

WEDNESDAY 22 APRIL 2009

Present

Avebury, L.
Faulkner of Worcester, L.
Garden of Frognal, B.
Hannay of Chiswick, L.
Henig, B.
Hodgson of Astley Abbots, L.
Jopling, L. (Chairman)
Marlesford, L.
Mawson, L.
Richard, L.

Witness: **Sir James Sassoon**, former President of the Financial Action Task Force, examined.

Q388 Chairman: Sir James, welcome. We much appreciate your coming. The Committee has received a document which is a report on money laundering by the Financial Action Task Force Secretariat. They were not content to come and talk to us and we perhaps might ask you more questions about that. We are delighted that you were able to come. If I could begin with a number of housekeeping points so that we all know where we are. As you realise, this is a public session. The webcast of the session goes out live as an audio transmission and it is accessible on the parliamentary website. We are taking a verbatim transcript of your evidence which will also go on the website. Within the next few days we will send you a transcript of the evidence session and we would like you to check it for accuracy and if you could advise us of any corrections as soon as possible that would be much appreciated. Also, if you feel on reflection that you would like to add to anything to what you have said, again we would welcome that very much. Maybe you would like to introduce yourself, but at the same time, if I could link that with the first question with regard to this inquiry, if you could tell us what in your experiences are the main strengths and weaknesses of FATF.

Sir James Sassoon: My name is James Sassoon. I acted as President of the Financial Action Task Force, the FATF, for the 12 months up to June 2008. As you probably know, the presidency rotates on an annual basis and I should hasten to add that I came at this as a non-expert on money laundering and terrorist financing issues. On the strengths and weaknesses of the FATF, let me take three strengths first and then pick out three areas of weakness. First, on the strengths, I think it is remarkable that through an entirely consensus-driven process of standard setting this body has developed a set of 40 plus nine recommendations that have global acceptance and endorsement. Second, linked to that, I think it is a huge strength of the organisation that while it has 34 members, actual full members of the organisation, there are over 180 countries now committed to the FATF recommendations through membership of either the FATF or of the so-called FATF Style Regional Bodies, of which MONEYVAL is one. There are very few countries in the world now that are not at least in principle and by voluntary buy-in to the process committed to the adoption of the full 40 plus nine recommendations. The third strength of the organisation, which I think is unique, is the peer review process which countries, in my experience, take enormously seriously and is a key driver in ensuring that the recommendations are implemented and countries continue to work to implement the standards better as the rounds of evaluation carry on. As I am sure you know, we are ending the third round of evaluations by the FATF within the next two years. On the weaknesses, one of the things that struck me when I started to get involved in the work of FATF was that it is the area of financial services policymaking where the policymaking was least rooted in hard evidence. We may talk about this a bit later, about some of the measures that the UK under its presidency proposed to try and get the FATF to give more consideration to measuring the outcomes over time of its recommendations and the costs that the recommendations entail. This is a very, very difficult area but I do think it is a major weakness. Second, I think that the organisation, having started as a task force with broad

principles, is getting dragged down to a degree of detailed interpretation and guidance, and methodology for the evaluations which now need to be questioned quite hard. There is a danger of a one-size-fits-all approach to the adoption of the recommendations. For example, there are always debates about how you apply the recommendations very differently in civil law and common law jurisdictions and there is a danger that this gets significantly in the way of the substance of what the FATF is trying to achieve. Third, and again linked to that, I would say that there is a danger and a risk that the assessments are getting too much focused on inputs and legal frameworks and forms and not enough on the effectiveness that is the ultimate objective.

Q389 Lord Marlesford: Following that up, Sir James, one of the impressions that some of us, or at least I had from our interrogation of SOCA about their SARs database is that they do not discriminate between what is important and serious and the trivial and I think there is a danger of them having a huge amount of data, much of which is really irrelevant to anything that could be called serious crime, money laundering or terrorism. Is this at all a problem with the FATF?

Sir James Sassoon: I cannot comment on the specifics of SOCA. I do think that it raises a very important general point on which I would hope that over time the FATF could shed some useful light, which is that as there is more global evidence developing of the way that suspicious transactions are reported and the actions that are taken on them, we can learn some real lessons by looking across, if not all countries, cross-sections of countries. I would be very keen for the FATF to be promoting much more research in this area. It is something that the revised mandate of the FATF, which was endorsed by ministers during the UK's Presidency year, now places on the table and I think the FATF can help to shed light on what is coming out of this activity, not just in the UK but globally.

Q390 Lord Richard: Sir James, I wonder if I could put to you some of the evidence we have actually been given and perhaps ask for your comments on it. We heard evidence from Professor Alldridge, who is the professor at Queen Mary looking at this, and what he said was: “FATF, in my view, needs a constitution. It was established in 1989 as an offshoot of the G7. It has operated on essentially an ad hoc basis for the last 20 years and a temporary basis for the last 20 years. Its decision-making, its policymaking and its information-seeking practices are by no means clear. I spent some time looking at their website yesterday and asking myself questions like, how exactly do you get to be a member of the FATF, how does it function, how does it make the rules and how does it come up with its recommendations? These matters are not as clear as they should be”. I was wondering, do you share that view that they are not as clear as they should be?

Sir James Sassoon: No, I think they are not as clear.

Q391 Lord Richard: Can I just put the second half of the question. If you did share that view do you think it has an effect upon the efficiency of the organisation?

Sir James Sassoon: I read the transcript of that evidence with some interest because it does not bear much resemblance to anything that I recognise. Just to take, in a sense, a trivial point, I double-checked that if you go to the FATF website there is a very clear set of rules for membership which is entirely publicly disclosed. I do not know whether there was some difficulty accessing the website, but even on some of the specific detail I would challenge that evidence. More broadly, the FATF is a very interesting entity. You have much more experience of comparative accountability and transparency of other international bodies, but it did strike me, when I first came at it, as a rather extraordinary entity in a way. When you look at the elements of accountability, there is a mandate which is set for eight years by the ministers of the member countries, that is reviewed at midway through the eight year term, so the mandate is re-looked at every four years, that ministers meet - we convened under our

presidency a meeting of ministers in Washington around the fringes of the spring 2008 IMF and World Bank meetings; we got a very high attendance of ministers with a short, focused, very good discussion about two or three of the key issues, including accountability, private sector engagement and so on; it was a good discussion - and there are annual reports to ministers. So in terms of the accountability, there is a high degree of it. In terms of how decisions are taken within the organisation, there was an implication in the evidence you have had that there is a sort of small black box which is the FATF, out of which recommendations come and then they are uncritically adopted by the EU and other people - and it is all very unsatisfactory. It is perhaps worth saying that as well as the 34 members of the organisation there are associate members, including the regional bodies, one of whom is MONEYVAL, who make very positive and important contributions to all the discussions, and there are some 20 other organisations who attend and speak at the meetings, including the IMF, the World Bank and the relevant agency of the United Nations, and other groupings of international regulators. I have to say as somebody who has chaired three day long plenary sessions where all the decisions have to be made by consensus, when you have 65 organisations and around 120 people in the room, I find this is a somewhat different picture than I have from the one Professor Alldridge gives. Having said that, I do think there are one or two areas in which the FATF could usefully improve its accountability. I think it is very striking that the FATF is the only global standard setting body that is not a full member of the Financial Stability Forum, which will become the Financial Stability Board. Having pushed for membership, I could understand why the Financial Stability Forum was initially unwilling to open up its membership because there were lots of other countries who were pressing to be members. But when the G20 very significantly increased the membership of the Financial Stability Forum at the recent London meeting it seemed to me a missed opportunity for the FATF to have been put on to the Financial Stability Forum because that would create another

layer of useful oversight and a sense check on the FATF's processes. That is one area for improvement. The other one is the question of how willing the FATF is to take forward membership applications, quite independent of what the rules say about the membership criteria. The FATF's stance on whether or not it is truly open to increasing its membership over time is something which is perhaps not as clear to non-members as it could be.

Q392 Lord Richard: What is it that not is clear, what you have to do to become a member or qualifications to become a member?

Sir James Sassoon: The technical criteria are laid out with great clarity, but alongside the technical criteria that need to be met there is a question, that I suppose many clubs have as to what is the appropriate total size of membership should be; on the one hand to make sure that this consensus-driven organisation is able to make decisions and it does not become too unwieldy; but, on the other hand, to make sure that its membership is sufficiently inclusive of a spread of countries which is reflective of where global financial activity is taking place. The membership of the FATF has evolved over time. China was admitted 18 months ago. It is by no means a closed door, but there are questions that an outsider might justifiably ask as to what the future membership approach of the FATF is going to be.

Q393 Lord Richard: You make it sound like the Garrick! Can you blackball a candidate? Are they blackballed?

Sir James Sassoon: Membership, like everything else, has to be dealt with on a consensus basis.

Q394 Lord Richard: If I can sum up your evidence it is really this: the FATF is sufficiently accountable, sufficiently transparent and the decision-making process is clear, sufficiently clear.

Sir James Sassoon: I have suggested one practical and important enhancement to that, which is through membership of the Financial Stability Forum.

Q395 Lord Hannay of Chiswick: If I could follow up and say how delighted I am that you gave such a masterly response to the Professor, with whom I disagreed strongly. He also said that what he thought would be the right way would be for all this to be turned into a legal international convention, which was the point I most strongly disagreed with because it seemed to me that in the negotiation of this in international legal form you would probably end up with a lot of gaps, let-outs and so on. Moreover, you would come across the problem of ratification by the US Senate, for example, which would probably be very difficult indeed, and therefore this was highly undesirable. Do you agree that is another reason why it is best left on the present basis?

Sir James Sassoon: I prefaced my last answer very carefully with saying that I, unlike several of you here, am not a great expert on this subject. Having said that, I entirely agree with your logic and I do think this interesting constitutional set-up of the FATF has served it well over the last 20 years.

Q396 Baroness Henig: One of the four essential objectives of the FATF under its current mandate is to engage with stakeholders and partners throughout the world. I wonder if you could tell us what was the nature and extent of the FATF's interaction with the private sector at the time you assumed office, and what improvements you were able to bring about? Secondly, what is the scope for extending and deepening that relationship in the future?

Sir James Sassoon: At the time we took over the presidency in 2007 I would say that the engagement with the private sector was patchy, it was not systematic and it was certainly not up to the standards that many of the individual countries would adopt when engaging with stakeholders to set financial services policy domestically. It was a bit of a surprise to me to

discover that finance ministries when setting all sorts of domestic rules would engage with the private sector in a completely different way from the way they were content for the FATF to do it. Having said that, there was some engagement, it was not that there was no engagement, but there was very much a view that the FATF was a public sector group of people and we told the private sector down the chain what they had to do. The UK's predecessor holding the presidency was Canada and they actually helped through joint working with the UK to push this agenda forward and, indeed, the South Africans and other presidencies before had all picked this up but had found it very difficult to get any traction. Maybe we came in at the right time, but we certainly made it a priority and we did make some very significant progress. We set up a standing consultative forum through which the private sector can now input ideas for the work plan and the agendas of the FATF and its working groups and through which we can give the private sector more consistent feedback on the work of the FATF. For the first time, and this was perhaps the thing that was most surprising to me, we did joint work on typologies. These are the case study exercises on particular areas of fraud or terrorist financing. We had a very effective, and much appreciated by the private sector, series of workshops in London in December 2007 to look at big areas like VAT carousel fraud, proliferation financing - four or five issues on which the private sector wanted to really understand how the public authorities were coming to them. So we kicked off typology work with the private sector and there is now an agreement that all future typology work that the FATF does will be run past the private sector. We also involved them in a series of streams of work to develop risk-based approaches to different sub-sectors. We initiated a lot of work and I have to say that the very good news is the Brazilians, who hold the presidency now, and the Netherlands that follow are equally committed to private sector engagement. I am optimistic but there is much more that needs to be done. In my answer to the first question I said that much more needs to be done on the whole evidence base that underpins the FATF's

work, particularly with the private sector as we put ever more reliance on them to be the frontline in the battle against money laundering and terrorist financing; and we do have to explore with them in much more detail what the cost burden is that the public authorities are putting on them and what the results are that are coming out. It also comes back to what is happening to Suspicious Activity Reports. There is only a certain length of time when we can expect the private sector across the world to be generating this vast volume of data without giving them more general feedback and an opportunity to discuss the methodology. There are various other important issues that are on the work programme for the coming year, such as the reliance the private sector can place on know your customer due diligence processes that have been carried out by other financial institutions; and I could go on. So I think there is an awful lot more work to be done.

Q397 Baroness Henig: So you are quite optimistic then that this very important relationship is deepening?

Sir James Sassoon: I think it will require committed presidencies who regard this as an important component of the FATF's work because it is discretionary around the core work, which is driving the standards forward in the FATF plenaries. I am optimistic but it is not going to happen unless it is very consciously pushed.

Q398 Baroness Henig: So it is a leadership issue as much as anything in terms of who is driving the FATF's agenda?

Sir James Sassoon: Correct.

Q399 Lord Mawson: What do you regard as the major accomplishments of the 2007-08 UK Presidency of the FATF?

Sir James Sassoon: I have talked about the private sector so I will not repeat that one. That was one that was certainly central to our agenda. I have also talked about the question of the mandate of the FATF and the fact that we conducted the four year review of the mandate. We convened the meeting that I described, for ministers to have a proper discussion because there certainly had not been a ministerial meeting for four years and my sense was that in some of the previous ministerial meetings it had not always been the ministers themselves who attended. Actually getting the ministers to look at a refreshed mandate, which included some new elements, particularly the commitment of the FATF to produce a regular global threat assessment, something that they had not done before, and to get into the mandate references to measuring the impact of the regimes, those were the first two areas. The third thing which was a priority of ours and that we made progress on was helping low capacity countries with the implementation of the FATF recommendations. I think it is quite right that there should only be one set of recommendations that apply globally. We cannot say there is one set of recommendations for countries below a certain level of per capita income or something. On the other hand, when I went to meetings of two of the African groupings of countries, if you had the justice minister of Sierra Leone, for example, around the table with his fellow ministers from countries which are struggling to be supportive members of the wider group of FATF members, they do need a lot of help. The fact that, under our presidency, we produced guidance for low capacity countries on the implementation of the standards was important to the UK. Two more things. The new approach that we rolled out for dealing with non-cooperative countries started to bear some fruit under our presidency and has borne more fruit in the succeeding nine months. The last thing I would highlight is the launch of the so-called Three Presidencies Paper which was the review that we decided should be kicked off to look at the FATF standards because, as we come towards the end of the Third Evaluation Round,

we thought it was important and appropriate for the overall standards to be subject to a periodic review.

Chairman: We are coming to the Three Presidencies Paper in a moment.

Q400 Lord Mawson: This is all about how we make this more effective in the sense that a lot of this behaviour around money laundering is very entrepreneurial behaviour. I am following a particular case of a family that I am aware of that got caught in this because I am always interested in the micro, in what happens to one family in detail as it passes through. In terms of ministers and politicians, how much work have you done with them in terms of this detail about particular individual cases? I am aware that often people get caught in the systems and processes and they talk strategies and documents, they never look at the detail of one example. Entrepreneurs and business people know that the one micro sample is very critical in terms of really understanding what is happening in the system. You have said a bit about case studies with business, but how much of that has been done with politicians in terms of understanding the detail?

Sir James Sassoon: Not very much is the straight answer. What the FATF does is to take problem areas and subject them to case studies, so it has recently, for example, produced a very big piece on casinos and how they operate. And, to give another example, we launched an inquiry into football clubs and other sporting clubs and their exposure to money laundering issues and a report will be produced. There is therefore work focused on the detail which is informed by as many countries as want to participate in each of these studies. How that is then translated into ministerial involvement at the granular level is essentially left to the individual national authorities to brief their ministers as they see fit.

Q401 Lord Mawson: It is my experience in terms of changes that if particular individual ministers never get hold of the granular detail, what often happens is very little actually

changes, as you know, so I just worry about how we enable some of that more granular stuff. This is all about the detail of pretty entrepreneurial behaviour by individuals and groups and organisations and that understanding is not there.

Sir James Sassoon: I do think it has to be done at the national level but there is a huge misunderstanding about the linkages in the chain. One of the things that I use as an example of the granular that we all face and the link through to the FATF is around the frustrations about opening bank accounts. It may all be done for very good purposes but you go into the bank to open an account for a child who is asked for a utility bill when obviously they do not have one. And then the very well-meaning person across the counter in the bank will say “We have to do this because the FSA tells us we have to do it.” Who tells the FSA to do it? It is the Treasury or the Government. And it is the European Union who impose the rules on the UK Government. So who tells the European Union? And of course right back up the chain it is ultimately the FATF that determines the rules. I suspect that even among a lot of ministers in the member countries actually understanding this chain and why it is important to start driving the FATF in some of the ways that would ultimately effect the end of the chain with everyday transactions is something that all involved in the processes need to understand better.

Q402 Chairman: Can I just go back to the UK Presidency? You twice referred to the inhibitions caused by the consensus rule; how limiting is it and in practice is it particular countries who refuse to come into a consensus and are they ones who are reluctant to take on fully the responsibilities which FATF rules impose on them? How much easier would it be to make progress if it was in line with OSCE which, I think I am right in saying, is consensus minus two as I recall – I may be wrong on that. Would it make life much easier and would it be possible to change the rules so that it was easier to get agreement without 100 per cent consensus?

Sir James Sassoon: It is a question that I pondered on a lot as I had to grapple with getting decisions taken. Ultimately for the FATF consensus works very well. But the first thing I said to myself was “I am going to be taking the chair of this organisation; what do I do if somebody is holding out against a decision?” There was no piece of paper anybody could give me, and actually it turned out to be rather a good thing that there was no piece of paper, that said if one particularly large country objects you cannot overrule that one, or if two of this other category of countries object you would be unwise to do that but if it is three or four of another group it is okay. I developed some informal lines which I thought I should not cross as chairman, but the ability of the Presidency, guided by the secretariat, to be able to sense the mood of the meeting without having strict rules about who we could not overrule worked well. Looking back on it, although it was enormously frustrating at the time, the ability of the organisation to take decisions that neither required unanimity nor where people could play games because there was a set rule that allowed, say, two members to hold out actually, on balance, worked pretty well. If one stands back from it, although a lot of the work does take a very long time to go through the various working groups and then through the plenary, the FATF has shown a very considerable flexibility to take on additional parts of its mandate, most notably the terrorist financing aspects. It has been flexible and pragmatic in its approach to non-co-operative territories, so on balance the impression I would like to leave you with is that the decision-making has worked well. To take your other point about does this reflect countries not being prepared to take on responsibility, I do not think that is right. When the consensus is struck I would say that it is very powerful because it is not that there is anybody who is formally seen to be holding out. The greater difficulty is that there are some issues that different groups of countries tend to coalesce on which are around, most aggravatingly from the perspective of countries like the UK, the approaches that FATF requires countries to take to enforce FATF recommendations. To give you an illustration, the

UK was found by the FATF to be non-compliant on the recommendation referring to politically exposed persons. If you look at all the hard evidence the UK does as much if not more than any country to generate activity reports and for there to be clear evidence of follow-up on politically exposed persons. Because of the way the UK had those rules in place in 2007, which was through guidance which the FSA required regulated bodies to adopt, but was not in some formal law or regulation, one side of the FATF was able to ensure that the UK was rated non-compliant. When faced with that sort of issue in an evaluation – and it comes up in almost every evaluation and causes enormous frustration and waste of time – there will be, and everybody knows it, a group that will hold out against allowing countries to be sensibly evaluated in their ratings on an issue like that. So there are fault lines which the consensus approach has helped to foster which are well understood by the FATF members, but the way around it is not to change the voting rules but is actually to look back at the recommendations and see whether the recommendations are being either drawn up or enforced in a way that puts form over substance.

Q403 Lord Avebury: Does what you said about the preferability of decision-making by consensus over having, for example, an OSCE-type rule, have a bearing on the willingness or otherwise of FATF that you talked about earlier to accept new members and would there have to be changes in the rules if you got much larger membership than you have now?

Sir James Sassoon: I cannot compare it with other organisations because I have not worked closely enough with enough other international organisations but my conclusion is that the consensus is working well with the limitations I have given for the FATF. I do not think that for the FATF now there is a better way of proceeding, but if the membership was significantly enlarged it is something the FATF would have to look at but I would not say it is a pressing issue for the FATF.

Q404 Lord Hannay of Chiswick: Is not the key criterion that none of the current members of FATF in your view, in your experience, were using the requirement for consensus abusively, i.e. to block something that the large majority of members believed should be done. Perhaps you could say whether or not you did have any experience of that and, if not, the answer is perhaps that is why consensus works quite well.

Sir James Sassoon: As you can imagine, in an organisation like this there were always cases when one country might have felt very strongly about something and they would rush around the table and try to get other people to block things, and of course that went on, but that is part of the baggage that goes with the consensus process and the FATF generally manages to work around that. If the secretariat, as they do, do their preparation work well and the Presidency does the work well in advance – these things happen but it is okay.

Q405 Lord Marlesford: Really following up, Sir James, a slightly earlier question, am I right in getting the feeling that you are talking about the importance of FATF acting in countries where there is widespread and systemic corruption, particularly at a political level, and the difficulties of doing so?

Sir James Sassoon: I was making the point about politically exposed persons to make another point which is that it was a very clear example, I would say, where a group of FATF members feels very strongly that legal form is as important, let us say – let us not say more important – as the outcome. I was not wanting to make a point particularly about the approach of different members to politically exposed persons, but of course as a general topic it is an area on which the FATF and individual national authorities could usefully make a huge amount of additional progress, so it is an area of continuing focus of course for the FATF.

Q406 Lord Marlesford: Could it be regarded as quite an important international priority for the FATF to improve the governance of countries where governance has been particularly inadequate due to a note of corruption of various sorts?

Sir James Sassoon: There are limits to what the FATF can do in this or any other area. The FATF can make sure that its broad recommendations impose a requirement on countries to be effective in addressing this issue. It can draw attention in a very practical way to some of the issues that fall out of it, so for example as I mentioned in the joint public/private sector work, one of the things the private sector wanted to talk about in very practical, granular terms was their approach to identifying the telltale signs and what they should do about them in relation to politically exposed persons. When it comes to broader questions of corruption in regimes the question would be, I suppose, would that pose such a risk to the international financial system that a country should be included within the special processes for dealing with non-co-operative countries. That would be the other way that it could bite on the work of the FATF.

Chairman: We must move on but first Lord Faulkner on this point.

Q407 Lord Faulkner of Worcester: Just a quick question on the membership. I am a little puzzled as to what the criterion for membership is because I see, for example – and these are only examples – Israel, India, Taiwan are not members of the FATF and I just wondered why that might be and whether their applications were opposed by other members?

Sir James Sassoon: India and Korea are the two countries that are on the list of prospective members; they are going through a process and if the next evaluations which they go through come up to the required benchmarks then the formal applications for India and Korea will be considered for the FATF. What the FATF has said in essence is that once those two countries have gone through the membership process then the organisation will have a further look at seeing where next it goes on membership, and at that point a whole list of countries would be prospective candidates.

Chairman: Thank you. Lady Garden, who has been most patient.

Q408 Baroness Garden of Frognal: Not at all, thank you, my Lord Chairman. Sir James, can I take you back to the *Three Presidencies Paper* which you alluded to earlier, which was June 2008 with the UK, Brazil and the Netherlands proposing a review of the standards set by the FATF and of the mutual evaluation process. You have mentioned some of the factors already, but perhaps you could crystallise what were the most important factors which prompted this particular initiative, what you hope will result from it and do you have any timescales for when you hope to see results?

Sir James Sassoon: What prompted it was first of all the desirability in any standard-setting organisation like this to do a comprehensive review on a periodic, regular basis of its standards, and such reviews have been done by the FATF in 1996 and 2003. I do not know whether there is a definitive timescale that has now been set on this but typically these reviews in the past have taken a couple of years and so now looks like a good time to kick one off, particularly because the FATF is coming towards the end of its third round of evaluations, and that would be the natural point to look at the whole construct before you then start putting countries through the evaluation cycle for the fourth time. The other thing is we touched on the fact that this an organisation where the Presidency only lasts one year and it seemed to be important and helpful to the organisation to try and give some sort of multi-year sense of direction of travel; that is why we kicked it off. What do I hope comes out of it? I certainly hope and believe that there will be a recommendation by recommendation review and that all the experience over the last six or seven years will be fed into the review. More importantly than that, I hope that the FATF will take the opportunity to consider some of the big picture issues because if there are lessons to come out of the financial crisis one is the danger of losing sight of the wood for the trees, and I would very much hope that big questions like the compatibility of a risk-based approach to more prescriptive guidelines, the question about

whether the FATF is going too far down the one size fits all approach to rule-making and some other issues to do with broad questions of law and regulation are going to get looked at. From the latest I hear, I am pleased that the latest plenary session seems to have given considerable impetus to the recommendation by recommendation review. I do not hear that there is much appetite – and maybe there is something else going on that I do not know about – for taking a broad overview and that would be disappointing. I hope over the next year to 18 months they do look at the whole shape of the wood.

Q409 Baroness Garden of Frognal: Did the three countries share the common view, was it relatively straightforward to focus between the UK, Brazil and the Netherlands as to what you hoped to achieve through the review?

Sir James Sassoon: There was a very high degree of common approach. I went to see the Dutch Finance Minister and even at that stage, some 18 months before they were due to take over they were already thinking about what they wanted to get out of their Presidency, so there was a high degree of engagement and forward looking by the Netherlands. I also had very extensive discussions with the now President from Brazil and we jointly put this together.

Q410 Lord Faulkner of Worcester: I wonder, Sir James, if I can ask you about how you feel the FATF is coping with the global financial crisis. The memorandum they have sent us I have to say for blandness is hard to beat. It contains, for example, phrases like “the FATF will take stock of the consequences of the financial and economic crisis for the FATF and identify issues for further analysis and discussion.” It does not sound like a great deal of urgent attention is being given to this and I wonder whether you feel that particularly the banking secrecy provisions that are contained in the way FATF works are making this job particularly difficult and whether you would like to see them do more.

Sir James Sassoon: I find it difficult to comment on what the FATF is up to and the speed and detail of its current work programme, but they clearly are collecting evidence from their members and I am sure they will be coming back to it at the next one or two plenaries. I would be surprised if, when the research is done and the discussions had, if there is anything in the basic FATF framework about banking secrecy that needs to be changed as a result of lessons from the crisis. My lessons from the crisis would be looking at two different areas. I would be very concerned about the possible diversion of resources within finance ministries and financial regulators, in particular, and maybe in other authorities away from this area of work as the authorities are under enormous and continuing pressure to deal with the day-to-day aspects of the crisis. I have no particular evidence about whether this is happening, but the diversion of resources away from the focus on this area would be one thing that I think needs to be guarded against. The other thing which is really important is whether one of the lessons for the FATF should not be so much about looking at whether the individual rules are still fit for purpose – which I am sure will get looked at – but are there questions about looking at the shape of the wood rather than being lost in the trees. While the situation is very different from straight financial regulation, and how the rise in debt was a key thing that somehow people missed or missed the consequences of, I do think that the commitment that the FATF gave under our leadership to the global threat assessment, for example, should be given more focus and attention post crisis.

Q411 Lord Avebury: My question earlier on about enlargement had in mind the differences between FATF and MONEYVAL and the reasons for the existence of two separate organisations. One thing we have been told is that 12 of the 27 EU Member States are members of MONEYVAL and not of FATF. Is there any need for the two organisations and why should they not be merged, apart from the difficulties of having a much enlarged membership?

Sir James Sassoon: One of the principles about the FATF and its membership is that it should be globally balanced and it should be reflective of factors to do with the size and importance of economies, so if one was to say that all the MONEYVAL members could become FATF members if they met the technical membership criteria, the implication of that would be that to all the regional bodies similar to MONEYVAL you would effectively be saying we open up FATF membership, to 180 countries provided they met the criteria, which many of them would. It would completely change the character of the FATF. You are taking evidence from MONEYVAL next week and of course they may say something different to me, but the relationship between FATF and MONEYVAL I would say is extremely close. There is a high degree of mutual respect and co-operation; they are working to absolutely the same standards in terms of their evaluations; and the MONEYVAL non-EU members are actually also assessed to some extent on EU standards, so the evaluation of the non-EU members of MONEYVAL will reflect, for example, the third Money Laundering Directive. It works extremely well and I had a couple of meetings, at his request, with the Secretary-General of the Council of Europe who, as you know, is the sponsoring body of MONEYVAL – Terry Davis – so there is commitment right through the Council of Europe to MONEYVAL; and most importantly in the current context, and it bears on some things we have just been talking about. MONEYVAL is ahead of the FATF in the cycle of their reviews, so they have completed their third round of evaluations and are already leading the thinking about what the fourth round should be. You might discuss this with Mr Ringguth, but I know from my discussions with him last year that they are already very focused on shorter evaluations, looking at effectiveness and outcomes, and I rather hope that if MONEYVAL is committed, as I am sure they are, to driving that through, the FATF will be able to learn from that. I think the construct works pretty well at the moment.

Q412 Lord Avebury: You said that there was use of the same standards in FATF and MONEYVAL; does that apply also to the monitoring mechanisms of the two organisations, are they exactly the same? If you have got the same standards and the same monitoring mechanisms can you really justify the existence and the superstructure of two separate international organisations?

Sir James Sassoon: They are exactly the same and the way they are kept exactly the same is in all sorts of ways. It happens, for example, that the Financial Services Authority recently seconded somebody into the secretariat of MONEYVAL so there is cross-fertilisation. And I have to say, in parentheses, that the Financial Services Authority is enormously supportive and effective in supporting the wider FATF efforts. It does work exactly the same so why does not one merge the two together? Quite apart from the fact that, as we have discussed, the FATF would become a very large organisation if everything was merged, in every region of the world there are particular challenges. As you know, many of MONEYVAL's members are in Central and Eastern Europe and have very particular characteristics and challenges of their own. Countries in the African region, for example, have particular and very different challenges, the Asia-Pacific region similarly, so one of the benefits of having these regional groupings is that they are able to tailor a lot of their training initiatives and their initiatives to look at particular typologies, for example, to their individual members and they can focus very particularly on the challenges of individual member countries. Again you should ask MONEYVAL directly about this but recently MONEYVAL identified concerns around one of its members, Azerbaijan, and issued a statement of concern on it. That was before the FATF had taken any particular public stance on Azerbaijan so it is an example of where a regional body is able to focus attention on particular regional problems, and I think that is rather powerful and useful.

Q413 Lord Avebury: Have you got any formal agreements between yourselves and MONEYVAL on how the relationship between the two organisations is supposed to function and, in particular, could you say anything about the function of the two EU countries which are appointed by the FATF Presidency to the membership of MONEYVAL. What do they do?

Sir James Sassoon: Again, you should ask MONEYVAL on the first question to make sure I have got it right. What the FATF sets out are some model rules for the regional bodies. MONEYVAL has been a model of what the regional bodies should be – it was one of the first to become an associate member of the FATF so the way it has developed is that the methods of operating of groups such as MONEYVAL, and very much led by MONEYVAL, have been the standards which have been encouraged in the other regional bodies, but you might want to ask them more about that. On the second point, again, they will know more of the background of this but it was just a question of making sure that at any one time, to reinforce the linkages between the two groups, there would be at least two FATF member countries within the EU who were going to all the plenaries, playing a full part, and it was thought that the best way of doing it would be to have this rotating approach. So I do not think there is any magic in it, but it was a pragmatic way of making sure that the linkages between the two bodies were kept strong and refreshed.

Q414 Chairman: Two questions about membership of FATF. I was surprised to see that the Gulf Co-operation Council is represented and not the seven Member States; is there any particular reason for that? The other question is the fact that those members of the EU who are not members of FATF, as you say mostly Eastern European states, to what extent is that a product of a consensus rule and to what extent is that due to the influence of Russia?

Sir James Sassoon: I cannot really answer the first question and it may be that you could ask supplementary questions on the specifics of the GCC from the FATF secretariat as that was

well before my time. The broad answer to the question is that when the FATF was originally set up 20 years ago it was a creation of the G7 and it has incrementally increased its membership from that point with a view to include at every stage countries or, in the case of the GCC and the European Union, representatives of important groups of countries, that were most significant in terms of economic and financial flows but also to keep a regional balance within the organisation. It has been an incremental process, in stages and it continues.

Q415 Chairman: What about the Russian influence and consensus with regard to the Eastern European countries?

Sir James Sassoon: I saw no particular evidence of anything there.

Q416 Lord Mawson: What strategies are utilised by the FATF to promote global implementation of its standards? What is the nature of the involvement of the International Monetary Fund and the World Bank in this process and how can this process be strengthened and improved?

Sir James Sassoon: I will come back to the IMF specifics and the improvements but in answer to your broad first question I would say, having quickly looked at the FATF secretariat paper, it actually sets out that answer well. On the specifics of the IMF and the World Bank, the FATF works incredibly closely with them; they put a lot of resources into this area and they are particularly effective and important when it comes to helping low capacity countries. There are questions that arise, particularly out of the IMF's involvement – they cut their budget for this area of their work during the UK's Presidency and the FATF quite rightly asked me to express in strong terms the FATF's concerns to the managing director of the IMF. I understand that the IMF's response has been to set up a trust fund to take up some of the slack from a reduction in the budget in this area and that the UK is one of a small group of donors that has contributed to this trust fund, so actually this may be good

news because it means that the UK will have particular influence on where this money is deployed and the areas of activity. So there are issues in particular with the IMF and questions, for example, about the balance in their work between developed countries and low capacity country evaluations that they contribute to. Why are they involved in evaluating countries like Germany and Luxembourg at the moment? I do not know. There are some questions therefore that need to be asked but the broad point is that the FATF relies heavily on the IMF, who are very good partners, as are the World Bank, when it comes to helping countries implement the standards.

Q417 Lord Hannay of Chiswick: Could you say, Sir James, what your assessment is of the current procedures within FATF for identifying and dealing with countries which do not apply, or insufficiently apply, FATF recommendations. Is there a need for counter measures, when called for, to be implemented in a more harmonised fashion – and I was thinking here of the example of Iran?

Sir James Sassoon: As I am sure you know the current process that the FATF is adopting for non-co-operative countries and territories has really only been in operation for 18 months or so now. It needed to be kicked off and we kicked it off under our presidency, but what can perhaps give us confidence that the new processes will deliver results over time is, first, that there was quite an interesting study very recently done by the IMF that attempted a scorecard across various different groupings of countries on the basis of their most recent reviews, and actually the 23 countries that went through the previous process, the so-called NCTT process, which was the previous approach to listing non-co-operative territories, if you take where those 23 countries are now they score almost up with the G7 countries in terms of their overall implementation of the FATF regulations. So the best evidence of how the current process might work is the evidence of the previous process and that is good news. What has been going on in the last year or two is that there is one territory, the northern part of Cyprus,

which came into and out of the current process. I am not completely up to date but that clearly reflects work that has been done by the authorities there, so that is encouraging. Another example I would give is Uzbekistan which went as far as completely rescinding all its anti-money laundering laws by presidential decree and they were put on the list. After repeating the concerns that the FATF thought Uzbekistan gave rise to, in the last six months there has been a delegation that has gone out there and, as I understand it, the laws have been or are being restored, so that is another bit of progress. Iran is clearly much the biggest challenge; in lots of respects it outweighs all the others and there is clearly an extremely long way to go – Iran does not have terrorist financing as a criminal offence – but as a result of letter-writing and public statements – there was correspondence that I as President had with their ministers – there is now a dialogue and some engagement. There have been meetings with groups of officials on behalf of the FATF member countries and the FATF secretariat and there have been requests from Iran to help with the setting up of a financial intelligence unit. I would not want to overplay the significance of those moves because Iran has a very, very long way to go, but it demonstrates that the FATF, because it applies to Iran, as to all these other countries, absolutely technical criteria on a consistent basis, independent of other broader political considerations, is capable even or particularly, let us say, with Iran of contributing to the wider global effort. On harmonisation – and it is really not for me to be able to go into much of the detail because it is very recent – I do note that the latest FATF statement on Iran does talk about counter measures but leaves it to individual countries to decide what counter measures they implement. Whether that is a pragmatic and sensible way to proceed or whether it is a cop-out I find it difficult to say because I was not involved in the discussions. I certainly think it would be highly desirable in these circumstances if the FATF, since it has a specific ranking of counter measures in its rules – whether it is for Iran or for anybody else –, was actually able to agree where in the ranking of counter measures they

would expect their members to be. There are some issues there, therefore, but I am really not in a position to answer on the specifics. When all this is said and done, where the most progress will be made on a lot of these countries is bilaterally with the countries that have the biggest flows, whether they are financial flows, trade flows or political engagement and therefore, yes, there should be harmonisation of the FATF but in the real world it will be the countries that deal most directly with Uzbekistan on a trade and finance basis or with the northern parts of Cyprus or Iran who are bound to have a disproportionate influence and therefore it is up to them to take the strain.

Q418 Lord Hannay of Chiswick: Thank you. Could I just lead you on from that into an area which was not probably quite so active during your chairmanship but which has become in the last months extremely prominent, which is the question of Somalia and piracy and the transfers of funds to Somali pirates basically to get back crews, ships and things like that. This has become much more prominent in the last few months and, to tell you the truth, we have been pretty puzzled – the polite word – by the lack of response so far by any of the organisations that deal with this. FATF has not uttered a cheep about it as far as I can see; the EU seemed not to know that it existed when we went to Brussels; and the British Government has given us some thoughts on it which can perhaps politely be described as not very substantial. I wonder what you think this says about FATF’s ability to respond to an emerging threat or challenge.. After all, we all understand that Somalia is not only a non-co-operating country it is almost a non-country, but that does not mean to say that there is not a problem here, a problem both in the money laundering sense but also a potential problem in the laundered money getting to terrorists. One cannot possibly assume that none of the millions that are going to Somali pirates are reaching terrorists; could you comment a bit on that and I do understand that this is not related to your period of the presidency. But from someone as skilled as yourself who has seen this whole process from the inside it would help

the Committee a great deal if you could tell us a bit about this because we are feeling somehow that there are tricks being missed here.

Sir James Sassoon: I will do my best although I fear that when you next recite this long list of people who have given these inadequate responses I risk being added to the list. Seriously though, as far as the FATF is concerned there are a number of ways in which they can engage with an issue such as this. First of all it would be unfair to say that they are not capable of moving at relative speed to identify threats and deal with them, but if you take something like the Somali pirate issue the first thing is that a lot of what the FATF does depends on being able to engage with a country that has some sort of structure with which you can interface and try and progress issues. You have said what the state of affairs is in terms of the government and governance of Somalia, so by that standard it is quite difficult for the FATF to find the right people to engage with in terms of the public authorities. The second thing is that, linking back very much to the previous question and answer, the question that the FATF should be going through – and I am sure it is – is to ask whether this activity mean that Somalia should be added to the list of territories which require governments and financial institutions to exercise heightened due diligence or whatever other counter measures. I do not know, because I am not there now, what discussion if any there has been to establish how Somalia ranks alongside these other territories and whether it should be brought to attention as a country that people should be wary of dealing with, although I suspect that everybody knows to be wary. The other way that the FATF could get into this sort of topic is through typology work and if it was thought that light could be shed on piracy and the flows of money out of pirates as a generic topic then that is the sort of case study that the FATF can usefully do, but that is obviously a slightly longer range activity and I do not have a particular view as to whether looking at piracy would be useful for the FATF to lead work on, but clearly they could get into it that way. Stepping back from that, this seems to me to be much more a

question of intelligence operations to try and get at where the money is flowing, for which the FATF on a month by month, year by year basis has no particular locus.

Q419 Lord Hannay of Chiswick: Yes, but national governments do of course.

Sir James Sassoon: Indeed.

Q420 Lord Hannay of Chiswick: And the EU of course does in applying its directives; and that is one direction in which our enquiries are going, not so much in the direction of FATF, though I do think it is surprising that you have a FATF communiqué issued quite recently that had a whole long list of problems for people to be aware of and there was not a cheep about this. As you yourself suggested in your first response that was something they could have done, which was to say watch out, this is an area where money is being laundered. And the evidence we have had so far from the British Government is quite the contrary, they actually told us they would not pursue anyone who did not file an SAR in the context of a payment that was being made that might end up with the pirates in Somalia.

Sir James Sassoon: These are all questions that are well worth asking. I am sorry that I cannot really help you very much.

Lord Hannay of Chiswick: You have actually helped quite a lot by your response; thank you very much.

Chairman: Lord Marlesford on this point?

Q421 Lord Marlesford: It is on a rather similar point, my Lord Chairman. It does seem to me, listening to the dialogue today, that an area where there could be a very useful role for FATF is that the IMF and the World Bank in deciding what help to give to countries whose financial governance is badly lacking could take into account the reports of FATF because

that would enable pressure to be put on those countries to put their house in order. Does that happen at the moment?

Sir James Sassoon: I am sure it does actually. As part of the IMF and World Bank's broader support for countries that they are engaged with, whether through direct lending support or through technical assistance programmes, they are pretty good at picking up on issues that come out of this area, so I would be reasonably confident that they do cover that one.

Q422 Lord Marlesford: If it were publicly known that particular countries were failing in this way and they were countries where one is constantly hearing about the diversion of international funds intended for the relief of poverty for very different purposes – if it could be publicised this would be not just good publicity for FATF, which I am not particularly interested in, but it would be a means of putting pressure on countries which do misbehave in a big way – one is thinking I suppose in particular of some African countries where there have been notorious accounts of major embezzlement of funds intended for its citizens.

Sir James Sassoon: My impression is that indeed the IMF and the World Bank do link concerns in this area through to the broader programme of work to support countries to reform their governance. I am sure there is more that can be done but they make every effort they can.

Q423 Lord Faulkner of Worcester: I am afraid I am going to continue with the slightly negative tone as well. I just wonder whether you would agree that in the 20 years of FATF's existence it has not really achieved very much in terms of countering the financing of terrorism or indeed money laundering if you judge that by the number of convictions secured and the quantity of criminal proceeds confiscated. Do you think it could have done better and do you think it will do better in future and, if so, what ought to bring about the change?

Sir James Sassoon: It is a perfectly fair question and implied or actual criticism. In my mind it gives rise to a number of issues for the FATF. First of all, frankly, the data in this area as in so many others is so patchy that it is very difficult, even if you can take a snapshot in time, to be able to get sensible data of the progress of effectiveness across a whole number of measures, of which you have referred to a couple; it is enormously challenging. The first thing is that there needs to be much better measurement over time, and tracking of such data as there is, to see how progress is being made, and then, of course, linking that to questions of which steps that have been taken or need to be taken in the future are the ones that are likely to deliver the best results. I am not remotely an expert on some of the areas that I know you have been discussing which are international co-operation on confiscations, on mutual legal assistance and areas like that where there is, I am sure, extremely practical and critical work to be done, some of which the FATF can do and some of which is for other groups to carry forward. Part of the answer to this is to get bodies like the new public-private sector funded International Centre for Financial Regulation in the UK , set up in the last year by the Government and the banks, to put on its research agenda some very practical issues like this to actually see what the way forward is. You are absolutely right, but there is not at the moment a proper road map forward.

Q424 Lord Hannay of Chiswick: I wonder if you could just comment at the end – this is the last of our questions – whether there are any other major challenges presently facing international efforts to combat money laundering and the financing of terrorism, and perhaps within the scope of that you could just offer us a comment on the Hawala system and whether or not that is in any sense a weakness in the present systems. We have found that the British authorities seem to be very aware of the Hawala issue and believe that it does not represent a real problem because the Hawala operators in this country are regulated. When we went to

Brussels we found a complete ignorance of the practical existence of Hawala, despite the fact that it clearly does exist in quite a large number of other European countries too.

Sir James Sassoon: It is interesting and anticipating this question I put down four thoughts of things that we might not otherwise have covered. These are things that we have not covered, so not necessarily the most important things, but I did have the law enforcement and effectiveness co-operation issues down as one of them and actually the last one I had was Hawala because I do think that informal money flows are a critical component of what makes economies and has made economies flow in parts of the world for many centuries. There is a very difficult ongoing tension between saying that informal money flows have to be subject to Western-style regulation on the one hand but on the other hand to be sensitive to long traditions of informal flows of money. These are not used to by-pass Western-style banking systems in order to avoid scrutiny; the original purpose of them was because in the absence of good banking systems this was the traditional way that money flowed and it also happened in different ways in Europe until relatively recent times. It is an ongoing tension and you see countries like the UAE where the central bank governor has made very significant attempts to get discussion and debate around what the methodologies are to reconcile the irreconcilable. Frankly, this is going to be a 50-year challenge which is only going to get resolved finally when more sophisticated banking systems come into less developed parts of the world or parts of the world that to a certain extent do not, for understandable reasons, want to lose their traditional approaches. Absolutely it is a big issue and it cannot be resolved quickly. There are two others I would quickly draw attention to. One is an issue you very well understand but is always worth reminding ourselves of, that on terrorist financing the challenge is the needle in the haystack. The fact is that the direct cost of the 9/11 operation is estimated at no more than half a million dollars, the 7/7 bombings in London were a few thousand pounds direct cost, so one has to be very realistic about the linkages between money flows and

terrorist outrages, and there is a lot more to be done to think about that. The last general area where we are only beginning to scratch the surface is what more can and should be done on the electronic filtering of data that is flowing around both the private and public authorities' systems. This is both a question of technical challenges, of the costs that are being incurred, the civil law and liberty issues that are implied by what is going on. There is a whole host of issues here and the world is only beginning to understand what can be properly extracted by sophisticated electronic filtering that might drive forward the effectiveness in this whole area of policy.

Q425 Lord Avebury: I just wondered where there was any particular reason why you had not mentioned the International Co-operation Review Group in answer to this question or the previous question of Lord Hannay about piracy because it seems to me that there is a severe deficiency here in both these sectors, in terms of informal money transfers and the leakage of very large sums of money to pirates, in the weaponry that we have got to combat ML and CFC. Is that not precisely what the ICRG's is attempting to address?

Sir James Sassoon: I did not name the ICRG as part of the process but when I said that the FATF would be looking, should be looking – it may well be looking, I do not know, because they do not publish the discussions of the ICRG – at whether a country like Somalia presents a risk that needs to be highlighted, it is the ICRG which is the working group that would be doing that. It may well have been looking at it, but it only publishes, quite rightly, its outcomes when it decides that it is appropriate to do so.

Chairman: Sir James, that brings our session to an end. I have to say and to put it on the record that the Committee was extremely disappointed and really very surprised when we discovered that the FATF do not go and discuss matters themselves with Parliaments; even the United States Congress fell foul I understand of that. That is as it may be; we have had, as I referred to earlier, a written report from FATF and you have been more than kind in coming

here and being very frank with us indeed. Those two together go a long way to giving us the answers that we might have liked to get direct from current management of FATF. We are extremely grateful to you, you have given us a fascinating session and we appreciate the fact that you have come to talk to us. On behalf of the Committee, thank you very much.