

THE BROOKINGS INSTITUTION
Dollar & Sense Podcast
How will the UK use financial sanctions in a post-Brexit world?
Tuesday, February 18, 2020

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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast, Dollar & Sense. Today my guest is Tom Keatinge, Director of the Center for Financial Crime and Security Studies at the Royal United Services Institute in London. Before joining the think tank world, Tom spent 20 years working on capital markets at JP Morgan.

Our main topic is going to be financial crime and financial sanctions, but I also want to get into the general question of how the UK's financial regulation is going to change now that Brexit is real, now that the UK is leaving the European Union.

So, welcome to the show, Tom.

KEATINGE: Thanks for having me and thanks for reminding me that Brexit has now really happened.

DOLLAR: So I'm going to start with a very specific financial crime question that I'm interested in, which is, namely, how the DPRK, North Korea, funds itself. There seems to be very tight sanctions on DPRK. That's a key part of the U.S. strategy, together with allies like the United Kingdom. But my casual impression is the North Korean economy is doing okay. And, in particular, the elites seem to be doing fine.

So how do they fund themselves?

KEATINGE: Well, it's a good question. It's obviously a question that the panel of experts at the UN is constantly reviewing through its six monthly reports. But one of the things I like about my new role is it actually allows me to use some of the skills that I developed at JP Morgan over 20 years. And in particular, the question of financial engineering. And I think if you look at the way in which illicit finance in general operates, but North Korea in particular, there is some tremendous skill in financial engineering, whether in the real world -- so through the movement of funds via ledger accounts, by raising money in one part of the world, spending it in another part of the world, and the benefit flowing back to North Korea -- or increasingly, in the online world -- so the hacking of cryptocurrency exchanges.

I think we see increasing evidence of North Korea opening a very effective fundraising front in the online world. And actually sanctions aren't really helping plug those gaps.

DOLLAR: Can you give us a sense of how this sanctions cooperation works among major financial centers? So we talk a lot about the need for New York, London, Hong Kong to coordinate, so how does that actually operate on the ground?

KEATINGE: So it's clearly the case that when it comes to developing an effective sanctions regime, coordination is what's required. So sanctions at a UN level are of course the most comprehensive and in theory should be implemented by every country around the world. They are international law. Obviously, at a UN level there is not nearly as much agreement as there has been in the past -- very difficult to pass sanctions at a UN level and so, of course, then you are left with bilateral - - so between the EU and the U.S., for example, or just the U.S. taking the lead on sanctions. But I think we often forget that there's another party in all of this sort of sanctions discussion, and that's the private sector, and in particular the financial sector.

So if you're a big global bank, it may well be the case that one country -- let's say the United States -- has put in place sanctions, but you're operating around the world and you don't want to fall foul of those U.S. sanctions from OFAC. And so inevitably, when you are operating in Hong Kong or Singapore or London or Frankfurt, you're going to have one eye on what does the United States expect of me. Even if the country you're operating in, even if the Singapore government says just look at UN sanctions and just look at Singapore sanctions, you as a bank operating in Singapore that also has operations in the United States, will pay close attention to what OFAC is saying.

So, as a result, there is a form of coordination around the world, particularly between financial centers, because the banks that operate in those financial centers have to give an eye to the sanctions that are being issued by the U.S. or the EU or the UK, or anyone else.

So I think that's the first thing. I think the second thing is that there is increasing

understanding between financial centers that they can be arbitrated. So if center A is not adhering to the same standards as center B and center C, then center A will end up being the route through which the money flows if we're not careful. So coordination between countries is absolutely critical, even if they're not necessarily signing up to the same sanctions regimes.

DOLLAR: So listening to you, is it the case that the compliance with these sanctions is putting a pretty big cost or burden on financial institutions?

KEATINGE: It puts a tremendous burden on financial institutions. And one of the burdens comes from the fact that sanctions are becoming increasingly difficult to implement. So if you remember back in the day, everyone was concerned about dumb sanctions because they were embargoes against the whole country. So, for example, the original sanctions against Iraq and everyone said, no, no, we need smart sanctions, we need sanctions that target individuals or specific companies. But what we're finding is that we're moving back towards the dumb sanctions era. So you've got sectoral sanctions, you're just saying sanctions against the Russian oil industry or sanctions against the North Korean seafood industry. And so for a financial institution that's very challenging because you're not just being told sanctions against Tom Keatinge, sanctions against David Dollar, you're being told sanctions against an expanse of companies.

So it's very complex and you will hear policy makers often say we quite like the ambiguity because it means that the sanctions spread further than perhaps we anticipated, and that's fine by us. The ambiguity is something that policy makers like, the private sector absolutely hates.

MR. DOLLAR: Right. It seems like the specific sanctions naturally spill over into general sanctions.

KEATINGE: That's right.

DOLLAR: My sense is there are certain transactions, at least up until recently, with Iran that were legal, but firms would just stay away from these because why take a chance at getting the U.S.

regulators on your back.

KEATINGE: Yeah, 100 percent. And you see that very clearly in the comments made by foreign minister of Iran, the president of Iran. You know, they expected -- when the JCPOA was signed, they expected suddenly that there would be immense economic activity, at least between Europe and Iran, but that has never materialized. And what little did come through was clearly knocked off course by the withdrawal of President Trump from the JCPOA.

So there's no doubt that the private sector does not just look at the black and white word on the page, the private sector thinks about the broader implications of what could happen if you happen to get your fingers caught in a sanctions regime that you're not necessarily meant to be complying with, but there could be knock on effects.

DOLLAR: The United Kingdom recently decided that it would let the Chinese company Huawei have some role in the development of 5G in the United Kingdom and the U.S. has been going around trying to encourage allies not to involve Huawei. So is this going to complicate security cooperation? Is this an important issue?

KEATINGE: That decision came at a very, very tough time for Boris Johnson because the UK is obviously cutting itself loose of its ties of the European Union, but it's obviously trying to cozy up to other countries thinking about future trade deals and all of that. So that decision I think was as much about the British government setting an early tone for how it's going to operate as an independent country as it was about Huawei itself.

And so when you hear the prime minister talking about his desire to do great trade deals, there have been encouraging noises coming from the White House about future trade cooperation between the United Kingdom and the United States, and then to have to make a decision, which he clearly thought that that was the right decision, to allow Huawei some access to the 5G network development in the UK at a time when he's trying to demonstrate to the U.S. that we're going to be great partners, is a

big challenge for Boris Johnson.

On the flip side, he clearly was very, very sensitive to the charge that was laid against, for example, Tony Blair, that he was, you know, the poodle of George Bush back in the day. So the last thing Boris Johnson wants to do is to be accused of, if you like, managing to free himself of the European Union only to immediately tie himself to the United States. And then you combine that all with the possibility that at some point down the line the President might make a tweet reference to Huawei at a delicate moment in trade negotiations. I think we will see the Huawei decision of Boris Johnson come back, no necessarily to haunt Boris Johnson, but certainly it will play a role in the future trade negotiations between the United Kingdom and the United States.

DOLLAR: President Trump has been pretty enthusiastic about Brexit, and some members of his administration, but it seems intuitively this has to complicate the U.S. developing these so-called like minded coalitions to deal DPRK or Iran now. UK is an independent player. It just has to make it a little bit harder, right?

KEATINGE: Yeah. The UK faces a tremendous challenge. One thing you hear regularly in the United Kingdom, this whole concept -- well, two concepts. One is global Britain. What does that mean? There's big discussion, what does global Britain mean -- different people have different views -- and also the importance of kind of UK values. Actually sanctions will play a role in all of that. And I think what the UK is trying to do is to develop an identity. It's weird to sit here as a British citizen and so oh, we're trying to figure out what our identity is. I mean we've been around for a long time as a country, you would have thought we would have figured that out by now. But actually there's a big debate amongst policy makers on Whitehall, but just amongst population at large, what does it mean to be British these days in a post Brexit world.

And so I think all of this discussion about future trade relationships, about the future use of sanctions, how is the UK going to demonstrate that it's different and that it's still a global player and can

be taken seriously on the global stage.

And as I say, the Huawei decision just came at a terrible moment. The timing was appalling, but I think it set the tone for future discussions with the United States.

DOLLAR: All right. So let's dig into that a little bit deeper, because that was one of the main justifications for Brexit. Now, the United Kingdom can develop its own regulations separate from the European Union and we're focusing particularly on financial regulation, financial sanctions. I mean what concretely can the UK do differently in the area of financial sanctions, for example?

KEATINGE: So the first thing to say is that the government is very clear that it will use sanctions as a way of demonstrating what the UK stands for on the global stage. So we hear a lot from the current foreign secretary, Dominic Raab, about using sanctions to demonstrate British values and in particular as it relates to human rights abuses. We have now the facility in law to implement Magnitsky style sanctions -- as you call them here -- and as have been promoted around the world by Bill Browder. So we have that opportunity in law in the UK and I think we can expect to see the UK implement human rights sanctions quite quickly. And whether that will just be following the lead of the United States -- obviously the United States has issued a lot of sanctions under its global Magnitsky program -- whether it will reflect perhaps a focus on parts of the world where the UK is more active -- historically is more active than the United States -- remains to be seen. So I think we'll see the UK try and demonstrate what British values mean through the use of sanctions.

The European Union is also moving in that direction, but the European Union has to get the consensus of now the 27 member states before implementing sanctions, and that's like herding cats. And with the UK out of the room decision making in Brussels might actually now be even slower, because I think everybody acknowledges that the UK was the driving force behind sanctions decisions in Brussels. So I think we'll definitely see some divergence there.

And then on your point about regulation and so on, obviously I just have to look in my rolodex

and the number of former investment banking colleagues whose addresses I'm crossing out London and I'm writing in Paris or Dublin, just goes to show to me that whilst there isn't a mass exodus, there is definitely a direction of travel in terms of where people will be based because of the fact that London is now outside the European Union and the regulatory umbrella that comes with that.

KEATINGE: What you were saying about bringing the human rights element into the sanctions, I think that's quite interesting. I didn't know that debate was going on in the UK.

Historically, obviously, the UK has played a very important role in greater China, if you're thinking about Hong Kong or UK's traditional role in Tibet. Has there been any talk about using sanctions concerning some of these Chinese human rights issues?

KEATINGE: From opposition MPs and certain MPs in the House of Parliament, yes, we should be doing that. It's not something that has been specifically suggested by the foreign secretary so far. I think they will stick to the easy decisions. Again, this reflects the challenge the UK faces. You know, there's a risk that you get accused of a double standard. So you're happy to sanction people from a country in Africa which has no bearing on the United Kingdom, but you're going to turn a blind eye to whatever's going on in bits of China where there are clear human rights abuses taking place. And this is the challenge that the prime minister and the foreign secretary face, is how do you avoid being two-faced. I don't think they have an answer to that yet. I think they're going to play it cautiously to start with and, as I say, follow perhaps some of the sanctions that the United States has put on through its global Magnitsky regime.

DOLLAR: Right. It seems like Boris Johnson is really going to be walking a knife edge there. If he's trying to develop more of a robust economic relationship with China and he wants to have more of a robust economic relationship with the United States, that's going to be difficult in this world we're living in right now.

KEATINGE: In recent years the UK has done a good job of navigating that very narrow margin

and trying to be everybody's friends. So if you recall, I think the UK was one of the first countries to back the Asian Infrastructure Investment Bank. And that was not popular on this side of the Atlantic. So, you know, I think it's not beyond the UK to play that role. I think the UK's diplomatic prowess is widely respected. So I suspect they'll find a way of playing that role, but they're trying to play that role at a time when they also want something from other countries. And I think that's something we have to remember, they want a trade deal with China, they want a trade deal with the United States, they want a trade deal with the European Union. And those three positions are not synonymous with each other, and therefore might it make things more difficult.

It's worth recalling -- it's not that long ago -- some people might remember David Cameron, our prime minister, who chose to call the referendum that led us to where we are today. But of course he met with the Dalai Lama and the UK was put on the naughty step by the Chinese for quite some time as a result of just that meeting. So if you imagine that the UK starts sanctioning people within China, you could see where that might lead.

DOLLAR: You mentioned the Asian Infrastructure Investment Bank. I actually think it was quite a shrewd correct decision on the part of the UK to support that early on. This is the kind of thing the global community wants China to be doing. They are now more than 100 members. U.S. and Japan have really kind of missed the boat in a sense. It's a little late for them to join at this point. So the Bank is really developing pretty quickly, started lending outside of Asia; it's lending in Africa, for example.

So I think that was a shrewd move.

KEATINGE: Look, I think one has to remember that, as in the United States, the British government is not just whoever happens to be prime minister on any given day. There's a tremendous amount of experience and expertise in the civil service, in the foreign office, in other ministries. And so I think if the politicians are willing to listen to that expertise, then I think the UK will be able to navigate this challenging period successfully.

The concern is that the politicians feel the weight of politics and the need to make decisions that are politically expedient, but might not actually in the long run be the right thing for the country. And I think that's where people would say they're concerned right now.

DOLLAR: Let's move away from the financial sanctions specifically, talk a little bit more generally about financial regulation. One idea about it related to Brexit is that now the United Kingdom could become what some people call Hong Kong on the Thames, so much more open, freewheeling, less regulated financial system, get away from the shackles of the European Union. So is this really a realistic vision?

MR. KEATINGE: I shared a platform with a minister back in November and I mentioned this, you know, are we going to be Singapore on Thames, Hong Kong on Thames, or whatever, and he shut me down immediately and he said the government has made it very clear that that is not their mission.

So one of the phrases of the day in the UK in discussions with Brussels is this whole question of level playing field. So as soon as Brussels feels that the UK is diverging from the standards of the EU, and that divergence is essentially undercutting the European Union, then we can see that will spill over into all the discussions about future trade relations, future deals on services, data access, security, and all these things.

So I think in the near-term we, I think, would expect, as relates to the financial sector, the UK to cruise alongside the European Union. The UK committed to introduce the fifth anti money laundering directive, regardless of whether we had left the European Union when that was introduced this January just gone. So the UK's initial signals when it comes to financial services has been business as usual, we see the importance of remaining aligned with the European Union. And I don't think in the near-term that alignment will be challenged.

I mean, let's remember, financial services and kind of associated services contribute a tremendous amount to the British economy. You would think, looking at newspapers, that the British

economy is built on fish and fishing rights. That's the big area of discussion. That's a fraction of 1 percent contribution to the British GDP, whereas financial services contributes double digits, or close to double digits.

So I think the government will be careful not to kill the goose that's laying the golden eggs. Equally, it will, at least verbally, be saying we're going to do whatever we want. But I think in practice on financial services we will remain pretty well aligned.

DOLLAR: Right. So as you say, it's a very big important sector in the United Kingdom and then must be that much of the exports of financial services goes to the rest of the European Union.

KEATINGE: Yes, it does. That being said, there are EU institutions, like the European Banking Authority, for example, that was in London that's now moved itself to Paris. So, you know, again, unsurprisingly, the center of gravity has shifted away from London. But the dominance of London, I think, means that for time being we can be fairly certain that the UK will stay as closely aligned with Brussels as possible.

Now, the question I think then comes, well, how does Brussels try and, if you like, use the fact that the UK's financial sector is vulnerable, use that as part of the negotiations on issues that Brussels cares about. So I think that's where we'll see some tension in the coming months on trade negotiations.

DOLLAR: I see you mentioned some of your financial sector contacts moving out of London toward continental cities. Is there any particular city that's the big winner here? And just kind of more generally, is this a big phenomenon or this is sort of a small amount of movement to sort of hedge in a sense? The sense I get from you is that London is going to continue to be, in many ways, the dominant financial center in Europe.

KEATINGE: It is. And for all the reasons that the infrastructure is there, the law firms and the expertise is there.

So I think there are three cities that will benefit from Brexit to a greater or lesser extent.

If you take a trip to Dublin, the skyline is full of cranes in the Dublin Docks areas where financial institutions are building new facilities. So my old employer, JP Morgan, has huge operation there. And I would say that's where some of the more payment services, that kind of operational businesses, are moving to Dublin, where they need to be based in the European Union. So I think Dublin will benefit to some degree. Frankfurt potentially will benefit. Obviously, the European Central Bank is there. You know, that's a center of financial power within the European Union. But I think the main winner for the moment is going to be Paris. That seems to be the place where banks are moving, capital markets, units, and that sort of thing. It's barely two hours by train from London, so you can say to your staff, would you mind working Paris during the week, but don't worry, we'll make it convenient for you to still live in Kensington in London and just sort of weekly commute or whatever. So I think for the time being, Paris will be the main beneficiary.

DOLLAR: So listening to you I feel like there's an interesting parallel as in between Brexit and some of the things happening in the U.S. The U.S. has renegotiated these trade agreements with Mexico, Canada, China, et cetera. Most economists, like myself, feel that there's very little beef there. These are trivial changes in trade agreements, and yet the Administration can claim accurately that it's gone out, it's gotten tough, it's renegotiated.

So is that likely what we're going to end up with, rather modest change in terms of London and UK's relationship to the EU and others, but the ability to say we are independent, we're going our own way?

KEATINGE: I think yes, you're right. I mean I think that the label might change, what's in the tin might stay the same. The difference I think in all of this is that the UK is a country of 60 million people and the European Union is, you know, 6 or 7 times bigger than that. So the UK, for whatever you might hear people say, the UK doesn't have the leverage over the European Union in the way the United States has leverage over Mexico, Canada in those kinds of negotiations. I think we may well end up with

something that looks not that dissimilar to what we have now.

One important issue in all of this is that Boris Johnson wants to get all this done by the end of December. And I think a lot of people forget that actually the crunch date for Brexit was not the 31st of January just passed, the crunch date for Brexit is the end of December, because that's the point at which we might face again a no deal Brexit, because if we have no trade deal, then we go onto WTO terms and everything that flows from that.

So there were a number of Brexit MPs kind of crowing on the first of February, you know, oh, look, there are no traffic jams at the ports, you know, no shortage of medicine, blah, blah, blah. It's like well, yeah, but you know full well that that's not the crunch time, the crunch time has just been postponed until the end of the year. Boris Johnson is an opportunist and I don't think that he will want to get to the end of this year and basically deliver a mess to the country. That's not what he's going to want. He will find some way -- and it will be in the European Union's interest as well -- he'll find some way of having some bare bones agreement that kind of kicks the can down the road. And I think we'll be in can kicking territory for a good many years to come.

DOLLAR: I'm David Dollar and I'm talking to Tom Keatinge about Brexit and how UK financial regulation, including financial sanctions and dealing with financial crime, is going to change given Brexit, given new relationships that are developing. So thank you very much for joining us, Tom.

KEATINGE: Yeah, thank you so much for having me. I appreciate it.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of Dollar & Sense every other week, so if you haven't already, make sure to subscribe on Apple Podcasts, or wherever else you get your podcasts, and stay tuned.

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And until next time, I'm David Dollar and this has been Dollar & Sense.