The Civil Law on Money Laundering

Authors:

Joseph Sullivan
jsullivan@2tg.co.uk
+44 (0)20 7822 1273

Robert Cumming
rcumming@2tg.co.uk
+44 (0)20 7822 1228

Introduction

Part VII of the Proceeds of Crime Act 2002 ('POCA') created a number of criminal offences in connection with money laundering. The creation of these offences gave rise to a tension between a bank's duties to its client and its obligations to the state. In a number of interlocutory decisions, the Courts have explored the interplay between these two, often competing interests, culminating in the decision of *Shah v HSBC Private Bank Limited* [2013] 1 All ER (Comm) 72, the first case to address these issues at trial.

Primary money laundering offences

The 'primary' money laundering offences under POCA are set out in sections 327 to 329. All utilise the concept of 'criminal property', which is defined in section 340 as property which (a) constitutes a person's benefit from criminal conduct or represents such a benefit (in whole or part and whether directly or indirectly, and (b) the alleged offender knows or suspects that it constitutes or represents such a benefit. The primary offences are as follows:

- Section 327: concealing, disguising, converting or transferring criminal property or removing criminal property from the UK.
- Section 328: entering into or becoming concerned with an arrangement which one knows or suspects will facilitate the acquisition, retention, use or control of criminal property by or on behalf of another person.
- Section 329: acquiring, using, or possessing criminal property.

Required and authorised disclosures

The principle of making disclosures to the authorities if a person suspects that an act may constitute one of the primary money laundering offences or if he suspects that a person is involved in money laundering forms a central feature of Part VII of POCA. Disclosures (known as 'suspicious activity reports' or 'SARs') perform a dual function under Part VII. First, it is a criminal offence under section 330-332 of POCA for persons in the regulated sector[1] to fail to make disclosures in certain circumstances. Secondly, making a disclosure (described in POCA as an 'authorised disclosure') insulates a person from criminal liability in relation to an act which would otherwise constitute one of the primary money laundering offences. In other words, no offence is committed under section 327 to 329 if, before performing the act in question, the potential offender (i) makes an authorised disclosure to the National Crime Agency ('the NCA') pursuant to section 338 and he receives appropriate consent for the act from the NCA or (ii)

[1] Defined in Schedule 9 of the Act

intended to make an authorised disclosure pursuant to section 338 but had a reasonable excuse for not doing so[2].

Suspicion

The notion of 'suspicion' therefore plays a key part in the operation of Part VII of POCA. A person cannot be guilty of any of the money laundering offences unless he suspects or knows that the property in question is criminal property. If he suspects that the property is criminal property then he may only carry out the act in question if he makes an authorised disclosure to the NCA and, if he is in the regulated sector, he commits a separate criminal offence if he fails to make a required disclosure within the meaning of sections 330 to 332.

In *Reg v Montila* [2004] 1 WLR 3141 the House of Lords confirmed that a mere suspicion that property is somehow connected with crime is not sufficient: the suspicion must be that the property is 'criminal property' as defined in section 340.

The definition of 'suspicion' for the purposes of POCA was set out by the Court of Appeal in *K Limited v National Westminster Bank* [2007] 1 WLR 311 in which Longmore LJ, approving of the test in *Reg v Silva* [2007] 1 WLR 303, stated of the person in question:

"…he or she must think that there is a possibility, which is more than fanciful, that the relevant facts exist. This is subject, in an appropriate case, to the further requirement that the suspicion so formed should be of a settled nature. If that definition is sufficient for criminal cases, so also should it be for civil cases."

Duty of care?

Section 335 of POCA sets out the timetable of events following a report to the NCA. Following receipt of the SAR, the NCA has an initial period of seven days to investigate and to determine whether the transaction should be blocked. If the reporting party does not receive a response from the NCA within seven days it has deemed consent to process the transaction and cannot be prosecuted for any of the primary money laundering offences in connection with that transaction. If, however, the NCA notifies the reporting party that consent for the transaction is refused, there commences a moratorium period which can last up to 31 days, during which the reporting party must not process the transaction.

As a consequence of these provisions, the customer of a bank might have a payment instruction delayed for up to 38 days on the basis of his bank's suspicion that the funds involved constitute criminal property. Such a delay can and frequently has caused substantial losses to customers in circumstances in which the customer has proved to be entirely innocent of any wrongdoing. It is trite that it is an implied term of the mandate between a bank and its customer that the bank must exercise reasonable care in processing payment instructions: *Barclays v Quincecare* [1992] 4 All ER 363. The Courts have therefore had to grapple with the question of whether a bank owes any duty of care to its customers when deciding whether it has a suspicion that funds are criminal property.

The answer is a resounding 'no'. In *K Limited*, Longmore LJ stated:

'the existence of suspicion is a subjective fact. There is no legal requirement that there should be reasonable grounds for the suspicion. The relevant bank employee either suspects or he does not. If he does suspect he must (either himself or through the bank's nominated officer) inform the authorities'

He repeated the point in *Shah v HSBC (No. 1)* [2011] 1 ALL ER (Comm) 67:

'In my view the judge was right to say that the claims of Mr Shah based on irrationality or negligently self-induced suspicion or mistake had no reasonable prospect of success. I need not set out again the reasoning in R v Da Silva on which the court founded its conclusion that the relevant suspicion need not be based on reasonable grounds. We are, in any event bound by both it and the K Ltd case. To allow a claim based on irrationality… or negligently self-induced suspicion would be to subvert those decisions as the judge correctly held.'

Implied term

Moreover, at trial in *Shah v HSBC*, Supperstone J held that it would be an implied term of a mandate between a bank and its customer (unless there was already an analogous express term) that the bank could not be liable for breach of its contractual duty to exercise reasonable care in processing payment instructions when it failed timeously to process those payment instructions as a result of making a SAR to SOCA (the predecessor of the NCA). This is the only example in English law of an implied exclusion clause and means that even if a bank is, in fact, negligent in the process of deciding whether it has a suspicion of criminal property, it cannot be made liable for its customer's losses thereby caused, which can be considerable (in *Shah v HSBC* the Claimant's losses exceeded $300 million).

The Court's approach in these cases has, it seems, been influenced by a recognition of the

[2] Other defences are set out in POCA, however they fall outside the scope of this Guide.

dilemma banks find themselves in when they have a suspicion that a customer's funds are criminal property and the burden placed upon them by parliament to assist in the fight against money laundering and organised crime. In *K Limited* Longmore LJ stated:

'The truth is that parliament has struck a precise and workable balance of conflicting interests in the 2002 Act. It is, of course, true that to intervene between a banker and his customer in the performance of the contract of mandate is a serious interference with the free flow of trade. But parliament has considered that a limited interference is to be tolerated in preference to allowing the undoubted evil of money-laundering to run rife in the commercial community'

Tipping off

The dilemma for banks is exacerbated by the offence of tipping off, also contained in Part VII of POCA. The rationale for the offence of tipping off is as follows: if a person was to disclose to the subject of an investigation the fact that law enforcement authorities had commenced an enquiry into his affairs, or that a production order had been obtained in relation to his bank account, or a financial institution had disclosed a suspicious transaction, this could prejudice the outcome of the enquiry. Accordingly, the legislation has been framed in a way that such disclosures could in themselves give rise to criminal charges.

The old (s.333) offence of tipping off

Section 333(1) POCA (entitled "Tipping Off") made it an offence for a person to make a disclosure that was likely to prejudice an investigation. No offence could be committed, however, if no SAR had been made. Moreover, there was an exception if the person was a 'professional legal advisor' and the disclosure was to a client in the context of giving legal advice or to any person in connection with legal proceedings or contemplated legal proceedings.

Understandably, the offence of tipping off was a cause for considerable concern to those in the financial sector. Banks, solicitors and accountants (amongst others) lost countless hours agonising over whether a disclosure made to a client (or even a colleague) could constitute the offence of tipping off and expose them to a prison sentence of up to five years.

Changes to the offence of tipping off, however, were afoot; the 2003 update to the FATF's 40 Recommendations included the following "*Financial institutions, their directors, officers and employees should be: a)... b) Prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU [Financial Intelligence Unit*" with a note stating "*where lawyers, notaries, other independent legal professional and accountants acting as independent legal professionals seek to dissuade a client from engaging in illegal activity, this does not amount to tipping off.*"

In an attempt to update anti-money laundering standards in accordance with the 2003 FATF Recommendations, the EU issued its third money laundering directive in 2005 (2005/60/EC). Article 28 was concerned with tipping off and its exceptions (which, in fact, went well beyond the one exception recognised by FATF).

Directive 2005/60/EC was incorporated into UK law by the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Amendment) Regulations 2007 which amended POCA, and the Money Laundering Regulations 2007 (in effect, the administrative and regulatory requirements and which replaced the Money Laundering Regulations 2003).

The new offences of tipping off

S.333 was revoked and replaced by s.333A. The pool of individuals affected was narrowed (it applies only to those in the regulated sector) but the scope of criminality was broadened; it is now not only an offence to disclose to any person that a SAR under Part VII has been made (s.333A(1)) but also an offence to disclose that a money laundering investigation under Part VII is being contemplated or carried out (s.333A(3)).

Section 333A(1)

Three conditions must be met for an offence to be committed under this section: (i) a person discloses that there has been a SAR; (ii) the disclosure is likely to prejudice any investigation related to that SAR; and (iii) the disclosure is based upon information which came to the person in the course of business in the regulated sector. This is similar to the old section 333 offence save that (i) this new offence focuses on disclosing that a SAR has been made and (ii) it can only be committed by a person who acquired knowledge of the SAR whilst acting in the course of a business in the regulated sector. No offence is committed under section 333A if the person did not know or suspect that the disclosure was likely to prejudice the investigation (section 333(D)(3)).

Section 333A(3)

This offence is committed when (i) a person discloses that an investigation into a money laundering offence under Part VII is contemplated or underway; (ii) the disclosure is likely to prejudice that investigation; and (iii) the information on which

the disclosure is based came to the person in the course of business in the regulated sector. Again, this is similar to the offence contained within the old section 333 save that (i) the focus is on a money laundering investigation that is contemplated or underway; and (ii) the knowledge of the investigation was acquired whilst acting in the course of a business in the regulated sector.

The overall result of both of these new offences is that whilst previously the offence could only be committed if a SAR had been made or the person knew or suspected that one had been made, now if a matter is merely being investigated or a SAR contemplated, disclosure of that fact will be in breach of tipping-off provisions. For example, the bank employee who learns from an MLRO briefing that the NCA is contemplating an investigation into customer X but that no SAR has been made will probably commit the section 333A(3) offence if disclosed. Strictly speaking, the new s.333A(3) offence was not necessary to criminalise this sort of tipping off. Section 342 POCA already provided for an offence (i) where a person knows or suspects that a confiscation investigation, a civil recovery investigation or a money laundering investigation is being conducted or about to be conducted and (ii) that person makes a disclosure which he knows or suspects is likely to prejudice the investigation. However, as part of the 2007 changes a new section 342(3)(ba) was introduced excluding from that offence disclosures based upon information which came to the person in the course of a business in the regulated sector.

Exceptions

There are four exceptions to the s.333A offences of tipping off:

- Intra-Institution disclosures. No offence is committed when a disclosure is made by an employee, officer or partner to another individual within the same undertaking (s.333B(1)). Nor is an offence committed if disclosure is made between credit or financial institutions in an EEA state (or country imposing similar money laundering requirements) so long as both institutions belong to the same group (i.e. parent and subsidiary company) (s.333B(2)). Nor will an offence be committed if disclosure is made by a professional legal adviser or a relevant professional adviser (accountant, auditor or tax adviser) to another adviser working in a different undertaking, so long as both carry on business in the EU or country imposing equivalent money laundering requirements and the undertakings share common ownership, management or control. These exceptions in s.333B go some way to easing the daily burden of managing money laundering within the same and related undertakings by allowing the flow of information.

- Inter-Institution disclosure. No offence is committed when a disclosure is made (i) by a credit institution, financial institution, professional legal adviser or relevant professional adviser to an equivalent party (which is situated in the EU or in a country with equivalent money laundering requirements); (ii) which relates to a client or former client or a transaction or provision of a service involving both parties; (iii) the disclosure is for the purpose of preventing a money laundering offence; and (iv) both parties are subject to equivalent duties of professional confidentiality and personal data protection (section 333C). The idea is to increase the web of people involved in combating money laundering. By sharing information (i.e. from bank to bank) about SARs submitted or investigations underway, the institutions or advisers to whom disclosures are made are able to investigate their mutual client (current or former) or look into the transaction or provision of service with which they are both involved. This exception is, however, narrowly drawn and requires the disclosure to be made to the equivalent party. Thus a disclosure made a lawyer in a London firm to an accountant in a German firm about a mutual client would not be protected. The London lawyer must make the disclosure to a German lawyer who in turn, relying upon the section 333B exception, may disclose the same information to the accountant at the same firm. This is perhaps an unfortunate rigidity and only serves to increase costs in combatting money laundering.

- Disclosure to supervisory authority. S.333D(1) provides a straightforward exception in relation to disclosure to a supervisory authority as part of compliance with POCA.

- Client Persuasion Disclosures. S.333D(2) is slightly more complicated and controversial; no offence is committed if a professional legal adviser or relevant professional adviser makes a disclosure to the adviser's client for the purpose of dissuading the client from engaging in an offence (section 333D(2)).

What can you tell?

The s.333D(2) exception replaced what was previously the privilege exception set out in section

333(2)(c) and sits uneasily with that previous legal adviser exception. The old s.333 privilege exception had a long-standing statutory base and it was clear that bona fide legal advice given to a client could not amount to tipping off (see *Bowman v Fels* [2005] 1 WLR 3038 §104).

The difficulty with s.333D(2) is that the exception applies only if the purpose of disclosure is to dissuade somebody from engaging in an offence. What if the facts of *K Limited v National Westminster Bank* [2007] 1 WLR 311 repeated themselves today? In that case, the Bank submitted a SAR in relation to a cross-border transaction involving its client. Consent to allow the transaction was refused and the Bank informed the customer that it could not honour the transaction requested and could not enter into further discussion. As a result, the customer applied for an injunction to release its funds. Following the procedure (under the old regime), the bank instructed its solicitors who wrote to the customer "*in connection with legal proceedings or contemplated legal proceedings*" (i.e. the old s.333(2)(c) exception) notifying them that a SAR had been made and that consent had been refused. Since that option of disclosing in connection with legal proceedings, or contemplated legal proceedings, is no longer available, it seems that now a Bank would have little option but to say nothing, refuse to advise, or to seek permission from the NCA before disclosure.

What about if a client's bank account is frozen and he wishes to obtain legal advice? The answer is that, whilst there is no applicable exception under section 333D(2), no tipping off offence can be committed because the solicitor's suspicion or knowledge of a SAR or an investigation will not have come to him in the course of a business in the regulated sector. Hence in cases of litigation advice there is no scope for a section 333A offence.

This exception is difficult – there are many cases where solicitors and other professionals operating in the regulated sector will want to disclose to clients suspicions of a SAR or an investigation in circumstances where the client does not need to be dissuaded against committing an offence. In those situations solicitors would have enjoyed the comfort of the privilege exception to section 333 but could now be at risk of committing a tipping off offence. In practice, due to the timetable employed by the NCA when dealing with SARs (7 day review, followed by 31 day moratorium if required) solicitors are potentially left in a somewhat difficult position for a long period of time without being able to say anything. It seems that those in the regulated sector will, in cases where the relatively low threshold of suspicion (a more than fanciful possibility) is passed, have little choice but to refuse to advise and suggest advice is sought from the unregulated sector, or seek permission from the NCA before making a disclosure. As a last resort those in the regulated sector may seek a declaration against the NCA (pursuant to CPR 25.1(1)(b) and *Bank of Scotland v A Limited* [2001] 1 WLR 751) in order to obtain protection against tipping off whilst being able to make some sort of disclosure.

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2 Temple Gardens
London EC4Y 9AY
Tel: + 44 (0)20 7822 1200
Fax: + 44 (0)20 7822 1300
LDE Chancery Lane 134
email: clerks@2tg.co.uk

About the authors

Joseph Sullivan
Call: 2006 jsullivan@2tg.co.uk +44 (0)20 7822 1273

Joe practices in commercial law and professional negligence. He was junior counsel for the claimant in *Shah v HSBC*, the first case at which Part VII of the *Proceeds of Crime Act 2002* was considered at trial. He regularly acts for claimants and defendants in claims involving allegations of money laundering and in commercial fraud actions more generally. He is instructed in a large number of claims concerning mortgage lending in which there are allegations of conspiracies involving vendors, solicitors and brokers. He is also currently instructed to act for the claimant in the Court of Appeal in *AmTrust v Trust Risk Group*, a case concerning allegations of misappropriation of trust funds in Italy.

Robert Cumming
Call: 2010 rcumming@2tg.co.uk +44 (0)20 7822 1228

Robert has a busy commercial practice specialising in insurance, commercial fraud and employment. Robert previously worked as tutor at the University of Cambridge and at a leading Offshore Law Firm in Guernsey.

Robert has been involved in a number of commercial fraud disputes, often involving international considerations. He has particular experience of cases involving freezing orders, search orders and other interim relief. Recent work has included assisting in obtaining a freezing injunction in an offshore jurisdiction in support of proceedings elsewhere and a claim against a Director of an international company (and his family) for allegedly taking secret commissions in awarding contracts (involving, in particular, issues of knowing receipt and dishonest assistance).

Robert's commercial fraud practice complements both his insurance and employment work; the former often involving the investigation into and defence of fraudulent claims and the latter often being concerned with complex "team moves", unlawful means conspiracy, restrictive covenants and the misuse of confidential information (for which he has been involved in various injunction proceedings). Robert is currently instructed by a leading insurance services company in a multi-million pound fraud claim arising from the purported constructive dismissal of an employee.

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