SHAH v HSBC – UPDATE

In April, our Compliance and Enforcement team wrote a client briefing on the case of Shah v HSBC[1], which concerns a damages claim brought by Mr. Shah against HSBC ("the bank") for breaches of duty and failure to follow his instructions to process transactions, whilst requests in relation for consent under the Proceeds of Crime Act ("POCA") were pending with the Serious Organised Crime Agency ("SOCA"). In the briefing we focused on the concerns for financial institutions and the duties owed to the client.

The judgment in the case has now been handed down. Amongst the notable highlights are:

1. the court has read in an implied agreement into the terms and conditions governing the relationship between a client and regulated business that a business can refuse to execute instructions in the absence of appropriate consent under s335 of POCA, where it suspected a transaction constituted money laundering. Despite this ruling, we consider it would be more prudent to include specific clauses in terms and conditions governing the relationship with the client, particularly where global transactions are taking place which originate outside the UK but touch the UK, as they may not be subject to the jurisdiction of local courts which may be unwilling to imply such a term.

2. the Money Laundering Reporting Officer ("MLRO") employed a deputy Money Laundering Officer ("MLO") whose duties allowed him to make suspicious activity reports ("SARs") on behalf of the bank. It was gleaned from the evidence that in practice reports would be made to the bank's deputy MLO and he was the one who independently exercised his judgement in relation to suspicion and would make reports if necessary. The Court considered that, irrespective of the job title, where individuals involved in the decision making process submit reports independently, they will also be seen as an MLRO and will be subject to the applicable criminal sanctions. Financial institutions will need to therefore consider the roles of those individuals within its money laundering function and specifically:

    - who within its reporting department will make the final decisions on reports;
    - does this person change dependent on the nature of the internal referral or value of the transaction;
    - have those individuals within the money laundering function had sufficient training to perform their roles;
    - who processes SARs when the MLRO is not available.

[1] Shah and Anor v HSBC Private Bank (UK) Limited [2010].

3. as expected, the case of Da Silva[2], and the test of reasonable suspicion, has been confirmed and the court has ruled out, certainly in the facts before it in this case, the claim of bad faith on the basis that the suspicion was honestly and genuinely held. It is clear that in a prosecution for non-reporting, it is material if a person had a suspicion but nevertheless then changed their mind, as the suspicion is usually the trigger for the report. Here a report was made when there was a suspicion and the court was satisfied that in fact there was a settled and continuing suspicion. It is therefore recommended that an MLRO clearly document the basis for their suspicion and to put those factors into the SAR, to help defeat allegations of reporting in bad faith;

4. the case also highlights the need for an MLRO to be aware of their legal obligations in making a report, to take into account of all information held on the client and to consider whether any answers to simple questions or an investigation might allay concerns prior to making a SAR;

5. the court determined that the causation of the customer's loss, which was very fact specific and possibly unique to this case, was caused, in some part, by government authorities from another country acting in a manner which may not have been lawful. It was also apparent that Mr Shah had failed to mitigate his own losses by not using other sources of funds to pay his debtor;

6. unfortunately, the court failed to answer the question posed by the Court of Appeal: at any point does the risk of tipping off cease sufficiently such that information can be provided by the business. In relation to the linked question of whether, if information had been disclosed it would have been likely to prejudice the investigation, the court placed weight on the fact that an investigation was taking place and that had the bank asked law enforcement for permission to disclose, law enforcement would have been concerned if the client was told. Clearly each case will still turn on its own facts, but the decision confirms that whilst a client does not have a contractual right to demand information about a SAR, there is nothing in this judgement which suggests that business should lie to their clients, send employees on holiday, refuse to answer phone calls or cut off all communication with clients while awaiting consent;

7. finally, the court considered liability exemption clauses were unlikely to have helped the bank had they been found liable because they did not lead evidence as to their reasonableness. We would still recommend that suitable exemption clauses are in place and are drawn to the customer's attention at the time of agreeing to them. Such clauses, together with proper systems and controls, which we dealt with in our previous briefing can help protect the institution.

Clearly, the case highlights the delicate balancing act that banks and other businesses in the regulated sector must perform in evaluating their duties to their customers, the potential criminal and civil liability they face in fulfilling those obligations and the potential for reputational damage.

[2] R v Da Silva, para 16, [2006] EWCA Crim 1654.

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For further advice or information on how reporting obligations might affect your business, please contact Peter Burrell (+44 207 153 1206, pburrell@willkie.com), Rita Mitchell (+44 207 153 1214, rmitchell@willkie.com), David Savell (+44 207 153 1204, dsavell@willkie.com), or the Willkie attorney with whom you regularly work.

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May 21, 2012