

FOUR LESSONS FROM SHAH

Focusing exclusively on

- Governance
- Risk
- Compliance

for the financial services industry and regulators, globally.

INTRODUCTION

On 16 May 2012 the High Court in London handed down an important judgment affecting the contractual relationship between banks and their customers. The Court found that HSBC Bank (UK) Limited (“the Bank”) had suspected one of its clients of money laundering. In those circumstances the Bank was permitted as a matter of contract law: (a) to delay the execution of the client’s payment instructions until consent had been obtained from the Serious Organised Crime Agency (“SOCA”); and (b) to refuse to tell the client the reason for the delay. Accordingly, the Bank had committed no breach of contract and the Bank was not responsible for any losses which flowed from its actions.

BACKGROUND

Mr and Mrs Shah (“the Claimants”) were account holders with the Bank. They sought damages in excess of \$300 million which were said to reflect losses incurred as a result of delays by the Bank in executing four transfers from the Claimants’ account during the period from September 2006 to March 2007. The reason for the delay in each case was that the Bank claimed to have formed a suspicion that the Claimants were engaged in money laundering. Acting on that suspicion, the Bank made a ‘Suspicious Activity Report’ (“SAR”) to SOCA. As is well known, the purpose of making such a report is to obtain the consent of SOCA before proceeding with the transaction, thereby avoiding any criminal liability for a money laundering offence under POCA.

While the necessary consent from SOCA was awaited, the Bank informed the Claimants that the reason for the delay was that the Bank was ‘complying with its statutory obligations’. Meanwhile, the authorities in Zimbabwe, who had also grown suspicious, asked the Claimants for an explanation as to the Bank’s conduct. The Bank refused to provide any further explanation. The Claimants alleged that, without an explanation from the Bank they were unable to allay the suspicions held in Zimbabwe. As a result, their assets were frozen and seized thereby causing losses of over \$300 million.

ISSUES

For present purposes, there were three main issues in the case:

1. Did the Bank suspect money laundering?
2. Was the Bank contractually permitted to delay performance of the transactions?
3. Was the Bank contractually permitted to refuse to provide information about the reason for the delay?

JUDGMENT

The High Court found in favour of the Bank, and answered each of the issues in the following way.

1. Did the Bank suspect money laundering?

The Claimant sought to show that there was insufficient material to justify a genuine suspicion about the Claimant’s activities. Responding to this, the Bank suggested that there were seven matters about the Claimants and their proposed transactions which had led it to form a suspicion. Some of these matters had not, however, been recorded in the SARs sent to SOCA. For this reason, the Bank was forced to accept that the content of the SAR was lacking and its wording ‘very poor’. Nevertheless, the Court found that the Bank had held a genuine suspicion which had led to the making of the SARs.

Next, the Claimant suggested that, even if Mr Wigley had held a suspicion, that suspicion could not be attributed to the Bank. The Claimants pointed out that the person who had formed the suspicion (a man named Mr Wigley) was employed by HSBC plc and not the Bank. Moreover, no document existed which showed that Mr Wigley had been formally appointed as the Bank’s ‘nominated officer’. Mr Wigley himself accepted that the Bank had not explicitly appointed him as its nominated officer. The Court observed that it would have expected documentary evidence in this respect, but nevertheless decided on the basis of other evidence that Mr Wigley had been acting as the Bank’s nominated officer.

2. Was the Bank contractually permitted to delay performance of the transactions?

This issue went to the heart of the conflicting duties owed by the Bank, on the one hand towards the Claimants, to whom the Bank was contractually bound, and, on the other hand, towards its money laundering obligations under POCA. The Claimants argued that no implied term could be read in to the contract permitting the Bank to delay performance of the transactions: if the Bank had wished there to be such a term it could have expressly included one in the contract. The Court, however, rejected this argument. The money laundering provisions of POCA struck a ‘precise and workable balance of conflicting interests’. The reasonable person would expect this to be reflected in the implied terms of the agreement. It followed that, given that the Bank had made a SAR, there existed an implied contractual term that permitted the Bank to delay performance of the Claimants’ instructions until SOCA gave its consent.

3. Did the Bank have a duty to provide information about the reason for the delay?

BRIEFING

The Claimants alleged that the Bank had been contractually obliged to inform the Claimants of the reason for the delay. The difficulty with this argument is that the provision of such information would often involve the commission of one or more offences, namely 'tipping off', contrary to section 333 of POCA (now amended) and 'prejudicing an investigation' contrary to section 342 of POCA. The Court accepted this point: an implied term should be read into the contract which permitted the Bank to refuse to provide information where to do so might contravene duties owed by the Bank as a result of sections 333 and 342 of POCA.

IMPLICATIONS

While this judgment is generally good news for financial services businesses, it also contains a clear warning. An aggrieved customer may put an FSB to proof as to whether it did, in fact, have the necessary state of mind justifying the decision to make a SAR. Where no such proof exists, the bank may be liable for losses incurred by reason of the delayed performance of a transaction. The judgment also contains a number of pointers towards best practice for those operating in the regulated sector:

1. Ensure that the 'nominated officer' is properly nominated. Wherever possible, this should be supported by documentation.
2. Clear records should be kept of matters relevant to a suspicion held. The text of the SAR should fully reflect these matters.
3. It may be advisable to incorporate express contractual terms as to the Bank's obligations: (a) to perform transactions where money laundering is suspected, and (b) to divulge the reason for not performing a transaction.