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Briefing note

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A mixed report for money laundering officers

Last week saw mixed fortunes for the individuals within financial institutions who act as Money Laundering Reporting Officers ("**MLROs**") and who oversee anti-money laundering ("**AML**") controls. The High Court has rejected a long running challenge by former customers to a bank's decisions to make Suspicious Activity Reports ("**SARs**"), in a decision that recognises the delicate balance that MLROs are required to strike between their own and their institutions' competing legal and commercial obligations. On the other hand, the significant personal responsibilities of such officers has been highlighted by the first fine imposed on an individual to arise from the Financial Services Authority's thematic review into authorised firms' compliance with their AML obligations.

The High Court, rejecting former customers' claims for damages of over $300 million in *Shah v HSBC Private Bank (UK) plc*, has confirmed that banks' contractual duties to comply with payment instructions from customers are not absolute. It has given approval to the decisions of the bank, through its employees, to decline to execute such instructions where they have genuine suspicions in relation to proposed transactions.

Mr Justice Supperstone found that the reporting regime under Part 7 of the Proceeds of Crime Act 2002 ("**POCA**") "*necessarily...makes inroads*" into those duties. However, he echoed the view previously expressed by Lord Justice Longmore in *K Limited v National Westminster Bank plc* that the provisions of POCA make it necessary to imply a term in the contractual relationship between the bank and its customers. This allows the bank to refuse to execute instructions if it has filed a SAR and not received consent from the Serious Organised Crime Agency (under section 335 of POCA) to continue with the transaction in question.

He also decided that neither the fact that the appointment of the *de facto* MLRO who made the SARs was not formally documented nor the fact that that he was appointed by the parent company of the bank instructed to make the transfers (rather than the bank itself) affected the validity of those SARs. He found that what is important is that the individual acting as MLRO has autonomy when deciding whether SARs should be made and exercises independent judgment when doing so.

Rejecting arguments (also extensively aired in numerous sets of interlocutory proceedings – see, for example, Clifford Chance briefing) that the reports made may not have been the product of genuinely held suspicion, the judge endorsed the three stage approach that the MLRO took in this case when deciding to submit the SARs: -

1. absorbing information from colleagues responsible for the management of the relationship with the customer, in relation to their suspicions as to the relevant transactions;
2. investigating the concerns escalated to him; and
3. reflecting upon the information provided to him before deciding, autonomously and independently, to make SARs in respect of those particular transactions.

It has required six separate visits to the High Court and Court of Appeal, over a period approaching four years, and the involvement of twelve different judges to reinforce these important, yet relatively straightforward principles. Nonetheless the judgment provides useful and favourable clarification of

banks' contractual liabilities and the regulatory responsibilities of individual employees, particularly MLROs (or "nominated officers" as they are called in the legislation), in connection with the reporting regime under Part 7 of POCA.

Many of the individuals whose responsibilities are clarified by *Shah* will also occupy the CF11 approved person function for money laundering reporting under Part 5 of the Financial Services and Markets Act 2000 ("**FSMA**") and Chapter 10 of the Supervision section of the FSA's Handbook ("**SUP**"). Under SUP, MLROs are not only required to report SARs but have a broader responsibility for establishing and maintaining adequate AML systems and controls. The FSA's robust approach to enforcement in the area of AML compliance was highlighted last week by the imposition of a financial penalty of £17,500 on Mr Syed Itrat Hussain.

Mr Hussain, who was formerly the MLRO of a Swiss bank with international operations, was found to have breached Principle 7 of the FSA's Statements of Principle for Approved Persons ("**APER**") by failing to identify due diligence shortcomings during his checks of customer files, adequately review AML systems and controls or revise training procedures to address shortcomings which he identified. He was also criticised for overseeing a flawed approach to the identification of high risk countries. Amongst other things, Kenya and Pakistan were excluded from the bank's list of countries that present a higher risk of money laundering, because the bank maintained offices in those jurisdictions. The FSA decided this was inappropriate because the bank's presence in those countries would not actually negate the higher risk of money laundering.

The penalty imposed on him is amongst the highest imposed on an individual for AML compliance oversight failings alone (although there have been higher penalties imposed where an individual's conduct has also included other compliance failings). The action against him and his former employer (which was fined £525,000 for AML compliance breaches – see Clifford Chance FSA Update) are the latest to emerge from the FSA's thematic review into firms' compliance with their AML obligations, the results of which it announced in June 2011.

Individuals with AML reporting responsibilities, particularly those in FSA regulated firms, will clearly welcome the High Court's clarification in *Shah* much more than the confirmation of the FSA's expectations and approach in the action against Mr Hussain. However, both decisions provide a useful reminder of the range of criminal, civil and regulatory liabilities that financial institutions and their employees can face if they do not follow proper AML procedures.

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