Reform of the SARs regime – back to the drawing board

July 31, 2018

On the 20 July, the Law Commission published a consultation paper on the reform of aspects of the anti-money laundering regime in Part 7 of the Proceeds of Crime Act 2002 (POCA) and the counter terrorism regime in Part 3 of the Terrorism Act 2000.

The consultation paper considers the reporting of suspicious activity to the National Crime Agency (NCA) and the consent process when a reporter suspects that he or she might be dealing with criminal property if they proceed with a transaction. In summary, when a person in the regulated sector has a suspicion that they might be dealing with the proceeds of crime they can seek consent to complete the transaction. Receiving consent will provide the reporter with a defence against an allegation of money laundering.

In April 2016, the Home Office and HM Treasury published an action plan in which they described the suspicious activity reporting regime as inefficient and indicated that they would consider whether it should be removed. Unfortunately, the key proposals contained in the Law Commission consultation paper fail to provide a workable solution to the concerns of those in the regulated sector. Indeed, they have the potential to significantly increase litigation risk for parties legally obliged to make disclosures to the NCA.

In preparing the consultation paper, the Law Commission has spoken to stakeholders and has identified the key issues. From a law enforcement perspective there is a concern about the poor quality of suspicious activity reports (SARs) and defensive reporting. From the perspective of banks (that provide 82.85 per cent of all SAR's) there is a concern about the overall compliance burden and the legal issues that arise from the regime including:

- the impact on banks when transactions / accounts are suspended;
- the issues that arise when criminal and non-criminal funds are mixed; and
- what would constitute a reasonable excuse for not making a SAR.

The paper provides a summary of the current regime and considers (amongst other things):

- the "all crimes" approach to reporting;
- the meaning of "suspicion" and its application by those in the regulated sector;
- criminal property and mixed funds; and
- what would constitute a reasonable excuse for not making a SAR.

Unfortunately, the Law Commission has been unable to come up with a silver bullet and although it briefly considers alternatives to the consent regime in chapter 14, its focus is on working with the existing regime structure.

Reasonable suspicion

A key proposal in the paper is the replacement of the current subjective "suspicion" test with a "reasonable suspicion" test. The paper states:

"Requiring 'reasonable grounds to suspect' … would introduce a qualitative standard to suspicion importing considerations of strength and cogency …"

"We consider that there are strong arguments that the anti-money laundering regime would be improved by raising the threshold for any disclosure from mere suspicion … to 'reasonable grounds for suspicion'. This would mean that the SARs that are filed should be fewer in number and of greater value. In addition, given the potentially serious consequences for the subject of the SAR, it is arguable that **those in the regulated sector should be held to a higher standard**. The onus should therefore rest on the party making the disclosure to have grounds which are objectively justifiable for doing so" (emphasis added).

The approach advocated in the paper is surprising and will be a disappointment to those in the financial services sector who have experienced real problems with the current regime and would have been hoping for proposals that would alleviate the issues they face. Instead, the paper advocates a greater burden being placed on firms that are to be held to a higher standard.

The proposal to introduce a "reasonable suspicion" test would, if brought into effect, have a significant adverse impact on banks. On the one hand, if a bank official failed to make a disclosure where there were reasonable grounds he or she would be criminally liable whereas if they erred on the side of caution and made a disclosure they would run the risk of exposing the bank to litigation risk where it is contended that the suspicion was not based on reasonable grounds. In circumstances where firms in the private sector are endeavouring to assist law enforcement it cannot have been the intention of Parliament to mire reporters in endless litigation in circumstances where they were simply trying to do the right thing.

The paper refers to large banks having trained financial investigators who make decisions on SARs and who will have undergone training in order to perform their role. As such, it is suggested that they will be sufficiently experienced to determine what is reasonably suspicious and what is not. This is, however, an overly simplistic view of the way banks operate and how SARs are currently submitted. Further, having regard to the speed with which transactions occur in the financial sector it is difficult to see how, in practice, the reasonable suspicion test would operate. In circumstances where a suspicion arises, speed is often of the essence and firms will report suspicious transactions as soon as possible. If in the future, however, firms are required to satisfy a higher test, would that entail a review of all recent transactions? An analysis of all recent contact with the customer? How far back in the relationship should the firm delve? Further, no matter how extensive the enquiries, customers may still suggest that key evidence was not taken into account or given sufficient weight.

The litigation risk can be illustrated by reference to the Shah case[1], where the claimant (a former customer of HSBC Private Bank) sought to suggest that the nature of the bank's suspicion was unreasonable. In that case the bank's nominated officer was cross examined at length at trial on the nature of the suspicion held. The court rejected the claimant's view. The key submission that suspicion should be reasonable or rational appears, however, to have resurfaced in the Law Commission paper:

"A reporter's subjective suspicion may be irrational, illogical or based on slender evidence. This may weaken the value of any potential disclosure and have a severe and unwarranted financial impact on the subject of the report."

Given that there have been only a handful of cases between customers and banks over the last 16 years the focus given to customer hardship is somewhat surprising. In our submission, the key aim of any regime should be to provide

useful intelligence to the NCA. Seeking to place reporters in a position where they have a very significant litigation risk, in circumstances where all they are doing is seeking to assist law enforcement, is not a sensible way forward.

Further Guidance

The consultation paper considers other aspects of the SARs regime but does not provide much comfort for those on the front line.

- **All crimes** - on whether the regime should be limited to just serious crimes, rather than all crimes, the paper suggests that such a change would be "problematic and undesirable".
- **Meaning of suspicion** - the consultation asks whether the word "suspicion" should be defined but concludes that there would be practical difficulties in formulating a workable definition that would add anything to the ordinary, natural meaning.
- **Fungibility** - on the question of mixed funds and fungibility the paper suggests that POCA be amended to permit the ring fencing of funds where the value of the criminal property is clear and readily ascertainable. Unfortunately, in practice, the position is seldom clear and in the absence of a solution, banks will continue to struggle with this issue.
- **Reasonable excuse** - the paper suggests that statutory guidance should be provided on the meaning of "reasonable excuse" not to make a SAR. This suggestion has some merit but again reporters require legal certainty. There is a plethora of industry guidance but with the threat of criminal liability hanging over individuals, it is submitted that those in the regulated sector should be provided with a solution that provides legal certainty.

Clearly, the paper is designed to stimulate discussion and to provide an opportunity to input on the issues identified. That said, it is disappointing that the key proposals do not provide a solution for the concerns of those in the reporting sector and that the proposals will, in fact, greatly exacerbate the tension that currently exists between banks and their customers. Unfortunately, unless the Law Commission radically changes its approach following the consultation it will yet again be a case of back to the drawing board.

The consultation poses 40 questions and the deadline for comments is 5 October 2018.

Shah and another v. HSBC Private Bank Plc [2012] EWHC 1283 (QB)↩

Your Key Contacts

Marija Bračković
Senior Associate, London
D +44 20 7246 7485
M +44 79 2050 4734
marija.brackovic@dentons.com