? How do the Germans deal with it? Is there any communication between the industry as to how it should be dealt with?

Mr McGovern: Given the role of the insurers in responding to indemnification for payment of a ransom, I am not aware of any steps that are taken at the point of capture, and tactics or process that is applied in dealing with the pirates at the point at which the vessel has been captured. We come into the process at the point at which the ransom has been paid and the owner is looking for indemnification. That is not to say that there is not co-ordination and co-operation. It is just not something that I am personally familiar with.

Q526 Lord Richard: What do you indemnify them for? The ransom?

Mr McGovern: I was going to take the opportunity, if it is acceptable, to walk the Committee through the process by which the loss arises and how the indemnification process works, if that would be useful in answering the question.

Q527 Chairman: I think it would, if you would be good enough to do so.

Mr McGovern: In broad terms, this is how this type of insurance works: shipowners will generally buy annual cover which will cover them for the hull, the basic structure of the ship, and they will also buy separately annual war-risk cover. That is obviously only required to the extent that the vessel is likely to be travelling into territories that might be considered a war risk. In the majority of policies that are in the market, coverage for the piracy peril is in the war policy. That means that the underwriters can, during the course of an annual policy, adjust the terms to take account of changes in security situations around the world. For example, the most significant means of doing that is through a system of listed areas which are higher risk zones within which shipping travels. The Gulf of Aden is a listed area and has been a listed area since May of last year. If a ship is intending to travel into a listed area, they are under an obligation to notify the insurers of that intention. The insurer is then able to assess the risk in a more real-time basis, take advice from security consultants and, if necessary, impose additional terms. That may be the addition of some further premium to cover the vessel whilst it travels through the listed area, but it could also be other conditions, such as notifying relevant navies, sticking to fixed navigational channels, et cetera, and they are all designed to help manage the risk of the vessel travelling through the area.

Q528 Lord Richard: Who produces the list?

Mr McGovern: That is produced by the insurance industry. We have, in London, a Joint War Committee which is made up of marine insurers of both the London market and the Lloyd's market. They, together with specialist adviser from security consultants, define what listed areas there are. The process of attaching any conditions to a particular policy as a consequence of it being a listed area, is a matter of negotiation between the insurers and the shipowner. As I have mentioned previously, as well as adjusting terms and requiring notification to navies, et cetera, the industry has produced advice working with shipowners about how to deter pirates and evade capture. However, notwithstanding all of that, if the

vessel travelling through the Gulf is attacked and taken by pirates, the process then is entirely driven by the shipowner. It will be the shipowner who will decide whether or not to negotiate with the pirates, to pay a ransom, and ultimately to deliver the payment. That is all handled by the shipowner. Assuming that the shipowner pays a ransom and the pirates release the vessel and it carries on with its journey, ultimately the shipowner has the right to claim the ransom payment through a process that is known as “general average” which is a concept of maritime law that predates the formal advent of insurance. You could substitute the word “average” for “loss,” so “general loss”. It means that all parties to an adventure at sea, to the voyage of a ship, effectively agree that if one party suffers a loss which is suffered in order to save the whole, then they will indemnify the one party who has suffered a loss to save the whole in proportion to the amount they would have lost if the venture had been lost entirely. The claim then goes into what is known as general average, and all insurers involved with the venture would share proportionately the cost of paying the ransom. That would be the cargo underwriters, the hull underwriters, and the hull war underwriters. Therefore the insurers are only ever indemnifying the policyholder. In addition to annual hull cover, war cover, and cargo cover, there is another cover which could be in play in this process, although it is relatively rare, and that is stand-alone kidnap and ransom insurance. It is very difficult to get data on kidnap and ransom insurance because one of the key terms of having kidnap and ransom insurance is that you keep the existence of that insurance confidential. Breach of the confidentiality is a breach that could lead to the avoidance of the policy, but it is our understanding that less than ten per cent of the ships travelling through the Gulf are likely to have stand-alone kidnap and ransom cover. Kidnap and ransom cover primarily occupies two additional areas. The first is that the shipowner, on the kidnapping of a ship, would notify the kidnap and ransom insurers, and as part of the policy the kidnap and ransom insurers would procure for the shipowner a third party expert, security consultant, who would help the

shipowner and advise the shipowner in handling the situation. Again, it is not something the insurer is involved in but is something the insurer covers the cost of. Kidnap and ransom insurance may also cover the shipowner for cash in transit, so, having decided to pay the ransom, he will then transfer those funds through one or more parties and obviously there is a risk that that cash will go missing during the process of making its way to the Gulf and kidnap and ransom insurance will often cover the shipowner for the potential loss of cash in transit. Again, all of this activity takes place without the involvement of the insurer and a claim would or would not arise after the ransom has already been paid. In terms of tying up all the loose ends, the application of the Proceeds of Crime Act and any terrorist financing legislation would not therefore apply to the transaction between the insurer and the shipowner because that is a transaction between legitimate parties for a legitimate purpose.

Q529 Chairman: Surely, with the 90 per cent of traffic which does not have kidnap and ransom insurance, any one of those people who was subjected to an attack would also use the services of the experts you referred to, the same people as would be assisting those who were covered. Would that be right?

Mr McGovern: That is probably right but they would just be covering the cost themselves. Instead of the shipowner being able to cover the costs of getting that advice through having bought a kidnap and ransom policy, they would just have to pay those security consultants directly.

Q530 Lord Marlesford: It seems to me that you have made a rather a good case for the insurers not being liable – at any early stage, at any rate to make a suspicious activity report and therefore to ask for consent. On the other hand, you make it very clear that the shipowner is in the driving seat. Shipowners, I think I am right in saying, are not part of the regulated

sector, so they would not be subject to the same obligation to make SARs as insurers are. Would that be correct?

Mr McGovern: I believe that is correct. Our assumption is that they are not part of the regulated sector and would not be covered by the same obligations.

Q531 Lord Marlesford: If one wanted to ensure that there was full notification in the case of kidnap and piracy, that would suggest that the regulated sector should be extended to include shipowners.

Mr McGovern: Possibly, if that was something that the Committee wished to recommend.

Q532 Lord Marlesford: The Treasury have indicated to us that their main reason for not wanting consent applications to be made, is that they are worried that they would in some way be compromised in the event of a later legal case, and the *quid pro quo* they have offered is that if a consent were not to be applied for when it would normally be required, they will give an *ex ante* undertaking not to prosecute. How happy are you with that, particularly in the light of the Lord Denning's ruling of January 1977 when he ruled against the Attorney General, in a not wholly dissimilar case, with the famous dictum: "Be ye never so high the law is above you." It was not seen as a discretion that the Attorney General had whether or not to enforce the law. Would it not, from your point of view, be safer if the obligation were made clear in statute, or lack of obligation, rather than a nod and a wink from the Treasury or indeed an exemption which has been given to us?

Mr McGovern: I think ultimately this is an issue for the shipowners and the risk that they are willing to take around the likelihood or otherwise of prosecution. My understanding is that any decision to prosecute for failure to make a report would be taken on a case-by-case basis – although I have seen the evidence that has been submitted by the Government on that point. I think it is a case of judging the objective of getting the kind of clarity that you have outlined

versus ensuring, as I have said earlier, that shipowners are not somehow constrained and the flexibility is not constrained in how they extract their ship and, more importantly, their crew from this kind of situation, but I quite understand the point you are making.

Q533 Lord Marlesford: What you are really saying is that, although there would be no problem in making a suspicious activity report, the bit of it which can cause the problem is getting the consent to collect or pay the ransom.

Mr McGovern: I would have thought the issue would be about the timing.

Q534 Lord Marlesford: Yes, but there are two parts to this regime, are there not? There is the SAR.

Mr McGovern: Yes.

Q535 Lord Marlesford: And then, where it is necessary, to get consent. You have indicated that there would be information passed to the authorities as soon as such an incident happened, which often would be publicly known anyway, so there is no need really to change the rules about making a SAR, but maybe it would be necessary to have an exemption from asking consent, which would have to be statutory, from which the Government could be excused from giving consent.

Mr McGovern: That would satisfactorily deal with the issues that I would see with putting the consent regime into this kind of situation, yes.

Q536 Lord Hodgson of Astley Abbotts: Presumably if the vessel is flagged in Panama and the shipowner is operating out of Panama, technically it never touches these shores at all, so there is no SAR to be reported here because the Proceeds of Crime Act will not apply unless it is a British flagged vessel.

Mr McGovern: Yes, I think that is right. One of the problems is that unilateral action taken by individual governments can lead to results which either have intended consequences, create competitive challenges for our jurisdiction, and do not often always deliver the solution that you might like them to.

Q537 Baroness Henig: Neither Government guidance nor the guidance issued by the Financial Action Task Force seems to make specific mention of the financial transfer aspects of piracy. Would the insurance industry welcome such guidance?

Mr McGovern: Clarity would always be welcome. I know that you have heard from Sir James Sassoon who would be certainly in a better position than I to judge whether or not FATF would be an appropriate body to do that. I am aware of the limitations of the effectiveness of their action, given that there is not a stable government within Somalia. I think, given the position of the UK industry in these situations as I have described them, it is difficult to see how we would benefit from that kind of clarity, but that is not to say that clarity should not be sought, but there is then the question about which is the appropriate body to do it.

Q538 Baroness Henig: Are you suggesting that you might welcome it but it would not necessarily make that much difference?

Mr McGovern: I think that is right. I do not think it would make a tremendous difference to us, but I think it probably would be helpful to others who face these situations.

Q539 Lord Mawson: I think you have answered some of this question, but I will ask it. At what stage might the insurers of shipowners who have paid a ransom become involved in negotiations for compensation? What obligations would be imposed on insurers by the Proceeds of Crime Act 2002 and other AML/CTF legislation?

Mr McGovern: I have set out, as you say, the way in which a shipowner would be identified. In terms of our obligations, we are involved after the event and we would view the payment of any money to the shipowner as part of that indemnification as being a legitimate transaction with a legitimate party. The Proceeds of Crime Act would not apply unless, as has been said, there was suspicion that there might be collusion between the shipowner and the pirates. As regards other anti money laundering legislation, the regulations would not apply to the general insurance sector and the counter-terrorism financing legislation again would not be applicable where we are paying money to a shipowner.

Q540 Lord Mawson: If the core business is about stopping money laundering, it seems to me it feels a bit like an elephant trying to catch a snake. For it to be effective, does there need to be a lot more flexibility and a greater attempt to innovate in this whole area of the question of money laundering? I wonder what is your business view is on that.

Mr McGovern: Again, looking at this from the general insurance sector, where there is relatively limited application of money laundering, we would say that the way in which the money laundering regulations have been applied in the UK is quite innovative, particularly if you look at the way in which it has been applied in other jurisdictions. The risk-based approach that the FSA have taken and the way in which they have tried to embed the management of financial crime within the overall management of the business is pretty innovative. I think the absence of a rules-based approach to money laundering does give an opportunity, whether it is through bodies such as FATF and others, for there to continue to be room for innovation in how money laundering risk is managed, because we are not boxed in in the same way as other jurisdictions might be where flexibility may be much more constrained.

Chairman: I wonder whether any of my colleagues have any final questions they want to ask at this stage.

Lord Richard: I have a very indiscreet question.

Chairman: Indiscreet? Let us hear it.

Q541 Lord Richard: Do we have any idea or does the general public have any idea how much money has been paid out in these given ransom policies?

Mr McGovern: I doubt the public do and I certainly do not. I am not privy to that information.

Lord Richard: A very discreet answer.

Chairman: Mr McGovern, thank you so much for coming. I am sorry we have not heard from your associates, but you have fully answered our questions. You have been very clear and we are grateful to you for coming. It has been a most helpful session.