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A Troubling Bank Balance — Competing Duties for Banks When Making Suspicious Activity Reports

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Reporting to, and obtaining consent from the U.K.'s Serious Organised Crime Agency does not necessarily protect against the risk of civil action based on a breach of mandate, or constructive trust liability, when banks fail to follow customer instructions.

Unlike in the U.S. and other jurisdictions, U.K. financial institutions and other firms in the U.K. regulated sector not only have to report suspicions of money laundering (including suspicions about their own clients) but they must also seek consent from the authorities to carry out any transactions which relate to the proceeds of the crime. Until a reporting firm receives actual or deemed consent under the legislation, it is not in a position to carry out a customer's instructions without the risk of committing a criminal offense.

The criminal consequences of a failure to report and obtain consent, and the low subjective threshold of suspicion required to trigger a disclosure,[1] under the Proceeds of Crime Act 2002 ("POCA"), have inevitably led to increased reporting by firms to the Serious Organised Crime Agency ("SOCA"). Making a report and obtaining the relevant consents from SOCA

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will generally protect the firm from criminal liability under the money laundering regime ("the regime").[2] However, as this article considers, reporting to, and obtaining consent from SOCA, does not necessarily protect against the risk of civil action based on a breach of mandate, or constructive trust liability, when firms fail to follow customer instructions.

SHAH v. HSBC[3]

The courts have demonstrated a willingness to protect banks from civil actions, which allege violations of the duty of confidentiality and duty of care, by relying on the criminal sanctions which banks face if they do not comply with the regime, specifically highlighting the low level of suspicion[4] which is required before a Suspicious Activity Report ("SAR") to SOCA must be made.

Last year, HSBC ("the bank") was successful in obtaining summary judgment on a claim brought by one of its customers, Mr. Shah, and his wife. In summary, Mr. Shah sought damages for breaches of duty and failure to follow his instructions to process transactions whilst requests for consent under the POCA were pending with SOCA. However, on 4 February 2010, the court of appeal allowed in part Mr. Shah's appeal against summary judgment. The key points from the judgments prior to trial can be summarised as follows:

- The test for "suspicion" remains of low threshold and is subjective.
- Where a firm relies upon having made a SAR and awaits consent from SOCA in defense of a damages claim for breach of duty to a customer, the defendant firm can be put to proof at trial of the suspicion of money laundering.
- A failure to make a SAR sufficiently promptly could give rise to liability.
- Financial institutions will have to consider what duties they have to inform their customers about their affairs. They cannot seek to rely on tipping off concerns once there is no risk of prejudice to an investigation.
- Customers can obtain relevant disclosures from a firm in order to ascertain the reasons for the making of a SAR.

The trial concluded in February 2012 following evidence from the bank's Money Laundering Reporting Officer ("MLRO"), its Nominated Officer ("NO") who was also the head of the money laundering reporting office, and separately, a former officer of the Metropolitan Police.

Banks frequently rely on "tipping off" issues to avoid informing a customer of what is happening on a frozen account. In other circumstances banks wish to explain why an account is frozen but are fearful that such an explanation could give rise to a tipping off offense. The former officer of the Metropolitan Police was asked, during the hearing, to consider thirteen circumstances in which disclosure of information to a client would not amount to prejudicing an investigation. In 10 circumstances he said it would amount to tipping off, namely:

- where a client is told that he is under investigation;
- where a client is told he is being followed;
- where a client is told that his transactions were being monitored by the authorities;
- where a client is told that the decision to remit monies had raised a suspicion that had led to an investigation;
- where a client is told that the reason his account is blocked was a government issue or mission;
- where the client is told that the reason his account is blocked was a statutory obligation;
- where a client is told that there was a possibility for a money laundering investigation;
- where a client is told that they were under investigation by government agencies for money laundering, drug related or terrorist matters;
- where the client is told that the reason his account is blocked was a banking statute, and;
- where a client is told that disclosures had been made under The Proceeds of Crime Act 2002.

In only three circumstances did the officer concede that he could not be sure that the disclosure of information to a client would amount to prejudicing an investigation or tipping off:

- where a client is told that the bank would have a decision in seven days;
- where a client is told that there had been an investigation, and;
- where a client is told that there had been an investigation and he had been cleared.

Whilst the comments of the former officer of the Metropolitan Police should not be taken as general guidance on what does/does not amount to tipping off in any particular case, his comments may assist.

The judgment in the case is expected in April 2012, but whatever the final outcome of the proceedings, 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 liability they face in fulfilling those obligations and potential reputational damage in court (see recommendations below).

FURTHER PROBLEMS — CONSTRUCTIVE TRUST LIABILITY

Reporting to, and obtaining consent from SOCA gives no protection with respect to the risk of constructive trust liability. Indeed, there is a serious risk that, in making disclosures to SOCA, an institution will increase its risk of liability, given that a disclosure will prove the existence of suspicion on the part of the firm, which in turn may assist in proving the existence of constructive trustee knowledge in respect of those funds.

Liability as a constructive trustee can arise in two main ways:

1. Liability for knowing receipt

   A firm can be liable for knowing receipt if (1) a person disposes of assets in breach of trust or fiduciary duty; (2) the firm beneficially receives those assets or assets which are traceable to them; and (3) the firm has knowledge that the assets received are traceable to a breach of trust or fiduciary

duty. The requisite state of "knowledge" is such that it must be unconscionable for the firm to retain the benefit of the property received.[5]

2. Liability for dishonest assistance

A firm can be liable for dishonest assistance if: (1) there is a breach of trust or fiduciary duty, causing or resulting in loss; (2) the firm assisted in that breach of trust or fiduciary duty; and (3) there is dishonesty on the part of the firm. "Dishonesty" takes into account the relevant subjective considerations such as a firm's experience, intelligence, and actual state of knowledge at the relevant time and whether the firm's conduct was objectively dishonest by the ordinary standards of reasonable and honest people.[6]

There has been very little guidance about what an institution should do where it has no grounds for refusing to comply with its customer's instructions (e.g., where SOCA consent has been granted). However, the courts have said (a) that it would be "almost inconceivable" that an institution which takes the initiative in seeking the court's guidance (rather than SOCA's) would subsequently be held to have acted dishonestly, and; (b) that if an institution complies with guidance given by the courts and does not pay the proceeds away (either to the customer or to a third-party account), then the risk of liability is "wholly unrealistic."[7]

There will be many cases where a firm may act on the basis of SOCA consent rather than formal guidance from the court. However, as stated above, SOCA consent will not, in and of itself, provide a defense to a liability claim.

RECOMMENDATIONS

In most respects *HSBC v. Shah* simply confirms the position that an institution is exposed to the risk of a claim if it freezes a customer's accounts. However, the case does not alter the fact that the test for suspicion is low and therefore provided that the institution properly records its reasons for making the SAR, it is unlikely to incur liability. *HSBC v. Shah* in short reiterates the need for detailed recordkeeping.

NOTES

[1] A firm need only suspect that the property concerned is criminal property to trigger its obligation to report, contrary to Part 7 of POCA.

[2] A firm will normally be exempt from breaching any duty of confidentiality owed to its customer by making an authorised disclosure, contrary to s338 of POCA.

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

[4] *See, K Ltd v. National Westminster Bank plc (Revenue and Customs Commissioners and another intervening)* [2006] 4 All ER 907 and *R v. Da Silva*, para 16, [2006] EWCA Crim 1654.

[5] *BCCI v. Akindele* [2001] Ch 437.

[6] *Abou-Rahmah v. Abacha* [2007] J.I.B.L.R.

[7] *Bank of Scotland v. A Limited* [2001] 1 WLR 751, *Tayeb v. HSBC Bank plc* [2004] 4 All ER 1024.