



House of Commons
Committee of Public Accounts

Foreign and Commonwealth Office: Managing Risk in the Overseas Territories

Seventeenth Report of Session
2007–08

*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

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The following were also Members of the Committee during the period of the enquiry:

Annette Brooke MP (*Liberal Democrat, Mid Dorset and Poole North*) and
Mr John Healey MP (*Labour, Wentworth*).

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Emma Sawyer (Committee Assistant), Pam Morris (Committee Assistant) and Alex Paterson (Media Officer).

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Summary

The United Kingdom retains responsibility for 14 Overseas Territories, 11 of which are permanently populated and which choose to remain under British sovereignty rather than to become independent states. The Territories are a diverse group, including Bermuda, home to 65,000 people and a major financial centre, and St. Helena, one of the most isolated populated islands in the world and reliant on UK aid.

While the Territories are a UK-wide responsibility, the Foreign and Commonwealth Office (“the Department”) is the lead Department for coordinating UK Government policy for the Territories. The Department for International Development (DFID) coordinates development assistance, focusing on the three Territories of Montserrat, St. Helena and Pitcairn.

Assessing and managing the diverse range of risks facing the Territories is challenging. The Department aims to strike a balance between maximising the autonomy given to Territories’ democratically elected governments, and minimising risks to the UK. The UK has dealt with a wide variety of risks and liabilities in the past, including pension liabilities of an estimated £100 million in Gibraltar and emergency aid of over £250 million to Montserrat after a volcanic eruption on the island.

The Department is attempting to increase capacity for oversight of Territories’ financial services industries. However, regulatory standards in most Territories are not yet up to those in the Crown Dependencies.¹ Limited capacity also reduces the ability of Territories to investigate and prosecute money laundering. The Department has written to UK agencies, such as the Financial Services Authority, the Treasury and the Serious Organised Crime Agency, to emphasise the need for their involvement.

The Governor retains responsibility for managing risks such as crime and disasters, yet is dependent on funding being provided from Territory governments. In order to preserve relationships with local governments, Governors tend to rely on their influencing abilities and are reluctant to use more coercive measures to require funding.

Territories have seen improvements in disaster management, but this needs to accelerate as rising sea levels and global warming add to the existing risks from hurricanes and volcanoes. The Department’s programme funds aimed at increasing Territory capacity to meet risks and encouraging sustainable development have been too thinly spread to be effective.

Standards of governance and financial reporting in the Territories are variable and can fall below standards acceptable in UK Local Government. Lax financial management can evade Departmental controls to protect the UK from risk, although there is stronger fiscal oversight of Territories receiving Development aid. The Department also represents the Territories’ external interests. It is continuing diplomatic contacts with Argentina over a lack of air access through Argentinean airspace to the Falklands Islands, and over rights to

1 Jersey, Guernsey and the Isle of Man

fishing licences, an important income generator in the South Atlantic. The Department also maintains that legal costs it has incurred in contesting the right of the Chagos Islanders to return to their homeland of Diego Garcia in the British Indian Ocean Territory are justified.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department and the Department for International Development on the oversight of offshore financial services in the Territories; on the balance between UK and Territory funding and responsibilities; and on governance and management of the Territories external relations.²

2 C&AG's Report, *Foreign and Commonwealth Office: Managing Risk in the Overseas Territories*, HC (Session 2007-08) 4

Conclusions and Recommendations

- 1. The Department has responsibility for managing risks such as crime and disasters, but does not have direct control over funding, which is provided by Territory governments.** The Department should go beyond its usual reliance on persuasion, and be more prepared to require money from Territory governments in areas where the UK has constitutional responsibility. It should also publicise where standards are not being met, better to inform Territory citizens.
- 2. Overall regulatory standards in most Territories, particularly those with smaller financial centres, are poor compared to standards achieved in the Crown Dependencies.** The Department and other relevant UK agencies, such as the Financial Services Authority, the Treasury and the Serious Organised Crime Agency need to deploy their expertise and capacity jointly to manage the risks better, particularly in the smaller offshore centres.
- 3. Territories' financial services lack the investigative capacity to scrutinise suspected money laundering activity fully and Governors have not used their reserve powers to rectify this.** In such a sensitive aspect of the global financial system it is complacent to allow territories for which the UK is responsible entirely to manage the risk themselves. UK technical assistance and advice should be matched by local efforts and funding to drive forward regulatory improvements. The Department and the UK agencies should bring in more external investigators or prosecutors from the UK to bolster capacity until the Territories can be self-sufficient in this area.
- 4. The Department has no dedicated training programme for Governors, despite the special characteristics of the role compared to mainstream diplomatic activities.** The Department should provide all Governors and other key staff with training in the key risk areas relevant to their post, including financial services. Training needs should be assessed throughout each Governor's posting.
- 5. The Department acknowledges that policing standards in the Territories fall short of its expectations, yet has used external inspection by HM Inspectorate of Constabulary on only three occasions.** Territory citizens should not have to accept less efficient use of police resources, nor less professional oversight than citizens in the UK. The Department should lay down the policing standards expected of the Territories, and test whether they are met on a more consistent basis.
- 6. There have been improvements in standards of disaster management, but ten years after this Committee's last report on the subject not all Territories have comprehensive disaster management strategies.** The increased risks posed by climate change and rising sea levels make disaster planning especially important for low-lying Caribbean Territories. The Department, together with the Department for International Development and Territory governments, should draw up disaster management strategies where they do not exist, setting out the responsibilities of each party and the minimum requirements for the frequency of disaster plan tests.

7. **The Department's Overseas Territories Programme Fund has been too thinly spread over too many projects to be effective in increasing capacity or promoting sustainable development in the Territories.** The Department proposes to move to fewer, larger projects in 2008/09, which should have the potential to generate a greater impact. The Department should develop benefits realisation for these projects to verify that they have lasting effect.
8. **The UK continues to subsidise wealthier Territories such as Bermuda and the British Virgin Islands, in the latter case providing over £600,000 of free services each year to regulate civil aviation on their behalf.** Unless there are compelling reasons to the contrary, the UK should charge for services such as aviation regulation where Territories are able to pay from their own resources.
9. **Public accountability in the Territories is difficult to sustain in small communities, and not all Territories have functioning Public Accounts Committees.** In dialogue with individual Territory governments, the Department should also explore how Territories can better use the expertise available in the UK to support the development of their own capability, and whether more use could be made of ex-officio members in individual Public Accounts Committees.
10. **Civilian use of regular military flights between the UK and the Falklands has become vital to the social and economic development of the Islands since the closure of Argentine airspace to civilian services.** The Department, the Ministry of Defence and the Falklands Government have been successful in jointly developing civilian use of these capabilities. As the new operator contract is taken forward, costs, risks and rewards should be apportioned between the partners so that reliable public access to the Islands is provided, and the requirements of all parties (such as a set number of premium seats) are met.

1 The Department's oversight of offshore financial services in the Territories

1. Seven of the UK's Overseas Territories have offshore financial centres, of varying size and significance to their economies.³ Of these, Bermuda, the Cayman Islands and the British Virgin Islands have a high importance in the global financial system. The UK's reputation in the financial services industry is linked to how well its Territories perform against international standards. The Department and its Governors have a key role in protecting the UK from serious reputational risks and possible financial liabilities by ensuring that global standards for banking, insurance, securities and defences against money laundering, to which the UK has signed up on the Territories behalf, are being met. The Department does not have an established financial services training programme for Governors, although it does provide tailored training to new Governors taking up Post, depending on experience and the issues relevant to that Territory.

2. Whilst the UK faces the ultimate risk should any financial malpractice occur, it is the responsibility of Territory governments to develop the necessary regulatory arrangements. The Department believes that, apart from UK encouragement, market forces and the need to get a positive rating from the International Monetary Fund are the most effective incentives for Territories to improve their standards.⁴ Despite this, regulatory standards have not yet reached those attained by the Crown Dependencies across the areas of banking, money laundering, insurance and securities. In Bermuda and Anguilla, anti-money laundering measures were 22% and 25% non-compliant respectively, compared to zero non-compliance in the Crown Dependencies.⁵ As **Figure 1** shows, there is considerable variation between and within the Territories.

3. The Comptroller and Auditor General's report found Territories to be lacking in regulatory capacity, especially those with smaller offshore centres, such as the Turks and Caicos Islands, Montserrat and Anguilla.⁶ As a result, they are increasingly struggling to meet rising international standards.⁷ For these three Territories, the UK retains direct constitutional responsibility for the regulation of financial services. The Department accepts that standards in these Territories need to improve, and is taking steps to drive up capacity: it employs a financial services adviser, based in the Caribbean, and is providing assistance in drafting legislation to allow the Territories to retain and reinvest the confiscated proceeds of crime.⁸ But it is improbable that the deployment of a single Departmental specialist is sufficient to address the scale of the risk.⁹ The Department

3 Bermuda, the Cayman Islands, the British Virgin Islands, Gibraltar, the Turks and Caicos Islands, Anguilla and Montserrat

4 Qq 36, 110

5 Q 104; Figure 1

6 Q 9; C&AG's Report, para 1.32

7 Q 63

8 Qq 8, 73–74

9 Q 40

acknowledged that the Comptroller and Auditor General's report was helpful in giving it added impetus to intensify its efforts in helping the Territories improve standards.

Figure 1: International Monetary Fund assessments regulation of offshore financial services in Overseas Territories¹⁰

	Test assessment results, showing the extent of compliance with global standards	Gibraltar 2001	Anguilla 2003	Montserrat 2003	British Virgin Islands 2004	Bermuda 2005	Cayman Islands 2005	The three Crown Dependencies 2003 ⁽³⁾
		%	%	%	%	%	%	%
Banking	<i>Compliant</i>	73	19	12	36	62	63	63
	<i>Largely compliant</i>	27	33	19	14	38	37	34
	<i>Materially non-compliant</i>		33	54	39	-	-	2
	<i>Non-compliant</i>	-	15	15	11	-	-	-
Money Laundering	<i>Compliant</i>		41	38	53	59	65	81
	<i>Largely compliant</i>		34	28	38	19	29	19
	<i>Materially non-compliant</i>		22	31	6	22	6	-
	<i>Non-compliant</i>		3	3	3	-	-	-
Insurance	<i>Observed</i>	76			76	38	47	70
	<i>Largely observed</i>	18			6	13	18	26
	<i>Materially non-observed</i>	6			18	44	35	2
	<i>Non-observed</i>	-			-	6	-	2
Securities	<i>Implemented</i>	86			25	40	46	81
	<i>Broadly Implemented</i>	14			31	37	19	8
	<i>Partly Implemented</i>	-			44	23	31	11
	<i>Not Implemented</i>	-			-	-	4	-

Source: National Audit Office analysis of International Monetary Fund assessments

Notes (1) The table summarises compliance in six of the seven Offshore Financial Centres. Turks and Caicos Islands were excluded because the International Monetary Fund has not published its detailed breakdown of results. Percentages are rounded and may not always add to 100%.

(2) The smaller centres were not assessed for insurance and securities business.

(3) The Crown dependencies are Jersey, Guernsey and the Isle of Man.

4. Regulators in Bermuda, the Cayman Islands and the British Virgin Islands have achieved major improvements in capacity since 2000, enabled by their ability to levy fees on their growing financial sectors.¹¹ In the centres with a smaller regulatory capacity, the Governor retains more direct powers to intervene. In Montserrat, for example, the Governor has the authority to restrict the development of the financial sector, although this power has not been used for over ten years.¹²

10 The table shows the first round of IMF assessments for each jurisdiction. At the time of this report, the first second round report, for Gibraltar, had been published, with highly favourable results. Assessments in Turks and Caicos Islands, Anguilla and the British Virgin Islands had been deferred at local request, and the reports on Bermuda and the Cayman Islands had not yet been published.

11 C&AG's Report, para 1.32

12 Qq 43, 68–70

Figure 2: Levels of monitoring and investigating suspicious financial activity in the Territories are variable

Territory	Number of suspicious activity reports (2005)	Estimated No. employed in Financial Services	Reports per hundred employed	Financial Intelligence and Investigative capability (1)	Number of successful local prosecutions (2)
Bermuda	380 (2006)	4000	10	11	0
Cayman Is.	244	5400	5	21	2
British Virgin Is	101	1600	6	5.5	0
Gibraltar	108	1500	7	8	0 (1 pending)
Turks & Caicos Islands	17	700	2.4	5	0 (3 pending)
Anguilla	2	200	1	1	0
Montserrat	1	150	0.7	1	0
External benchmarks:					
Jersey	1162	11800	10	22 (2003) (3)	
Isle of Man	1652	7010	24	22	

Source: Summarisation by National Audit Office, and latest IMF assessment reports

Notes: (1) Full time equivalents. Professional staff.

(2) In some cases investigations are ongoing and charges have been laid

(3) Included at the time seven staff seconded from the UK

5. A lack of local capacity has also impacted on Territories' ability to investigate and prosecute suspected money laundering activities. Governors have sought a balance between pushing for more local capacity on one hand and respecting local autonomy on the other. As **Figure 2** shows, the number of suspicious transaction reports across the Territories appears low: Anguilla and Montserrat produced only three such reports between them. The Department agrees that there is a serious risk of money laundering in the Territories, particularly in the smaller Territories which lack the critical mass of regulatory and investigative expertise to follow up these reports. It has written to other UK departments and agencies, such as the Financial Services Authority, the Treasury and the Serious Organised Crime Agency, to emphasise the need for their involvement.¹³

6. The Department was unable to state clearly the comparative advantage which the Overseas Territories used to attract offshore financial business, but cited their tourist infrastructures and low taxation as areas where the Territories are in a more advantageous position.¹⁴ The Department stressed the self-governing nature of the Territories and has therefore accepted their evolution as tax havens as a way to diversify their economies further. However, it has continued to exert pressure on Territory Governments to develop regulatory standards which are the best in the region. The Department for International

¹³ Qq 9, 37, 78, 147-149

¹⁴ Qq 83-84

Development (DFID) confirmed that it was not planning to assist St. Helena in developing a financial centre, but was concentrating on developing it as a niche tourist destination.¹⁵

2 Attaining the right balance between UK and Territory funding and responsibilities

7. Governors' constitutional responsibility for internal security requires them to exercise oversight of Territory prison and police services and prepare them for dealing with natural and man-made disasters. Governors depend on funding being provided from the Territory governments in order to discharge these vital functions. Managing this balance has proved a challenge in the past. For example the prison in Anguilla, although built with UK funding, does not meet minimum standards of security and segregation, and there have been three breakouts, and other serious incidents, in the last two years.¹⁶

8. The Department admitted that there was no easy solution; while it felt that it is right for law and order to remain a Governor responsibility, it ought not to fall to the UK to meet the costs of law enforcement, prison and disaster management agencies in the Territories, especially those which are richer per head than the UK.¹⁷ The onus is on Governors to use their diplomatic influence and their position as head of Territories' Executive Councils to encourage Territory governments to allocate necessary funds to law and order and disaster management. If Territory governments fail to make funds available, Governors have reserve powers to require funding. The Department cautioned that the use of these powers must be balanced against the need to respect democratically elected local governments.¹⁸

9. The UK also has a responsibility to ensure that Territory police forces are fit for purpose. The Department funds a law and order adviser to Governors and maintains a database of retired British police officers to provide advice and expertise to the Territories. It has only used external inspection by the UK HM Inspectorate of Constabulary on three occasions, though as external inspection is perceived as expensive, Territory governments are often unwilling to provide the necessary funding.¹⁹ The Department is not yet happy with the overall level of policing expertise but was reluctant to use its reserve powers to force Territories to fund inspections for fear it might jeopardise good working relations between the Territory governments and the UK.²⁰

10. The Overseas Territories are at risk of natural and man-made disasters. The extent to which the UK could be called on to provide funding for disaster response depends on the wealth of the Territory and its ability to fund any response and recovery for itself. Since the 1995 volcanic eruption in Montserrat, the UK has provided over £250 million in emergency aid, whereas the Cayman Islands met the US\$2.5 billion cost of Hurricane Ivan without recourse to UK financial assistance.²¹ The standard of disaster management in the Territories is improving, but Territories are at very different stages, with some, such as the Cayman Islands and the British Virgin Islands, having more advanced systems. All

16 C&AG's Report, Appendix 3.1, p 43

17 Q 12

18 Q 147

19 Qq 138–143

20 Qq 142–147

21 Q 153; C&AG's Report, Figure 11, p 27; Appendix 3.4, p 47

Territories now have elements of an overall disaster management strategy; however climate change and global warming has exacerbated the risk in low-lying Territories.²² DFID funds a disaster management adviser to support disaster management agencies in the Caribbean. It told us that Territories were exercising plans more regularly and are progressively incorporating disaster risk management into their own planning, though it conceded that the rate of improvement needs to accelerate to respond fully to the increased risk.²³

11. A lack of capacity in-Territory is also a challenge when responding to law and order and disaster risks. Increased cooperation and sharing of resources between Territories has been used to address this, most notably in the recently established legal drafting centre in Anguilla, which will provide other Caribbean Territories with access to legal drafting expertise.²⁴ The Department maintains an Overseas Territories Programme Fund of approximately £5 million, which aims to promote sustainable development and build capacity in the Territories, across all risk areas. So far, the funds have been spread across too many small projects to be fully effective.²⁵ The high number of projects has also made it difficult for Governors' offices to manage and to monitor them. From 2007/08, the Department intends to move to fewer, larger, and more sustainable projects which have the potential to generate greater impact.²⁶

12. Wealthier Territories such as Bermuda and the British Virgin Islands still receive some UK resources, despite their GDP per head outstripping that of the UK. The British Virgin Islands receives £600,000 of free services each year to regulate its civil aviation. Aviation regulation has been successful across the Territories due to ongoing support from the UK Department for Transport and Air Safety Support International, although the Department agrees that, where the Territories can afford it, they should fund themselves.²⁷

22 Qq 32, 33

23 Q 34

24 Q 153

25 Q 112

26 Q 113

27 Q 152

3 Governance and managing Territories' external relations

13. The Territories share the challenge of running a system of government in a small community, where the legislature is made up of a few individuals, and direct personal or family relationships often exist between officials and citizens. There are added difficulties in promoting good governance in such communities, which can result in a weakened ability for the UK to identify potential risks.²⁸ Not all Territories have a Committee of Public Accounts, for example, and some that do exist only meet in private. The rare instances of using ex-officio members in Committees to provide expertise, and the NAO's recommendation that Territories pool their expertise on public accounts, are examples of how more can be done to improve public scrutiny.²⁹

14. The former Chief Auditor of the Turks and Caicos Islands approached the UK's Comptroller and Auditor General about the lack of qualified audit staff and visibility of audit reports, rather than addressing these issues through local channels.³⁰ The reports of the Auditor General of Bermuda also noted that, while the accounts of Bermuda's central government were up to date, other public bodies were five or six years in arrears. And there were delays to the public pension and insurance fund which controls assets of approximately \$1billion.³¹ These standards would not be acceptable in UK Local Authorities. The Department is taking some action, for example, by organising a link between the National School of Government and the Turks and Caicos Islands public service, but it also emphasised that Territories should also be putting in place measures themselves.³²

15. DFID has a good system for monitoring expenditure by those Territories in receipt of budgetary aid. This includes a financial risk assessment every two years, an annual statement of progress, and regular visits by DFID staff.³³ Both DFID and the Department also use an adapted version of the Public Expenditure and Financial Accountancy framework, which was developed by the World Bank. But they do not apply the framework so that they can benchmark Territories against standards elsewhere.³⁴ The Department operates further control through its borrowing guidelines. These aim to protect the UK from Territories taking on too high a debt, which they may be unable to service. Borrowing controls can be evaded, however, by late accounts or subsequent adjustments, causing the UK to make borrowing decisions which might not have been agreed to if accurate accounts had been available.³⁵

28 C&AG's Report, para 2.16, p 30

29 Q11; C&AG's Report, Recommendation 9

30 Q 9

31 Q 88; C&AG's Report, para 2.17, p 31

32 Qq 90, 93

33 Qq 93–95

34 C&AG's Report, endnote 7, p 66

35 Qq 97–98; C&AG's Report, Figures 4, 14

16. Since 2000, the Department has spent in excess of £2.1 million on legal cases contesting the right of the Chagos Islanders to return to their homeland in the British Indian Ocean Territories.³⁶ The Department is now appealing to the House of Lords on three issues: firstly that any lasting settlement of the islands would be precarious and expensive for the UK; secondly that the resettlement of the Islands would pose a security risk to the United States defence base at Diego Garcia; and thirdly whether Orders in Council made by the UK for the administration of the Overseas Territories can be challenged in the UK courts.³⁷ The Department feels that the costs incurred to pursue this case are justified, and noted that the Chagos Islanders had already accepted compensation for their displacement.³⁸

17. The UK maintains responsibility for the external defence of its Territories and their international relations. Since 2003, Argentina has withheld permission for UK charter flights to the Falkland Islands to pass through its air space. This restriction makes the direct military air service provided by the Ministry of Defence via Ascension Island vital for the development of the Falklands. The Falklands Government has raised concerns about the lack of a regular air service and the need for more certain booking arrangements for a business class service.³⁹ A new contract between the Ministry of Defence and the operator, Omniair, began in October 2007. This service guarantees up to 29 seats southbound and 39 seats northbound for the Falklands Islands Government, and 20 commercial seats each way between the UK and Ascension Island. In addition there will be up to 10 premium economy seats available on each flight. The Department is liaising with the Ministry of Defence and the Governments of the Falkland Islands and Ascension Island on negotiations for the future service, including seat costs, advance payment and booking mechanisms.⁴⁰ The Department plans to continue its diplomatic activities to address the air access issue with the new Argentinian President and Government.⁴¹

18. The development and diversification of income streams is important to the development of the Territories. This is demonstrated by the positive impact achieved by the annual £26 million fishing licence income generated for the Falkland Islands government.⁴² After the 1982 conflict, the British Government and the Falklands Islands Government were concerned over the threat to fishing stocks in the waters around the Falklands. After unsuccessful attempts by the UK Government to promote a multilateral fisheries management regime in the South West Atlantic, the UK decided that it had no option but to take unilateral action and announced the introduction of the Falkland Islands Interim Conservation and Management Zone. There is currently no treaty governing fishing on the high seas in the South West Atlantic. The Department is in ongoing negotiations with the World Wildlife Fund, the European Commission and relevant coastal states about a possible resolution.⁴³

36 Q 17

37 Ev 16

38 Qq 17–29, 123–132

39 C&AG's Report, Appendix 3.5, p 50

40 Ev 16

41 Q 115

42 Q 114

43 Ev 16

Formal Minutes

Monday 31 March 2008

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon

Mr Alan Williams

Mr Keith Hill

Phil Wilson

Mr Don Touhig

Draft Report (*Foreign and Commonwealth Office: Managing Risk in the Overseas Territories*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Seventeenth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Wednesday 2 April 2008 at 3.30 pm.]

Witnesses

Monday 10 December 2007

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Sir Peter Ricketts KCMG, Permanent Secretary, Foreign and Commonwealth Office, and **Dr Minouche Shafik**, Director General, Country Programmes, Department for International Development

Ev 1

List of written evidence

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Oral evidence

Taken before the Committee of Public Accounts

on Monday 10 December 2007

Members present:

Mr Edward Leigh, Chairman

Mr Richard Bacon
Mr Ian Davidson
Mr Philip Dunne

Mr Austin Mitchell
Dr John Pugh

Sir John Bourn KCB, Comptroller and Auditor General, **Mr Tim Burr**, Deputy Comptroller and Auditor General, and **Mr Tim Banfield**, Director, National Audit Office, were in attendance.

Mr Marius Gallaher, Alternate Treasury Officer of Accounts, HM Treasury, was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

FCO: MANAGING RISK IN THE OVERSEAS TERRITORIES (HC 4)

Witnesses: **Sir Peter Ricketts KCMG**, Permanent Secretary, Foreign and Commonwealth Office, and **Dr Minouche Shafik**, Director General, Country Programmes, Department for International Development, gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Public Accounts Committee where today we are looking into the National Audit Office Report, *Managing risk in the Overseas Territories*. We are joined by Sir Peter Ricketts, Permanent Secretary, Foreign and Commonwealth Office. Would you like to introduce your colleagues?

Sir Peter Ricketts: I have Minouche Shafik from the Department for International Development with me today at the table and a number of colleagues from our Overseas Territories Directorate, including the Head of it, Leigh Turner, who doubles in a number of roles, including Commissioner for the British Antarctic Territory.

Q2 Chairman: Have we had the pleasure of your company before at the PAC?

Sir Peter Ricketts: No, sir.

Q3 Chairman: I am sorry about that. I hope it is an enjoyable experience for you. I see that the Argentines have a new lady President and there are also reports that the economy may now be overheating. What is the risk, do you think, of Argentina increasing pressure on the Falkland Islands in the foreseeable future?

Sir Peter Ricketts: We do not believe that there will be pressure of a kind that is going to create difficulties in the islands. This is something we shall have to talk to the new Argentine President and her government about but there is a lot of scope and mutual interest in cooperation between us and Argentina on the Falklands.

Q4 Chairman: Can you speak up, please? I did not quite hear what you said. The acoustics are not very good in this room.

Sir Peter Ricketts: I said it will be our intention to engage this new President and her team to show that we have mutual interests in working together on the Falkland Islands.

Q5 Chairman: Do you think that will meet with a positive response, judging by what has happened, say, in the last 18 months?

Sir Peter Ricketts: That is what we will be working to achieve. Now that the lady is in power I think we have every interest in engaging early on with her to show that we have mutual interests here.

Q6 Chairman: Are there any risks of inconveniences being re-ignited to any extent in Gibraltar at the moment?

Sir Peter Ricketts: No, I think things are positive in terms of managing the risks in Gibraltar. As the Report sets out, we have made progress in mitigating a number of the risks, for example, on the Gibraltar pensions issue, and I think after the Cordoba Agreement last year things look more positive now in Gibraltar.

Q7 Chairman: In terms of Montserrat, physical risks there, what do you have in place to deal with that?

Sir Peter Ricketts: I visited Montserrat earlier this year in fact because I was worried about the risk management there. We have put an awful lot of scientific expertise on to the island to monitor the volcano and we have a Scientific Committee that meets twice a year to bring together the best volcano watchers in the world to advise the Governor on what is likely to happen with the volcano. I think it is probably the most observed volcano in the world. There are some pretty careful restrictions in place on the island so that, if there were another eruption, the lava flow would not injure life. Some of those restrictions are controversial on the island because

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the volcano has not actually erupted for the last few years but we are keeping it under very vigilant scrutiny.

Q8 Chairman: Can we look at risks from money-laundering? If you look at paragraph 1.35 on page 23 of the Report under the heading “Limited capacity to investigate and prosecute financial crime is a risk in most Territories”, if you look at the figure there, you can see, for instance, Bermuda, number of suspicious activity reports, 313; estimated number employed in financial services, 4,000; reports per 100 employed, only eight. If you compare that with another example, say, the Isle of Man, you will see reports per 100 employed, 24. It seems that most suspicious activity reports are not being properly investigated, so how can we know whether these territories constitute a significant money-laundering risk?

Sir Peter Ricketts: I share your worry about the risks in the financial services area, the risk of money-laundering on the territories, particularly the smaller territories, who, as the Report describes, do not yet have the critical mass of regulatory expertise to follow up on these reports. What we are trying to do is drive up capacity in the smaller territories to be able to employ more regulators. We have a financial services adviser based in the region whose job it is to go round territory by territory, trying to drive up standards. We are supporting the introduction of legislation in some of the smaller territories that will give them rights to proceeds of crime and to civil recovery so that they have more revenue with which to employ more regulators so that they can follow up more of the suspicious activity reports. I share your concern, Chairman, at the risks here. That is why we have it very much on our—

Q9 Chairman: We are responsible for this, are we not, obviously, if something goes badly wrong? For instance, in paragraph 1.32 on page 21 we read of limited regulatory capacity. This is particularly marked in the Turks and Caicos Islands, Montserrat and Anguilla. Apparently, the Chief Auditor of the Turks and Caicos Islands herself had to come to our own Comptroller and Auditor General to express her concern about what was going on in the Turks and Caicos Islands. Does this worry you, the lack of regulatory activity and capacity?

Sir Peter Ricketts: Yes, it worries me and we are doing everything we can to improve the capacity, as I say, by increasing the revenues that these smaller territories have by giving them advice from the UK. In the light of this Report, Mr Chairman, I have written again to the other Departments concerned, the Treasury, the Serious Organised Crime Agency, and others to reinforce the need for all of us in Whitehall to be doing everything we can to make sure that we are giving these smaller territories the technical assistance they need to keep up to date with developments and to pursue any suspicious activity.

Q10 Chairman: Can you say anything more specifically about the Turks and Caicos Islands? It seems to me one of the problems with these

territories is that they often have very small numbers of people involved in the legislature. People shift from opposition to power and may be investigating themselves almost. Tell us exactly what is happening in the Turks and Caicos Islands and reassurance that you have got a grip there, please.

Sir Peter Ricketts: First of all, the Governor—

Q11 Chairman: For instance, our Clerk has just shown me that on page 32 we see that not all territories have a committee of public accounts or similar scrutiny body. Some that do only meet in private. I am sure many Permanent Secretaries would like us to meet in private or not exist at all, but we do.

Sir Peter Ricketts: Mr Chairman, I am delighted to respond to that. On the question of committees of public accounts, there is a problem in some of these tiny places with tiny legislatures in constituting and having a properly functioning committee of public accounts, and indeed producing properly audited accounts. There is some good practice, even from the smaller territories. I know that Montserrat has introduced a practice of having an *ex officio* member of the public accounts committee who can bring in from the outside some expertise. I think that is something we could do more of around the Caribbean overseas territories. We had all the elected Chief Ministers here for a conference last week and I took the opportunity of going through the Report with them, including this point, and recommending that they think about perhaps a pool of expertise on public accounts that they could draw on so that they do not have to have it all resident on the islands all the time but can draw on it. You referred to the Turks and Caicos Islands. I too am concerned that there is still not enough capacity to deal with the regulatory issues that they face. The Governor is very conscious of that. The Governor himself watches this very closely. We make sure that our financial services, and other, advisers visit regularly. We have organised a link between the public service in the Turks and Caicos Islands and the National School of Government here to introduce public service reform and to make available to them the best expertise we have in the UK to try and improve the capacity on the islands to manage these difficult issues. I think provision of advice and technical assistance is probably the best contribution that we can make, Mr Chairman.

Q12 Chairman: Is there a problem that in these territories the Governor is responsible for law and order but the local government pays for it and there might be a tension there? For instance, we read on page 43 about Anguilla’s prison. It was built in 1996 with UK funding. “However, it currently fails to meet minimum standards of security and segregation. A serious assault led to the death of a remand prisoner in 2006. The prison’s town centre location and its basic perimeter fence enables

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contraband goods to enter the site. There have been three breakouts in the last two years.” How do you resolve this tension? What more can Governors do when they feel that law and order is threatened by under-resource and by local government?

Sir Peter Ricketts: I do not think there is an easy solution because I think it has to be right, Mr Chairman, that the Governor has responsibility in the end for law and order in his or her territory. On the other hand, I do not think any of us would want HMG to be financially liable for all the costs of law enforcement and prison improvement in the islands. They do have their own revenues and, in the end, it comes down to a question of priorities as to how they apply those revenues. The Governor in the first place has the responsibility, I think, to encourage and cajole the local governments to spend the money necessary on police, on prisons, to make sure that there is a properly functioning criminal justice system. I do not think the answer would be to take back—

Q13 Chairman: This has always been a problem, has it not, the fact that the government is responsible for law and order but the local parliament has to pay for it? This is what caused the American Revolution in the first place, was it not? In a tiny scale, you are trying to resolve the same problems, are you not?

Sir Peter Ricketts: Yes, you are. As I say, I do not think the answer is to repatriate the financial responsibility. I think the answer is to make sure that we have proper advice. We have a prison reform co-ordinator resident in Miami who is there to help Governors and governments on what needs to be done. At the end of the day it is a question of prioritisation and I think it is up to the Governor and his Executive Council, his Ministers, to decide on the prioritisation that gives enough resources to law and order.

Q14 Chairman: Can I ask one of you—it may be DfID can comment here—on figure 11, right at the bottom, the Tristan da Cunha harbour saga. What happened there? What went wrong?

Dr Shafik: That issue dates from about 15 years ago, when we were asked to look at the harbour and there were modifications made to the original design in response to the local fishing community. They finished it in time for the winter storms. As a result of that the conditions in the harbour deteriorated and they were damaged. I am pleased to inform you though that we have now got agreement from the Royal Engineers, who will be going to repair that harbour in time for the next winter in March.

Q15 Chairman: How many of these places have you been to, Sir Peter, as a matter of interest?

Sir Peter Ricketts: I personally in this job have been to Montserrat so far.

Q16 Mr Mitchell: Can I just ask you about the Chagos Islands? We have a letter from

David Snoxell,¹ who was High Commissioner in Mauritius until November 2004. He questions the expenditure on the lawsuits to keep the islanders from going home. Could you tell us how much these have cost over the years?

Sir Peter Ricketts: I believe we have incurred legal costs of several hundred thousand pounds so far, in the order, I think, of £300,000, from memory.

Q17 Mr Mitchell: The legal costs that have to be paid by HMG were admitted by the FCO to be in excess of £2,171,000. That is in an answer to a PQ. That is substantially higher than that.

Sir Peter Ricketts: That, I think, relates to all the legal costs paid in the successive cases since the year 2000, the costs of the Chagos Islanders themselves. The figure I have here is £1.8 million. That is the total cost of all legal proceedings. My figure, I think, was the cost of our appeal to the House of Lords on this point of law.

Q18 Mr Mitchell: Mr Snoxell estimates the total cost to be in excess of £3 million, not counting the cost of going to the House of Lords, as we now are. Is it justified to spend this amount of money?

Sir Peter Ricketts: We believe it is.

Q19 Mr Mitchell: Why?

Sir Peter Ricketts: For two reasons. First of all, there is a very important point of law here on whether the Government can make laws for the overseas territories by Order in Council or not and, if not, then there are serious implications for the governance of the overseas territories.

Q20 Mr Mitchell: Is it not a daft legal position that Orders in Council cannot be subject to judicial review? Surely they must be subject to judicial review.

Sir Peter Ricketts: The Government’s position is that, if these types of Orders in Council are subject to judicial review under UK public law principles, then there is potential for enormous confusion because they are laws for the overseas territories and they will bind the overseas territories in their own territories, their own parliaments, but not in the UK, but they will bind UK Ministers in the UK. This risks undermining the way in which we have governed the overseas territories using Orders in Council to adopt their constitutions and then for them to make laws. There is a second point as well, which is our defence obligations, since the United States have made clear that resettlement of the islands by the Chagos Islanders would pose security risks to the operation of the base at Diego Garcia.

Q21 Mr Mitchell: That is the real reason, is it not? We do not want to inconvenience the Americans.

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Sir Peter Ricketts: No. There are two reasons. One is that there is a very important point of law here about the governance of the overseas territories. The other is our obligations as an ally of the US for the defence interests of the base.²

Q22 Mr Mitchell: These are more important than the human situation of people who have been taken away from their homes and want to go back there?

Sir Peter Ricketts: Remember also, Mr Mitchell, that we have already compensated the Chagos Islanders and we have already given—

Q23 Mr Mitchell: I do not think you can compensate people adequately for the loss of their homes in this fashion.

Sir Peter Ricketts: They have accepted financial compensation and British citizenship, so all the Chagos Islanders have the right to come to the UK as British citizens.

Q24 Mr Mitchell: So we are going to go on fighting it?

Sir Peter Ricketts: We intend to go on. We have asked for leave to appeal to the House of Lords. We have been given that right of appeal to the House of Lords.

Q25 Mr Mitchell: In November 2000 Robin Cook accepted the judgment of the High Court that they had the right to return. Why did we not adhere to that position?

Sir Peter Ricketts: I cannot speak for the position as it was in the year 2000. All I can do is set out the position that we are in—

Q26 Mr Mitchell: It says here that in June 2004 the FCO overturned Mr Cook's decision. That would presumably be a ministerial decision to overturn a ministerial decision.

Sir Peter Ricketts: I am afraid I do not have the background to that, Mr Mitchell.³

Q27 Mr Mitchell: Perhaps you could tell us. If this is going to be pursued at considerable expense, which must mean economies elsewhere and cuts in posts elsewhere, we would need to know on whose authority it is being pursued and who reversed Robin Cook's decision.

² *Note by witness:* There were three, not two, grounds on which the decision to appeal this case to the House of Lords was based. The first two are set out in the response to Q25-27 below and were the ones we sought to address in the 2004 Orders in Council. The third reason for appealing was the constitutional point, set out in response to Question 132 (Ev 32).

³ *Note by witness:* The two grounds for the 2004 Orders in Council were as follows. First, that HMG had concluded on the basis of the feasibility study commissioned in 2002 that lasting resettlement would be precarious and, if sponsored by the Government, would entail expensive underwriting by the British taxpayer for an open-ended period. Second, the restoration of full immigration control over the entire territory was necessary to ensure and maintain the availability and effective use of the Territory for defence purposes, for which it was constituted and set aside in accordance with the UK's treaty obligations.

Sir Peter Ricketts: I can of course write to you on that point. It is being pursued on the Foreign Secretary's authority at the present time.

Q28 Mr Mitchell: Whatever the estimates of the costs, if they are over £3 million, as suggested here, have we asked the Americans, whose convenience we are protecting, to fund any part of this?

Sir Peter Ricketts: Mr Mitchell, I have not accepted that we are protecting the Americans' convenience. No, I think this is a cost, this is an issue—

Q29 Mr Mitchell: They do not want people intruding on their base, do they, and that is basically what we are defending?

Sir Peter Ricketts: I have said there are two points here. There is a point of law about governability of the overseas territories and there are our obligations to the United States. The answer is no, we have not sought payment from the US.

Q30 Mr Mitchell: Perhaps we should submit a bill to the Americans and they can happily consider paying part of it since they are being so well defended by the Foreign and Commonwealth Office quibbling on obscure points of law about Orders in Council. However, let us pass on. I was surprised: we have obligations to these territories; they are mini-states, most of whom are not going to be able to provide the framework, the apparatus of a big state for themselves, and therefore presumably they need more help. Why are we cutting down our obligations in general to these mini-states which do need the help and support we can provide, and should provide?

Sir Peter Ricketts: The Foreign Office is not reducing the fairly small programme funds that we make available.

Q31 Mr Mitchell: We are reducing funding for law and order, are we not?

Sir Peter Ricketts: I will ask Mrs Shafik to say a word in a moment on the DfID side. We are maintaining our own funding through the FCO's programme funds, which are thinly spread, I accept, across the territories but we try to target them on the places that need them most. I wonder if we could have a word about the DfID programme.

Dr Shafik: In total, DfID and the FCO spend about £43 million a year. Over half of that is DfID funding for the three poorest of the overseas territories, St Helena, Montserrat and Pitcairn. I think by any benchmark we provide what we consider reasonable needs. Just to give you a set of benchmarks, Montserrat we aid at the level of £2,607 *per capita*, St Helena about £3,331 *per capita*. If you look at other countries, for example, the French overseas territories, they support them on the same order of French Polynesia £2,514, the Netherlands Antilles £643, Aruba £242, New Zealand Tokelau £3,352, so we are on the high end of aid levels to our overseas territories.

Q32 Mr Mitchell: Are we helping them with disaster plans? I see from the Report that several of them in fact do not have disaster plans. We have seen the

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effect of disaster in Montserrat. How many do not have disaster plans and why are we not helping them develop them?

Dr Shafik: They all have elements of an overall disaster management strategy and we have been helping them on that. DfID provides a dedicated person who serves all the overseas territories to improve their disaster planning and in every case they are at different stages in the process, some of them quite advanced, like Cayman, and others at earlier stages. We have supported Anguilla building a new disaster office, Cayman has a new agency as of 2006, Turks and Caicos has strengthened its disaster office in the last year.

Q33 Mr Mitchell: At the same time they are presumably becoming more exposed, given climate change and global warming. This surely imposes a need to accelerate the development of disaster planning for all of them.

Dr Shafik: Absolutely.

Q34 Mr Mitchell: Is that being done?

Dr Shafik: I think it is. We are advancing in almost all the cases now. Exercises are more frequent, testing is more frequent and they are incorporating disaster risk management into their own planning functions more actively to take into account the greater risk they may face in future as a result of climate change.

Q35 Mr Mitchell: Let me ask about financial services. About half the tax havens in the world are Crown dependencies. Some of them are making a fairly rich living—Jersey, for instance—out of financial services. What are we doing to ensure the proper regulation of financial services in these dependencies so they do not become tax havens on the scale of Jersey? Indeed, the Cayman Islands are already a tax haven.

Sir Peter Ricketts: We take that very seriously. A number of them do now have significant financial services industries and we have been pressing them very hard through the Governors and in direct contacts with the Prime Ministers and Chief Ministers to make sure that they have the regulatory arrangements so that they can be safe and effective financial centres. I think all the territories understand that.

Q36 Mr Mitchell: It is also in their interests to develop them and to have a lax regulatory regime to attract funny money, is it not?

Sir Peter Ricketts: No, I think it is in their interests to have a proper regulatory regime, to get a proper bill of health from the IMF and the Caribbean Financial Action Task Force.

Q37 Mr Mitchell: Jersey does not have that.

Sir Peter Ricketts: As I understand it, these territories are seeking to be world-class financial centres and a number of them are now very large financial centres and they understand that they need

to have the regulatory underpinning for that. Many of them need our help—I absolutely accept that—which is why we have a financial adviser deployed in the region who is there to help them and to get the best advice we can from the UK.

Q38 Mr Mitchell: They are going to find that difficult when they have not even bred their own auditors, and when we read in the Report that the auditors are subject to very severe social pressures, are inadequately backed, how are they going to develop an effective regulatory regime in a world that is awash with funny money looking for a home?

Sir Peter Ricketts: I do not underestimate the challenge of that. I think in the richer and bigger financial centres, like Bermuda and the Cayman Islands, there is now a well developed financial services regulation function and indeed I think the NAO Report says that.

Q39 Mr Mitchell: I doubt that. Can you tell us that they are not being surreptitiously encouraged to develop this as a form of self-sufficiency?

Sir Peter Ricketts: I can certainly tell you that the Government are not surreptitiously encouraging them to do that. We are encouraging them to be proper, world-class, international financial centres. That is the way to mitigate the risk to the UK, which we do take very seriously.

Q40 Mr Dunne: I would like to explore this a little further. You have mentioned that you have one individual covering the Caribbean to advise on financial services compliance, if that is the right way of expressing it. Do you think that is enough?

Sir Peter Ricketts: It is never enough and the more we can do to provide technical assistance and help to the territories, the better, which is why I have recently written again to the Treasury and the financial authorities here, encouraging them all to do everything they can to work with the various financial centres in Bermuda and in the Caribbean Overseas Territories.

Q41 Mr Dunne: If you look at appendix 4, I have counted a total of 33 FCO members of staff plus four from DfID, two of which are part-time, in post in location for all of these overseas territories, only one of whom looks after financial services. Is that right?

Sir Peter Ricketts: Only one official—

Q42 Mr Dunne: I assume DfID and administrative staff are not involved in financial services. Is it right that only one of the 33 has a focus on financial services?

Sir Peter Ricketts: I think the number that you are counting up includes our Governors and Deputy Governors and UK-based staff in the Governor's offices in the territories.

Q43 Mr Dunne: I think it excludes the Governors. I am counting up the bottom line in the table, so it

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excludes the Governors. It might include the Deputy Governors.

Dr Shafik: We do use external expertise on a regular basis. For example, even in St Helena, which has a very modest financial sector, we are providing advisers to help them write new legislation. In Montserrat similarly the Governor retains special powers to restrict the amount the sector can grow because they have had past problems, and again, we have made external advice available. So the numbers here are really just the officials who administer and oversee but it is not the total pool of expertise that we draw on.

Q44 Mr Dunne: Apart from the physical risk of natural disaster, which is obviously ever present in the Caribbean and in the remoter territories, the reputational risk from financial malpractice is rightly identified in the NAO Report as one of the most serious reputational risks, which obviously affects this country as much as it does those territories, as we have an oversight responsibility, and particularly given that Cayman, the British Virgin Islands, Gibraltar and, to a lesser extent, Anguilla but also Bermuda are increasingly significant players in the offshore financial industry, it would seem to me that the use of the occasional outside consultant and one individual does not begin to address the risks that this country is facing from having oversight of all of these territories.

Sir Peter Ricketts: The first point I would make, going back to the table on page 23 of the Report, is that it is primarily the responsibility of the territories themselves to develop the regulatory arrangements that are necessary. I see Bermuda have 11 people dealing with financial intelligence and investigative capacity; Cayman Islands have 21. The larger financial centres are employing significant numbers of experts to monitor and regulate their own financial services industry, which I think is right. We need to stand behind that. Just to finish my point, the primary responsibility has to lie on the territories themselves. In the larger and wealthier ones I believe that they are discharging that more effectively now and I think the Report bears this out. In the smaller territories I share the concern that the regulatory, anti-money laundering and financial investigative powers are still small and we need to do the maximum we can from the UK to bolster those.

Q45 Mr Dunne: Do you train Governors or Deputy Governors or other in-post staff on financial irregularities and how to look out for them?

Sir Peter Ricketts: That, I am sure, is part of the training that we give Governors before they go out.

Q46 Mr Dunne: Can you confirm that for us in writing afterwards? You say you are sure, but you say it in such a way as to assume rather than to know.

Sir Peter Ricketts: By all means I will confirm that but all Governors of relevant territories are very conscious that the regulation of the financial services industry and the oversight of contingent liability to this country is a very important part of their job.⁴

Q47 Mr Dunne: Can I turn to physical risk? I recall as a schoolboy in the 1970s the Governor of Bermuda was shot and killed. What risk assessment do you undertake for posting people to vulnerable and far remote territories, which in many cases are not accessible by aeroplane in less than 24 hours?

Sir Peter Ricketts: Some of the Governors are in very remote places, I agree. I saw the new Governor of Bermuda today. I did not actually raised with him his personal security but we maintain a watch on the threat, terrorist or other threat, to all our heads of mission worldwide through the joint Whitehall arrangements for threat assessment. That would cover potential threats to Governors in the overseas territories.

Q48 Mr Dunne: Do we have personal security contracts in place in any of these locations to look after our staff?

Sir Peter Ricketts: No, sir, I do not believe so.

Q49 Mr Dunne: Can I ask about the British Antarctic Survey? We continue to lay claim to land in the Antarctic. That is correct, is it not?

Sir Peter Ricketts: Yes, and I believe that all the territorial claims are on hold as a result of the Antarctic Treaty but I believe that the claims stands, yes.

Q50 Mr Dunne: We also have both the Falklands and South Georgia and the Sandwich Islands within our territories. Do we maintain claims over the seas around these territories for mineral extraction rights?

Sir Peter Ricketts: I think I need to write to you with the full details of that. I do not want to mislead you.⁵

Q51 Mr Dunne: We certainly do in relation to the Falkland Islands because it is identified in the NAO Report on page 49. My interest would be in how extensive these claims are in the whole of the South Atlantic area and what we are doing to facilitate exploration of where it is commercially viable. This links into the risks identified by the air access agreements for the Falklands, where it is clear from the NAO Report in appendix 3 that the Falklands government have raised concerns about the lack of a regular service. There is reference to a new service

⁴ *Note by witness:* Financial services training for Governors-designate is considered with the individual concerned in accordance with their requirements, taking into account their experience and skills, and the issues relevant to their Post. For example, the new Governor of Bermuda (sworn in on 12 December) had pre-posting calls on a range of financial services-related departments, agencies, associations and companies in the UK. He also visited relevant experts in Washington and the Cayman Islands, and had extensive consultations with his predecessor and with the FCO.

⁵ Ev 16

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with a civilian operator coming into force from last October. Can you confirm whether that has taken over and who the operator is?

Sir Peter Ricketts: I confirm that it has taken over. I can confirm that it has a premium economy service for tourists and others wishing to pay more to travel with a bit more comfort. I cannot tell you the name of the operator but no doubt I could rapidly discover that for you.⁶

Q52 Mr Dunne: Is that service from the UK to the Falklands and back and that is the extent of it?

Sir Peter Ricketts: That is right.

Q53 Mr Dunne: Could you also let us know the frequency of that and the cost to the Exchequer of underwriting that, if there is a cost?

Sir Peter Ricketts: Of course.

Q54 Mr Dunne: There is a suggestion that it has not been underwritten in the past and it would be useful to know whether we are continuing to subsidise that and whether that might be a fruitful source of encouraging increasing economic self-sufficiency, not just of the Falklands but also the other territories to the south, and whether or not that could then become effectively a profit centre for the FCO to help fund activities elsewhere in the world.

Sir Peter Ricketts: I am always in favour of profit centres for the FCO, Mr Dunne. I will certainly look at that and write to you.

Q55 Mr Dunne: Thank you. Finally, are we going to lay claim to any of the Arctic territory?

Sir Peter Ricketts: I do not believe so.

Q56 Mr Dunne: Do we have any historic claim to the Arctic in view of the fact that our northernmost islands are, I assume, eligible to claim?

Sir Peter Ricketts: I will mislead you if I try to answer that. I will include that in my letter.⁷

Q57 Mr Dunne: It may be a policy issue. There may be some historic antecedents that you could look up for us.

Sir Peter Ricketts: I will cover that in my written response, Mr Dunne.

Q58 Mr Davidson: Can I ask what assessment has been made of the reputational risks to the United Kingdom in view of the fact that so many of the overseas territories are low-tax jurisdictions and established simply in order to offer low tax basically? How does this impact on the City of London and our reputation?

Sir Peter Ricketts: I do not think we have carried out a survey on that point. It goes to the heart of the overseas territories in the sense that these are self-governing territories with their own governments, their own elected legislatures, they make their own rules and regulations, so it is their choice which economic path to follow. Many of them do not have

all that much by way of diversity of their economy. In many of them one single sector of the economy dominates. The Report here makes reference to the narrow tax base and the need for economic diversification in many of them. They choose different ways of doing that diversification and because we want to—

Q59 Mr Davidson: You have presumably condoned over a long period the development of some of these islands as financial tax havens on the basis that it avoided British subsidy to them.

Sir Peter Ricketts: I do not think we have condoned it.

Q60 Mr Davidson: Have you stopped it then?

Sir Peter Ricketts: No. What we have said is—

Q61 Mr Davidson: Have you taken action to stop it at any stage?

Sir Peter Ricketts: No, and I think it would have been—

Q62 Mr Davidson: So if you have not stopped it, you have obviously been happy to see it develop.

Sir Peter Ricketts: We have given these territories autonomy to develop their economies.

Q63 Mr Davidson: That is right. OK. I have had my answer to that. Thank you very much. Can I just ask about this question of weak regulation and the impact upon the United Kingdom's reputation and financial liability if the regulators were not adequate in Anguilla, Montserrat, Turks and Caicos, and we were then sued in some way? There is a wonderful phrase in the briefing that we have been given referring to these three jurisdictions which says that they: "have been increasingly left behind by rising international standards". That basically means they are not up to par. You are condoning that, I presume, by not taking action. Why have you done so?

Sir Peter Ricketts: I do not accept that we are condoning it. We are—

Q64 Mr Davidson: Sorry. Can I clarify that? What action have you taken to resolve it then?

Sir Peter Ricketts: As I have said in answer to previous questions, we are working with the small territories, with advisers based in the region—

Q65 Mr Davidson: This situation exists at the moment. The standards of supervision in these territories are presently inadequate and you are allowing that to continue, leaving the United Kingdom at risk, not only of reputational damage but also of financial liabilities. How long has this been going on?

Sir Peter Ricketts: The risks have been growing as the development of all the territories as financial centres has been growing. That is why we, as this Report indicates, have been working increasingly hard—

⁶ Ev 16–17

⁷ *Note by witness:* The UK will not be submitting any claim to an extension of the continental shelf in the Arctic.

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Q66 Mr Davidson: You are a bit complacent about all this really, are you not?

Sir Peter Ricketts: No, sir.

Q67 Mr Davidson: What are you doing urgently to deal with the inadequate financial supervision in Anguilla, Montserrat, and the Turks and Caicos?

Sir Peter Ricketts: As I have described, we are seeking to develop their own capacity to regulate themselves.

Q68 Mr Davidson: “Seeking to develop” does not give me any smack of urgency, does it? This is a classic Foreign Office phrase: “Some time in the future we might get round to it if we have nothing better to do.”

Dr Shafik: In the case of Montserrat, they did have problems in the late Eighties and early Nineties and the FCO has given the Governor special powers to restrict the development of the financial sector because they judged that their capacity was inadequate. So they have actually frozen the development of the financial sector.

Q69 Mr Davidson: That is good. So it has not been felt sufficiently inadequate in the other authorities to take the same action, so you are happy to condone it there. You must be happy with it because otherwise you would have taken the same action as you have in Montserrat.

Sir Peter Ricketts: I am never happy where there are contingent liabilities of the UK that are not being fully managed.

Q70 Mr Davidson: Why have you not then taken the same action as you have in Montserrat?

Sir Peter Ricketts: Because with all the overseas territories there is a balance to be struck between oversight from the UK and giving these territories local autonomy to run their own affairs. If we kept stopping them and intervening and preventing them from taking action that they ought to to diversify their economies, in a way, that contingent liability to the UK rises in other ways. So it is a balance.

Q71 Mr Davidson: That is true. We might require to give them subsidy, but surely the financial responsibilities that you might be shouldering on our behalf would far outweigh any conceivable subsidy that we might have to provide to these locations given the enormous sums of money that are potentially at stake. I presume your pension is not affected by any of them but many of the rest of ours might very well be. Does that not seem a trifle complacent to you?

Sir Peter Ricketts: No, I do not think we are complacent about this. I think there is a question of scale because the biggest financial risks are occurring in the territories which are more able to fund the necessary regulation. In the smaller territories to which you refer, quite rightly, you point to the risks. We are very conscious of this and we are doing things about them. They are smaller financial centres

and therefore the contingent liability of this country is lower, but it is not negligible and we do take it very seriously.

Q72 Mr Davidson: How do you deal with this unwillingness of the overseas financial sectors to place what they describe as “undue burdens of reporting” upon their clients which they feel might drive them away, while at the same time we have to have adequate standards? There is always somebody providing a lower quality service somewhere in the world but surely we ought not to accept their existence as an argument for second class standards. You have accepted this Report, have you not? This point is made very well, I think, in paragraph 1.33.

Sir Peter Ricketts: Yes, we have accepted the Report. We think this Report is extremely useful and it reinforces our existing view that we have to concentrate on this very hard. We do not want any of these territories accepting lower standards than the best in the region and the best in the world.

Q73 Mr Davidson: They do at the moment.

Sir Peter Ricketts: They can always be improved, and they must be.

Q74 Mr Davidson: Of course they can always be improved. That is a slightly different point though. Some of them do have standards well below—not just below but well below—the best standards elsewhere in the world, and you are condoning that.

Sir Peter Ricketts: I accept the judgement in this Report and I accept the responsibility for us to be very active in dealing with it.

Q75 Mr Davidson: I do not get the impression that you are very active, you see. That is the difficulty. I get the impression that you would much rather it all went away.

Sir Peter Ricketts: I am sorry that I fail to convince you on that point but it is something—

Q76 Mr Davidson: I think I would be convinced by evidence and you have not actually produced any evidence that there is any degree of urgency in your actions in this matter.

Sir Peter Ricketts: I do not believe that is the case. I believe that there has been a lot of activity undertaken to improve the regulatory position of these smaller territories.

Q77 Mr Davidson: Can I come to the question of offshore money-laundering? I see that in paragraph 1.35 and in chart 9 there are very small numbers of successful local prosecutions despite quite a number of suspicious activity reports. Is that because they are just being hyper-cautious in putting forward the suspicious activity reports or is it because they are not particularly active or there is a lack of capacity to prosecute?

Sir Peter Ricketts: I think there is certainly some of the latter. I think there is a lack of capacity to follow up all these cases. I saw the same figures and I was concerned by them.

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Q78 Mr Davidson: What have you done about it since you saw the figures then?

Sir Peter Ricketts: As I said earlier on, the first thing is I have written to other Departments in Whitehall who are experts in this area of financial regulation and international crime, the Serious Organised Crime Agency, for example, urging them to redouble their efforts to help us improve capacity.

Q79 Mr Davidson: That will really terrify them, will it not, the knowledge that there is a letter circulating in Whitehall? It just seems that you are not making much of an effort. Any locals who are involved in money laundering will presumably be known by other people in the islands, those who might have responsibility for taking action, but you do not seem to recognise that that is an enormous inhibitor. Have you considered putting in external authorities, investigatory or prosecution authorities, from the United Kingdom because we bear the ultimate risk?

Sir Peter Ricketts: Yes, and I think that is the sort of issue that we will now be talking to others in London about like the Serious Organised Crime Agency.

Q80 Mr Davidson: Now you are talking about it. It has never occurred to you before then?

Sir Peter Ricketts: This Report has redoubled our efforts on the issue.

Q81 Mr Davidson: So if this Report had not been produced, your efforts would not have been redoubled?

Sir Peter Ricketts: They were continuing but this has been a helpful impetus to us to do more.

Mr Davidson: Most of what we do is for your own good, even though it might not appear that way at the time.

Chairman: You are allowed to smile, by the way.

Q82 Mr Davidson: We will try and stop that then. You are not here to enjoy yourselves, as I am sure you realise. Moving to St Helena, if I remember correctly, Dr Shafik mentioned that you were going to be helping St Helena develop a financial services industry.

Dr Shafik: No. To be honest, we are helping them draw up legislation. They currently do not have a significant financial sector and we do not see it as a major source of comparative advantage for them. We are setting our hopes more on the tourism sector.

Q83 Mr Davidson: In terms of comparative advantage, it is difficult to identify anything that some of these jurisdictions have as a competitive advantage except the ability to have lax standards and low tax. Bermuda and Cayman Islands have now built it up and I can see the comparative advantage there now but some of these others, apart from not bothering too much where the money comes from and not pressing for information on who actually owns the money, what is exactly the comparative competitive advantage of Montserrat, for example, when it comes to financial services?

Dr Shafik: Many of them do have a significant comparative advantage in the tourism sector, which is the fastest growing industry in the world.

Q84 Mr Davidson: Let me stick with financial services. I can understand why you would want to move it on to something else. Let us just deal with financial services. What competitive advantage do they have in financial services in Montserrat?

Dr Shafik: I think not a lot, which is why the Governor has restricted the growth of the industry.

Q85 Mr Davidson: I am sorry. In Anguilla then?

Dr Shafik: Anguilla is not my . . .

Sir Peter Ricketts: The point is that if we have given these territories autonomy of governance, it is really for them to decide how it is that they are going to diversify their economies.

Q86 Mr Davidson: Up to a point, surely, because if this goes pear-shaped, who ends up being ultimately responsible? Not you but us collectively, is it not, really?

Sir Peter Ricketts: Yes.

Q87 Mr Davidson: So we do have a bit of an interest in these matters.

Sir Peter Ricketts: Absolutely. We do.

Q88 Mr Davidson: What concerns me is that, if you look again at paragraph 2.18, about the deficient public accounts, I am surprised to read here that though Bermuda central government departments are up to date, other public bodies had not produced accounts since 2002 and 2003, and then we see the Auditor General of the British Virgin Islands estimates her staffing levels are one third below complement. These are in locations which are meant to be leading examples of financial probity and excellence and yet they cannot actually look after their own books, so what are they doing with other people's?

Sir Peter Ricketts: You rightly point to the need to improve their public accounts and to get more people in to be able to do that.

Q89 Mr Davidson: You are redoubling your efforts, I take it.

Sir Peter Ricketts: Yes, sir.

Q90 Mr Davidson: Have you ever considered putting people directly into these locations? If the Bermuda Auditor General cannot produce public bodies' accounts, is that not an argument for saying perhaps the National Audit Office should be responsible for these locations also? I appreciate that it would be an onerous task for staff of the NAO to go out to these places but, nonetheless, it would ensure a degree of probity and assurance to those of us in the United Kingdom.

Sir Peter Ricketts: In the case of Bermuda, Mr Davidson, they are a wealthy territory and they are capable of improving this performance themselves. I do not think this is adequate performance—

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Q91 Mr Davidson: Why have they not then?

Sir Peter Ricketts: I understand that they are bringing in private sector expertise to improve their record on public accounts.

Q92 Mr Davidson: They have not up to now.

Sir Peter Ricketts: My understanding is that they are now doing it.

Q93 Mr Davidson: This is not acceptable, is it, that public bodies have not produced accounts since 2002 and 2003? That is not acceptable but you have accepted it. You have not done anything about it.

Sir Peter Ricketts: I would say it is not primarily for us to do something about it. It is primarily for the government of Bermuda to do something about it. This is a wealthy territory with resources of their own. I think it is primarily for them to do something about it. I agree that they should and I understand that they are now bringing in additional support from the private sector to do it. I do not necessarily see that it is for the British government to put in people to audit the accounts of the Bermuda government, unless they ask us to.

Dr Shafik: For the poorer territories which we give budgetary aid to, we have quite a rigorous process of monitoring their expenditure, their audit. We do a rigorous analysis with 28 indicators called PEFA, we do a fiduciary risk analysis thoroughly every three years, we do an annual statement of progress on how they are managing their own resources, so we do have a process for the smaller territories.

Q94 Mr Davidson: In paragraph 2.20 it mentions that in some of the small communities, it says here, “the auditors are more directly exposed to pressures from auditees and local interests” and basically it goes on to say, in suitably guarded language, that they are pressed to produce results which are not really justified. Why are you allowing this to take place?

Dr Shafik: We are not allowing it in the places where we are putting UK taxpayers’ money through the budget, where we do our own reviews externally.

Q95 Mr Davidson: What then does overseas territory status mean in these circumstances? Do we have no responsibility for making sure that their books are correct or that their money is not being stolen or anything like that?

Dr Shafik: Yes, we negotiate their budgets every year, we have agreed a set of benchmarks—again, I am speaking for the ones that do not have their own resources and are not responsible for their own economic management. For those we do a mid-year review, we have quarterly visits by DfID staff to make sure they are using their resources properly and we do a full fiduciary risk analysis.

Q96 Mr Davidson: Are you happy with the situation where in the Turks and Caicos the only person in the audit office with any accountancy qualification is the chief auditor? It does not seem to me to be a very professional outfit.

Sir Peter Ricketts: No, I am not happy about that.

Q97 Mr Davidson: So what have you done about it?

Sir Peter Ricketts: For a start, we have our lever with the Turks and Caicos Islands and others of the borrowing guidelines that do not allow them to borrow beyond a certain limit given the risk that debt might also come back to this country as a contingent liability. We have exercised that and we continue to do that. We have required from them regular financial reporting so that we can see the data and we have told them that they need to improve it.

Q98 Mr Davidson: How can you have any faith in the regular financial reporting when they do not have any more than one accountant in their audit department?

Sir Peter Ricketts: The answer is we need to get more auditors and more professional staff—

Q99 Mr Davidson: Redoubling of the effort is being called for, unless I am mistaken.

Sir Peter Ricketts: These are tiny places with small populations and difficulty recruiting the right people.

Q100 Mr Davidson: We would not accept this for a moment in a small local authority in the UK. If we retain the same sort of responsibility for them that we do for local authorities, why are we prepared to put up with it? If we do not have any responsibility, why not just say they are independent? The assumption is that if they are overseas territories and we have given them citizenship, we do expect a certain standard of behaviour and we expect it to be policed by yourselves, who clearly seem to have been asleep on the job.

Sir Peter Ricketts: There is a difference with the local authorities here in the sense that the UK is not funding many of these territories, apart from the two that Dr Shafik refers to. In the territories we are not funding by the UK taxpayer our position is a bit different but I accept that overall, because we have this underlying responsibility and potential contingent liability, we have got to go on improving their capacity. I said in the case of the Turks and Caicos Islands, for example, we have the National School of Government working with them to try and improve the standard of public servants there, we are trying to get more expertise into the public accounts and auditing process. So we are working to improve the capacity but in these very small places it will remain a problem.

Q101 Chairman: You say they are very small places. Bermuda has a population of 63,000, it has a GDP of \$4.9 billion. Their GDP is the first in the world, \$76,000 per head. That is all, by the way, on page 44. If we look at page 29, Sir Peter, you will see that, despite the fact that it is this fabulously rich place, you are giving £338,000 to them. Why? If it is so hands-off, if, as you say, they are small places, they

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run themselves, it rather begs the question why are you giving Bermuda £338,000? You are accepting responsibility, are you not?

Sir Peter Ricketts: My comments earlier on were really in respect of Turks and Caicos Islands rather than Bermuda. It is the very small territories like the Turks and Caicos, Anguilla and Montserrat where there are real capacity constraints which we need to improve. Bermuda I think is a different case, Mr Chairman.

Q102 Chairman: Why is Bermuda still a colony, by the way?

Sir Peter Ricketts: Because this Parliament has given it an overseas territories constitution.⁸

Q103 Chairman: Why are we giving them £338,000 when it has the highest GDP per head in the world?

Sir Peter Ricketts: I think it is the costs of the staff working for the Governor, Mr Chairman.

Q104 Chairman: If it is still a colony, which it is, will you now look, please, at page 22 at the traffic lights there. This is following on from Mr Davidson's question. That is why I am intervening at this point. You will see that some of these territories which you are responsible for perform very badly. There is a large number of red lights. If you look at Bermuda, for instance, money laundering, materially non-compliant, 22%. This is on page 22, figure 8. Insurance, materially non-observed, 44%. If you compare the British Virgin Islands, banking compliance, 36%. If you compare that to the three Crown dependencies, the Isle of Man, Jersey, *et cetera*, they are 63%. They are performing poorly and you, Sir Peter, are responsible for them. There is a large risk involved here and apparently you are asleep on the job.

Sir Peter Ricketts: I would contest that, Mr Chairman.

Q105 Chairman: Why have you got some of these very bad figures and these traffic lights very clearly laid out in figure 8? You can compare them directly with the three Crown dependencies, which generally seem to perform much better.

Sir Peter Ricketts: I raised this with the Chief Ministers who were in London last week for the Overseas Territories Conference. I explained to them that this is not satisfactory as far as we are concerned—

Q106 Chairman: How long have we been running these places, Sir Peter?

Sir Peter Ricketts: A number of them pointed out that—

Q107 Chairman: How long have we been running these places? You raised it last week!

Sir Peter Ricketts: Of course, it has been the subject of continuing discussion but I had the opportunity to raise it again last week.

Q108 Chairman: Are they colonies or are they not? If we are responsible for them, you can see that this record in terms of compliance in money laundering, banking, insurance, securities, compared to the three Crown dependencies, Jersey, Guernsey, Isle of Man, is appalling and you are directly responsible for these places. We are responsible. There is no point shuffling and saying, "Oh, they manage themselves." Why are they still colonies?

Sir Peter Ricketts: We are ultimately responsible for them, Mr Chairman, but in terms of their own economic and internal self-government, they are responsible for themselves and, in a territory like Bermuda, which is, as you say, wealthy, they are capable of pulling these up.

Q109 Chairman: Why are they not doing it then?

Sir Peter Ricketts: I am told they are.

Q110 Chairman: A GDP of \$4.9 billion, a population of 63,000, a GDP per head of \$76,000, yet look at their record. It is appalling! Perhaps some people might say they are taking you for a ride.

Sir Peter Ricketts: I think that actually the most effective pressure on them to improve their standards, apart from our continued encouragement, is market forces. If they want to go on being successful in the world, they need to improve.

Q111 Chairman: It is not working up to now. You think market forces will work. If market forces work, why has it not worked up to now?

Sir Peter Ricketts: I was looking, for example, in the banking column, where I see that Bermuda is actually doing pretty well in this data here. I agree with you on insurance it is not doing adequately and I think it is something that the Bermuda government need to take very seriously.

Q112 Mr Bacon: Sir Peter, I would like to ask you first of all—and in a way it follows on from what the Chairman was saying about the large number of red lights for observance and compliance. In paragraph 2.15 on page 30 it refers to the overseas territories programme fund and it states that of the £11 million spent on overseas territories, just under £5 million relates to this fund, and aside from £1 million to meet international commitments in the polar regions, its aim is to promote sustainable development and build capacity and so on, and there is therefore roughly about £4 million if you leave aside the polar region, £1 million. The second bullet points down it says that there were 118 applications and 65 approved in the most recent year. That works out on average at £61,000 per successful application, which is tiny. It is hardly therefore a surprise that it says there is a burden that Governors' offices are unable to meet in terms of monitoring and keeping track of these. How long has it been like this, with lots of small projects, and how soon is it going to get where the paragraph says you want to get, with fewer larger projects?

⁸ *Note by witness:* In addition to its constitutional status, Bermuda is still an Overseas Territory because a majority of its people has not expressed the wish to become independent.

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Sir Peter Ricketts: Right now we are trying to improve that. I agree with you. I think there are too many, too small projects and that they will be more effective if they can be combined into larger, multi-annual, sustained projects. We are taking that forward now.

Q113 Mr Bacon: So in future, assuming the money stays the same, how long will it be before we see 20 or 15 projects rather than 65?

Sir Peter Ricketts: In the new financial year, with the new spending round starting from April, we are trying to get all our programme funding into fewer, larger, more significant streams. So as from the new financial year I hope you will see that.

Q114 Mr Bacon: Can I ask you about the Falkland Islands? On page 49 it refers to the economic success which the islands have enjoyed since enforcing a 200-mile fishing zone in the mid-1980s. Besides direct economic activity, this has generated annual licensing income of up to £26 million for the Falkland Islands government. This is on page 49. That is by far the biggest slug of income for the Falkland Islands government. Having visited the Falkland Islands myself a few years ago, I can see what difference it is making to their ability to develop infrastructure. I have often wondered—can you explain why it is that the Foreign Office opposed the attempt by the Falkland Islands to be able to license fishing in that way originally?

Sir Peter Ricketts: I am afraid I cannot, no. I can write to you on that. I cannot recall that period precisely.⁹

Q115 Mr Bacon: This is over the page, on page 50, where it says that since 2003 Argentina has withheld permission for charter flights through its airspace. What diplomatic activity has been taking place with Argentina to try and get that decision rescinded so that there can be charter flights going through Argentine air space?

Sir Peter Ricketts: We began the hearing, Mr Bacon, with a discussion of the new Argentine government and we certainly have been trying to persuade them that it is in the interests both of Argentina and the Falkland Islands to open up the islands to charter flights in that way. We have not succeeded yet. We have raised that with them this year and we would intend to raise it with the new President and the new Government as soon as they are in place.

Q116 Mr Bacon: Perhaps I ought to know this. Is there yet a treaty governing the fisheries on the high seas, those outside the exclusion zone? When I visited it was clear that there was a mutual interest for Argentina and the Falkland Islands to obtain such a treaty under the provisions of the UN Law of the Sea. Has progress been made on that?

Sir Peter Ricketts: I believe there is not yet, subject to correction, a treaty.

Q117 Mr Bacon: Is it possible you can send the Committee a note, also stating what activities there have been towards that goal in the last five years or so?

Sir Peter Ricketts: I agree with you about the importance of it and of course we can.¹⁰

Q118 Mr Bacon: Thank you. I would like to ask you about page 26, where it states in paragraph 2.3 that there is an ambition to build up overseas territories as a career specialism or career anchor, whatever that is, and to increase the number of key officials with a background of direct administrative experience in territories, and while this is especially welcomed by territory governments, there is still some way to go. Only four out of 11 Governors had previous experience working in overseas territories. If you go to appendix 4 on page 60 it sets them out. You can see in the second line there: “Governor’s previous overseas territories experience” and quite a few of them just say no, no, no, no, no. If you are interested in improving the quality of administration in the territories, would not a good starting point be to ensure that nobody was appointed to a governorship who did not previously have some overseas territory administrative experience? Would that not be a very easy thing to do? The Governors do not stay that long; they are only there for—how long? Two or three years?

Sir Peter Ricketts: Three or four years.

Q119 Mr Bacon: It would be extremely easy to do.

Sir Peter Ricketts: It would mean we would then have a very limited pool of people to appoint as Governors.

Q120 Mr Bacon: Why?

Sir Peter Ricketts: If you look at the lower item on that table, there are only a very small number of people in Governors’ offices so the pool of people who we are giving experience to in the overseas territories—

Q121 Mr Bacon: Hang on a minute. In Governors’ offices?

Sir Peter Ricketts: Yes.

Q122 Mr Bacon: Surely the person has to have some governmental experience in the overseas territories. They do not have to have sat in a Governor’s office in order to gain experience of government in the Cayman Islands or in the Falkland Islands or Anguilla or wherever, do they?

¹⁰ *Note by witness:* There is no treaty governing fishing on the high seas in the South West Atlantic. The UK has suggested the establishment of a Multi Lateral High Seas Agreement to Argentina many times within the context of the South Atlantic Fisheries Commission (SAFC) but the Argentine side has resisted this. The UK and Argentina last met to discuss the mandate of the SAFC in Buenos Aires in March 2007. There has been some recent World Wildlife Fund (WWF) activity aimed at creating a High Seas Marine Protected Area (MPA). The WWF is discussing its ideas with the FAO, the European Commission and relevant coastal states.

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Sir Peter Ricketts: For diplomatic service officers it is either doing that or serving in the Overseas Territories Directorate of the FCO. We do and have successfully gone outside government to recruit specialists who have had experience. The new Governor of St Helena, for example, was former Chief Secretary in the Falklands, I believe, and where we can use prior experience of the overseas territories, we will but I would not want to exclude others because some of the skills of a Governor are skills that other civil servants, diplomats, or people from other home departments will have. Leadership, influencing, persuading, judgement on financial resources issues—these are qualities that others can have apart from those who have had experience in the overseas territories. I would be reluctant to narrow our pool to that point but I certainly do agree that we should be trying to build on expertise that people have gained when they have been working in or on the overseas territories earlier in their career when we are appointing Governors. I certainly agree with that.

Q123 Mr Bacon: I would like to pursue this point that Mr Mitchell raised about the letter that we had from the ex-High Commissioner of Mauritius about the situation of Diego Garcia. Just to be clear, your position is that you are trying to find out whether Orders in Council are subject to judicial review. That is the thing you are trying to find out—is that right? Is that the purpose of the litigation now, from your point of view?

Sir Peter Ricketts: Whether Orders in Council made to make laws in the overseas territories are subject to judicial review in the British courts.

Q124 Mr Bacon: I understand. Are we really saying we have got to this point without this ever having been tested in court so that there is no clear position on it?

Sir Peter Ricketts: I believe that is the case, it yes.

Q125 Mr Bacon: Even though the House of Lords is for many of these territories the Supreme Court?

Sir Peter Ricketts: Yes.

Q126 Mr Bacon: I have just been sent—and unfortunately I cannot read out the whole thing because it is too long—a note which I asked for from the Library about this, which says—and it is referring to one of the leading textbooks, Bradley and Ewing's *Constitutional Law*, 14th edition—“Some prerogative acts are unlikely to give rise to the possibility of challenge in the courts. For example, the conferment of an honour or the dissolution of Parliament, but where an act purporting to be done under the prerogative”—I take it that Orders in Council are acts purporting to be done under the prerogative?

Sir Peter Ricketts: I understand so, yes.

Q127 Mr Bacon: “. . . where an act purporting to be done under the prerogative directly affects the rights of an individual, the court may be asked to determine a number of issues.” In other words, it is justiciable, is it not?

Sir Peter Ricketts: That is the question we are seeking to establish.

Q128 Mr Bacon: The Foreign Office's position at law, the position you are contending for in the court and will when it gets to the House of Lords, is that it is not even justiciable? I just want to be clear that is the Foreign Office's position.

Sir Peter Ricketts: I am reluctant to go too far down this road in a case which is going to shortly be before the House of Lords.

Q129 Mr Bacon: I do not want you to go into great detail, I just want to ask what is the Foreign Office contending for? You are contending for the notion this is not even justiciable, that is what you are saying?

Sir Peter Ricketts: Not justiciable in the UK courts, because these are laws which apply in the overseas territories and they are of course justiciable in the overseas territories' courts. There is a risk of two jurisdictions coming to two different conclusions on a point of law if it is justiciable both in the UK courts and in the courts of the overseas territories.

Q130 Mr Bacon: Since the Supreme Court is the same in both cases, it seems quite unlikely they would not know what they had done.

Sir Peter Ricketts: I think I have gone as far as I can as a layman in explaining the position.

Q131 Mr Bacon: When are you expecting this to appear before the House of Lords?

Sir Peter Ricketts: I think not until well into next year.

Q132 Mr Bacon: Could you send us a note setting out as far as you can the Government's position?

Sir Peter Ricketts: Of course.¹¹

Q133 Mr Bacon: That would be very helpful. I would like to ask you about pension liabilities. You mentioned them much earlier and I think you said that something had been settled in relation to

¹¹ *Note by witness:* As well as striking down part of the 2004 Orders in Council which prevent the resettlement of the outer islands by Chagossians, the Court of Appeal judgment raises issues of constitutional law of general public importance that, in HMG's view, would adversely affect the effective governance of all British Overseas Territories. This would include confusion in the legal system to be applied in those Overseas Territories, and potential conflicts between local and English courts. For these reasons, in addition to the two grounds given above, the former Foreign Secretary concluded that it would be in the public interest that the Court of Appeal's judgment should be appealed to the House of Lords. We hope that the appeal in respect of this constitutional issue will restore clarity and certainty to the way legislation is enacted—and subject to legal challenge—in the Territories.

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pension liabilities. Plainly if there were any pension deficits presumably the ultimate liability would fall on the United Kingdom, would it not?

Sir Peter Ricketts: Yes, my reference to that point was to the pensions agreement in respect of Gibraltar, the so-called Cordoba Agreement, which drew a line under a long-standing dispute over pensions in Gibraltar.

Q134 Mr Bacon: Does that make for a precedent in other territories, or are there similar disputes elsewhere?

Sir Peter Ricketts: I think this case was unique to Gibraltar.

Mr Bacon: Thank you very much.

Chairman: Mr Mitchell and Mr Davidson have one or two final supplementaries.

Q135 Mr Mitchell: It is a point which springs from my affection for Pitcairn because I have in my possession a tortoise carved by Mr Christian, which was carved especially for me when he sold it, so I have always taken an interest. We have just recently had this complicated and extensive prosecution of islanders, British police were sent out and I think a policewoman was resident there for some time, there was a trial and now five people are in prison for various forms of sexual abuse, which seems to be a way of life on Pitcairn; five out of a population of 45 on the island are now in prison. Who pays for all that?

Sir Peter Ricketts: Who pays for the—?

Q136 Mr Mitchell: For the police going out, the trial, the prosecutors, moving people around, putting them in prison, who pays for all that? It must be a major part of the budget.

Sir Peter Ricketts: Yes, and I believe this led to a position where the financial resources of the territory were exhausted. The FCO has paid for these costs because there was no other source of funding for them.

Q137 Mr Mitchell: Is there now going to be a continuing police presence; are we assuming they are still at it?

Sir Peter Ricketts: I am not informed enough. There is a continuing cost for the imprisonment of these people on the island, I am not aware there is a continuing police cost. It was a very traumatic case for the whole community given the scale of it, as you say.

Q138 Mr Davidson: Can I come back to the question of governors and I want to ask about the efficacy of police forces. Do we have a responsibility for ensuring that police forces in the various overseas territories are fit for purpose?

Sir Peter Ricketts: We have oversight responsibility for them, yes, because the governors are responsible for law and order in their territories.

Q139 Mr Davidson: Can I ask then about the inspection thereof? How do you ensure that the various police forces have got the capability and the levels of personnel and equipment to meet the obligations which are placed upon them?

Sir Peter Ricketts: There are possibilities, for example, for HM Inspector of Constabulary to visit and to examine the state of police forces.

Q140 Mr Davidson: They have only been to three, I think.

Sir Peter Ricketts: That has happened in a few cases. It is expensive and therefore a number of the territories find that a big financial burden.

Q141 Mr Davidson: So it has not been done for financial reasons?

Sir Peter Ricketts: We have not done it in all the territories. We have an adviser who can go out to visit, we have a database of retired British police officers who are available to go out to advise, to be seconded—

Q142 Mr Davidson: Do I take it then that you are happy with the levels of expertise of all the police forces in all the overseas territories at the moment?

Sir Peter Ricketts: No, I do not think we are happy. I think we are always looking for improvement.

Q143 Mr Davidson: If you are not happy, then there is this question of not being particularly active and appearing a trifle complacent, and it just appears that you are condoning behaviour which is not considered acceptable but you are not doing anything about it. That is my anxiety. You have had three Inspectorates of Constabulary visits but all the rest have not had that. Do I take it then that the local governor has a veto or the locally elected members have a veto in some way over whether or not the police should be inspected?

Sir Peter Ricketts: It would be for the local territory government to decide whether they wanted to bring in the Inspector of Constabulary or some other process.

Q144 Mr Davidson: Even though the governor has responsibility for law and order?

Sir Peter Ricketts: Yes, because it is the government to find the money to implement what is necessary.

Q145 Mr Davidson: So if we have a situation where the governor says, "This police force is not up to the job" but the local government decides to do nothing about it, we, you, are powerless, is that correct?

Sir Peter Ricketts: In the first place, it is up to the governor to encourage governments of the territories to prioritise the funds so we can do—

Q146 Mr Davidson: I understand that. If we have a situation where the governor says, irrespective of whatever diplomatic back and forwards we have had, "This police force is not up to the job" and the local authorities/government decide not to do anything about it, what then happens? Is the governor powerless?

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Sir Peter Ricketts: No, he is not powerless because he has reserved powers, as is stated in the Report, to require funding if absolutely necessary.

Q147 Mr Davidson: So the fact these powers have never been used means that the governors in all circumstances are happy in fact to put up with the levels of policing available at the moment?

Sir Peter Ricketts: No, I do not think they are happy, but the governor has to judge, does he want to invoke this nuclear deterrent power of requiring funding from the government, or can he achieve the objective in other ways which are less confrontational in his territory.

Q148 Mr Davidson: Coming back to the question of money laundering and those with investigative powers, we can assume then that the governors in circumstances where they feel these issues have not been adequately investigated, or the capacity is not there, are declining to use the only weapon that is available in their armoury if the local regime does not agree and that is, as it were, the nuclear option? So we have a situation where not upsetting the local jurisdiction is more important than the probity of the financial system, is that true?

Sir Peter Ricketts: That is not how I would describe the balance.

Q149 Mr Davidson: I know it is not how you would describe it; I am asking you whether or not it is true or false.

Sir Peter Ricketts: I do not agree with it and I do not think that is an accurate way of describing it. The governor has to balance—

Q150 Mr Davidson: I understand that. Can I pursue a final point, aviation regulation and BVI, why are we subsidising them to the tune of £600,000 a year when their GDP is as great as that of Britain as a whole and is probably a great deal more than my constituency?

Sir Peter Ricketts: I think the aviation safety arrangements have been a success and I think this—

Q151 Mr Davidson: That is not what I asked, I asked why are we subsidising them.

Sir Peter Ricketts: If I may I will come to that. I think it has been a success, I think we now need to move on from the UK subsidising it to increasingly the funds being provided by the territories themselves and in the case of BVI we should be now moving to the point where they can take over their funding of it.

Q152 Mr Davidson: Why have we allowed to develop a situation where people who are better off than people in my constituency are being subsidised by us?

Sir Peter Ricketts: I think we were right to set up this aviation safety risk management process because one of the biggest liabilities we face would be a major air accident or a major maritime accident. I think it has done a good job, now I think we need to move off funding from the UK and encourage the territories themselves to take on the funding of it.

Q153 Mr Davidson: A final, final point I wanted to ask is in terms of aid to the overseas territories. I am aware that Cayman after Ivan got support from several other jurisdictions, have there been other examples of that? Is that something you are trying to build up so the overseas territories, as it were, pool resources to some extent and work collaboratively?

Dr Shafik: Cayman in fact did not receive aid from the UK after the hurricane because we felt they were well enough off to be able to afford it themselves, and actually they did an excellent job. We do encourage the overseas territories to tap into other resources and the European Union is an important source and pooling resources is something we are looking at. For example, one of the issues in the territories is updating their legal systems and we are funding a shared legal drafting capacity in Anguilla which will serve three of the territories and possibly more in the future, with qualified lawyers who can help them drafting and up-dating their legal systems on a regular basis.

Sir Peter Ricketts: A number of the territories are pooling resources in terms of disaster management, so they can help each other in the event of a major disaster.

Q154 Chairman: I have one last question. I am looking at the map of South Georgia and the South Sandwich Islands on page 57. The Falklands are a thousand miles away, what would you do if an Argentine whaler or business landed on one of these islands and started doing business? It happened before, did it not, in 1982? Would that be your response? Where is the nearest Royal Navy ship?

Sir Peter Ricketts: It might be in and around the Falkland Islands.

Q155 Chairman: A thousand miles away?

Sir Peter Ricketts: I do not suppose it would be closer than that.

Q156 Chairman: You have worked this all out, have you? It happened once before, did it not?

Sir Peter Ricketts: It is a very remote area, Mr Chairman, yes. It would be a challenge.

Q157 Chairman: It would be a challenge. The Royal Navy is up to it, is it?

Sir Peter Ricketts: The Royal Navy is always up to a challenge, I think, Mr Chairman.

Chairman: All right, we will leave it there. Thank you very much for your attendance.

Letter from Mr David Snoxell to Comptroller and Auditor General

My attention has been drawn to the section dealing with BIOT (Chagos Islands) in your Report, *Managing risk in the overseas territories*, at page 27 and at page 40 in Appendix 2. You might just remember that we touched on the issues when you came to my office. I am afraid the wording is somewhat misleading and I thought I should bring it to your attention in case you wished to issue an amendment.

On page 40 (Key developments since the last NAO Report in 1997/8) it is stated, with reference to the Territory (not just Diego Garcia), that: "Successful court rulings and Orders in Council have disputed the right of displaced Chagossian natives to return to the Territory". This is not correct. Only HMG has disputed the right of the inhabitants to return to their homeland. But in November 2000 Robin Cook accepted the judgement of the High Court that the Chagossians had the right to return. Naturally he excluded the US base on Diego Garcia which is the most southerly island of the Archipelago. It is some 150 miles from the Outer Islands, which number between 55 and 65 islands. The exclusion of Diego Garcia is not at issue. Three years and seven months later, in June 2004, the FCO overturned Mr Cook's decision, and the High Court judgement by Orders in Council. At judicial review in May 2006, the High court once again restored the right of Chagossians to return to the Outer Islands. The FCO appealed and lost a third time in May 2007 at the Court of Appeal. What the FCO are now appealing to the Lords over is not the Chagossians' right to return, restored three times by the courts, but whether Orders in Council may be subject to judicial review. They say they need clarification. The Lords have agreed to hear the appeal in the spring on condition that the FCO pay all costs whatever the outcome. That outcome must be fairly obvious. So it is not true to say that the Courts have disputed the right to return, rather they have upheld it.

At page 27 (Illustration of UK risks and liabilities in the Overseas Territories) the legal costs are put at £600,000. Legal costs paid by HMG since 2000 must be in excess of the £2.171 million which the FCO has admitted in answer to a PQ, because that figure does not include the cost of the Appeal so far. It is difficult to get an accurate figure (it depends what you count) but my guess is that the FCO must have spent in excess of £3 million, not counting the cost of going to the Lords. I would have expected the NAO to question the wisdom of this expenditure since posts had inevitably had to be closed to fund it.

It seems to me also that the language used on page 27 to describe the findings of the Feasibility Study has been exaggerated. I don't think the Study added the words: "would involve expensive underwriting by the British Government for an open-ended period, and probably permanently." It looks as if your Report repeated part of Mr Rammell's statement to Parliament on 15 June 2004, rather than the exact words of the Feasibility Study conclusions which Mr Rammell also quoted.

22 November 2007

Supplementary memorandum submitted by the Foreign and Commonwealth Office

Question 50 (Mr Philip Dunne): *Falkland Islands: Continental Shelf*

The UK is currently researching its submission to the UN Commission on the Limits of the Continental Shelf (CLCS) in respect of the Falkland Islands continental shelf. Our plans for submission have not been finalised. The deadline for submission to the CLCS is May 2009. Any UK submission will be strictly in accordance with the UN Convention on the Law of the Sea. An extended continental shelf gives the coastal State sovereign rights over the seabed and subsoil. No such rights are accrued in respect of the water column or fishery resources.

We have had useful contacts on the issue with Argentine MFA technical and legal experts. Meetings took place in 2001 and 2004. In June this year, we proposed a further meeting. If this goes ahead, it will be another example of the UK's commitment to co-operation on areas of mutual interest in the South Atlantic.

The UK has no doubts about its sovereignty of the Falkland Islands/South Georgia—or its right to consider submitting a claim to extend the continental shelf.

Question 51 (Mr Philip Dunne): *Falkland Islands: Air Bridge Contract*

The operator of the contract from October 2007 to September 2008 is a US company, Omniair, who won the contract through an open tender process run by the MOD, and involving the FCO and the Falkland Islands Government in parts of the tender process. Each return flight has a direct cost to the MOD of some £300,000 (for the cost of the charter plus fuel at current prices). The airbridge currently operates three return flights a fortnight, via Ascension Island. It is a military flight run primarily to service the UK military garrison on the Falklands, and the UK military base on Ascension. The MOD funds this service, but in recognition of its vital importance to the social and economic development of the South Atlantic Overseas Territories, it carries a number of fare-paying non-MOD passengers and freight to and from both destinations. The fares charged by the MOD cover the bulk of the cost to the MOD of providing this civilian service (although for children and students discounted flights are currently offered). The MOD guarantees an allocation of up to 29 seats southbound and 39 seats northbound for the Falklands Islands Government,

and 20 commercial seats each way between the UK and Ascension Island. The MOD has responded to a Falklands Islands request and provided up to 10 premium economy seats on each flight. The FCO is liaising between the MOD and the Governments of the Falkland Islands and Ascension Island on negotiations for the future service, including seat costs, advance payment and booking mechanism.

Question 114 (Mr Richard Bacon): *Falkland Islands: Fisheries*

After the 1982 conflict, the British Government and the Falklands Islands Government were concerned at the threats to fishing stocks in the waters around the Falklands, and the need for conservation measures highlighted by scientific studies. The Falklands Islands Government at that time had no control beyond the three-mile territorial limit and were pressing the British Government unilaterally to impose restrictions and a Falklands Islands licensing regime. At the time, the British Government was concerned about the practical difficulties of implementing and policing a regime. In view of the issue of straddling stocks around the Falklands, the British Government preferred to seek a multilateral fisheries conservation agreement sponsored by a UN body. The British Government attempted to promote a multilateral fisheries management regime in the South West Atlantic through the UN Food and Agriculture Organisation (FAO). Unfortunately, this made little headway and the Argentine Government undermined its prospects by signing bilateral agreements in July 1986 with the USSR and Bulgaria, purporting to allow them to fish in Falklands waters. By October 1986, the British Government decided that it had no option but to take unilateral action and announced the introduction of the Falkland Islands Interim Conservation and Management Zone (FICZ). The FICZ, and the licensing regime, came into operation in February 1987.
