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# The Impact of Recent Money Laundering Legislation on Financial Intermediaries\*

Nicholas Clark\*

## I. Introduction

The Proceeds of Crime Act 1995<sup>1</sup> is the newest of several recent pieces of legislation designed to remove the ill-gotten gains of criminal activity from those involved with "dirty money." It follows hard on the heels of the Criminal Justice Act 1993 (CJA 1993),<sup>2</sup> which introduced a wide array of offenses designed to combat the threat of money laundering. While not the first piece of legislation with such a purpose, the CJA 1993 is a major bulwark in the United Kingdom's anti-laundering legislation, creating several offenses for what might at first seem barely criminal behavior. Further, the Money Laundering Regulations<sup>3</sup> (the Regulations) of the same year place an onerous burden on financial institutions to incorporate systems to combat laundering.

The CJA 1993 and the Regulations, enacted to fulfill the United Kingdom's obligations arising from the EC Money Laundering Directive,<sup>4</sup> together mark a major overhaul of Britain's legislation in this area. This Article considers their implications, and those of the Proceeds of Crime Act, for financial intermediaries. It first briefly outlines the importance of money laundering to the modern criminal. The Article then explains the inherent threat posed to financial institutions by money laundering. The Article concludes with an overview of the recent legislation.

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1. Proceeds of Crime Act 1995 (Eng.) [hereinafter *The Crime Act*].

2. Criminal Justice Act 1993 (Eng.).

3. SI 1933/1993 (Eng.).

4. Council Directive No. 91/308/EEC, O.J. L 166/77 (1991) [hereinafter *EC Money Laundering Directive*].

The article's central theme is then explored: the uneasy and ill-defined relationship between civil and criminal liability. There are very real dangers posed to the banking industry by the suspicion-based reporting system. The last few years have seen a judicial willingness to impose what amounts to liability as a constructive trust on those who knowingly assist in the disposal of funds in a fraudulent breach of trust.<sup>5</sup> At the same time, the recent money laundering legislation perpetuates the "know your client" ideal of the Financial Services Act 1986.<sup>6</sup> Is such knowledge not dangerous in view of the potential civil liability faced by a financial intermediary who comes to know too much? Bearing in mind the potential financial catastrophe facing an intermediary unaware of the civil law consequences of "over-compliance" with the new legislation, this question is of particular relevance at the moment. It is the author's belief that the recent plethora of decisions on liability for assistance in a breach of trust can only add to the dangers.

The answer, if any, to the previous question rests on the vexed issue of the state of knowledge required for intermeddler liability to be imposed. The recent judgments of the courts in this area are considered side by side with an examination of what knowledge is required of financial intermediaries by the new legislation. In particular, the implications of the decisions in *Finers (a firm) v. Miro*,<sup>7</sup> *Agip (Africa) Ltd. v. Jackson*<sup>8</sup> and *Royal Brunei Airlines v. Tan*<sup>9</sup> are considered.

Further consideration is given to another problem the financial services industry may face: claims against institutions for refusing to carry out a client's instructions if they have disclosed their suspicions to the authorities. If a financial intermediary reports a suspicion which is found to be groundless, the Criminal Justice Act gives it immunity from actions for breach of confidence,<sup>10</sup> yet leaves open the possibility of a claim for defamation or breach of contract.

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5. See, in particular the decision of Millett J. in *Agip (Africa) v. Jackson* [1990] Ch. 265, and of the Privy Council in *Royal Brunei Airlines v. Tan*, [1995] 2 A.C. 378, [1995] 3 All E.R. 97, [1995] 3 W.L.R. 64. See also *Third Party Liable to Beneficiaries for Loss in Breach of Trust*, TIMES (London), May 29, 1995, at Features.

6. Financial Services Act 1986 (Eng.).

7. [1991] 1 W.L.R. 35.

8. [1991] Ch. 547.

9. *Royal Brunei Airlines*, [1995] 2 A.C. 378.

10. Criminal Justice Act 1988, § 93A (Eng.).

## II. Money Laundering and Its Importance to the Criminal

The modern money launderer will no doubt adopt rather more sophisticated techniques than the gem carriers of India or the Knights Templar, but his objectives and essential *modus operandi* will be the same. The objectives will be to obscure the source and thus the nature of the wealth in question and the *modus operandi* will inevitably involve resort to transactions, real or imagined, which will be designed to confuse the onlooker and confound the enquirer.<sup>11</sup>

Money laundering, simply, is the process by which the proceeds of crime or fraud are made to appear as if they have emanated from a legitimate source. Today, this typically involves a complex web of transactions, often across several jurisdictions, so that the proceeds of violent crime in, for example, Italy, resurfaces as the seemingly normal profits of a pizza restaurant in New York. The aim is thoroughly to confuse any investigator attempting to trace the "hot" money either by "losing" it or by creating an intricate web of transactions that is virtually impossible to follow. By any criteria, the global level of money laundering is staggering. In 1989, the Financial Action Task Force estimated that the money laundered globally through banks amounted to some \$85 billion each year.<sup>12</sup>

There are various reasons, commented on by Haynes,<sup>13</sup> why money laundering is an increasing focus of law enforcement agencies. Originally, these agencies fought organized crime by seeking to imprison those at its heart. This was ineffective and thus asset forfeiture was viewed as the key to combating such crime. If the criminal is prevented from enjoying the fruits of his labor, then his motivation for committing that crime also disappears. As the U.S. Drug Enforcement Administration found, the most effective way of "immobilizing drug organizations [was] by removing their financial resources . . . incarceration of the highest level violators alone was not substantially disruptive to many drug trafficking organizations and an attack against their acquired assets was

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11. Barry A.K. Rider, *Fei Ch'ien Laundries: The Pursuit of Flying Money*, 1992 J. INT'L PLAN. 77.

12. See Andrew Haynes, *Money Laundering and Changes in International Banking Regulation*, 1993 J.I.B.L. 454.

13. *Id.*

necessary.”<sup>14</sup> To an extent, however, there is a vicious circle in this approach: stringent legislation enabling asset forfeiture merely makes it necessary for the criminal to launder his money more effectively (to hide those assets) which, in turn, requires further anti-money laundering legislation.

Before considering the inherent dangers posed to financial institutions by money laundering, it is helpful to explore the various stages of a laundering transaction. While no two systems are the same, there are recognized patterns in many of them comprised under the following three headings:

*Placement*: the actual dispersal of illicitly earned cash into a banking system;

*Layering*: separating the proceeds of the crime from their source through complex, and often illusory, transactions disguising the provenance of the funds;

*Integration*: the re-introduction of the proceeds into the financial system as apparently normal and legitimate business funds.<sup>15</sup>

Financial intermediaries of some sort are nearly always necessary for a successful laundering operation, and it is this aspect of laundering that is now considered.

### III. The Threat Posed to Financial Institutions by Money Laundering

Be it a bank, accountant, solicitor, or insurer, inevitably a financial intermediary of some sort will be required for a successful money laundering operation. This being so, it is perhaps equally inevitable that the authorities decide to lean on those organizations so heavily involved in laundering, albeit often unwittingly, for their cooperation. If all financial intermediaries are required to report their suspicions, then the launderer will find his task that much harder. London, of course, as one of the world's major financial centers, has a special responsibility in this regard.

The other reason financial intermediaries are compelled by legislation to cooperate with this process is that the authorities have recognized that there are certain stages in a typical laundering process that are more vulnerable to recognition. These stages are:

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14. *Id.*

15. See JOINT MONEY LAUNDERING STEERING GROUP, GUIDANCE NOTES FOR MAINSTREAM BANKING, LENDING AND DEPOSIT TAKING ACTIVITIES ¶ 8 (1993) [hereinafter GUIDANCE NOTES].

(1) the entry of cash into the financial system; (2) cross-border flows of cash; and (3) transfers within and from the financial system.<sup>16</sup> The metaphor of dropping a stone into a pool is appropriate: when the dirty money is first deposited it creates a noticeable ripple, but if unnoticed it may well remain undiscovered. These stages necessarily involve the participation of banks or other deposit-taking bodies, hence the importance of banks' vigilance in detecting unusual transactions at the point at which the launderer is most vulnerable to exposure.

Most financial intermediaries and their employees are honest. However, a dishonest person who works for an organization capable of laundering funds is easily corrupted:

Money laundering is now an extremely lucrative criminal enterprise in its own right. The Treasury's investigations have uncovered members of an emerging criminal class — professional money launderers who aid and abet other criminals through financial activities. These individuals hardly fit the stereotype of an underworld criminal. They are accountants, attorneys . . . and members of other legitimate professions. They need not become involved with the underlying criminal activity except to conceal and transfer the proceeds that result from it . . . money laundering, for them, is an easy route to almost limitless wealth.<sup>17</sup>

Given that financial intermediaries are so crucial to a successful laundering process, and also that the personal rewards of laundering are so high, it is not surprising that such intermediaries find themselves at risk of being tainted by the activities of a small number of dishonest employees. It is obvious that the entire finance industry is also tarnished by dubious banks and shell companies that countries with lax legislation permit to be established within their jurisdictions. Launderers gain apparent legitimacy by having as a "front" a bank or a firm of attorneys, and there are several regimes prepared to tolerate such activity of dubious legitimacy in return for the revenue that pours in.

With such simple ways of erecting a veil of legitimacy through the incorporation of a laundering vehicle like a bank, it is easy to see the pervasive cancer of fraud that threatens to sweep through

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16. *Id.*

17. U.S. Senate Committee on Government Affairs, 1985, *reprinted in* ROWAN BOSWORTH-DAVIES & GRAHAM SALTMARSH, *MONEY LAUNDERING: A PRACTICAL GUIDE TO THE NEW LEGISLATION* 53 (Chapman & Hall, 1994) [hereinafter BOSWORTH-DAVIES & SALTMARSH].

the financial services industry. It is a mistake to assume that it is only banks that are at risk: solicitors and accountants are accustomed to performing a wide array of services for their clients, and many of these could be used for the purposes of laundering money. One commentator has gone so far as to say:

solicitors probably contributed the greatest degree of professional support and facilitation to the activities of the launderers . . . such professionals would create offshore companies; arrange for the handling of large sums of money; sign cheques with a power of attorney; and give instructions to third parties; all the while protected behind the cloak of legal privilege.<sup>18</sup>

The advantages for launderers of using professionals bound to respect the confidentiality of their dealings with clients is obvious. It can be very difficult to break the privilege that attaches to lawyer-client relationships, especially bearing in mind how jealously guarded this privilege is: The Law Society when initially commenting on the new legislation considered it "repugnant to the lawyer/client relationship."<sup>19</sup>

It is because of the inherent dangers to the financial services industry that the European Commission has targeted that very industry which is so much at risk, as the preamble to its Directive makes clear, "[W]hen credit and financial institutions are used to launder proceeds from criminal activities . . . the soundness and stability of the institution concerned and confidence in the financial system as a whole could be seriously jeopardized, thereby losing the trust of the public."<sup>20</sup> The Criminal Justice Act 1993 and the Money Laundering Regulations 1993 were promulgated to give effect to the Directive, and it is to this legislation that this Article now turns.

#### IV. The Criminal Justice Act 1993, The Proceeds of Crime Act 1995, and Other Recent English Anti-Money Laundering Legislation

It is now necessary to consider the new statutory responsibilities faced by financial institutions. In addition to the CJA 1993, the

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18. BOSWORTH-DAVIES & SALTMARSH, *supra* note 17, at 73.

19. See Stephen Solley & Christopher Quinn, *Too Cosy with the Client*, TIMES (London), Feb. 22, 1994, at features.

20. EC Money Laundering Directive, *supra* note 4, at pmb1.

offenses are contained in several other Acts.<sup>21</sup> The nature of this Article does not permit an exhaustive examination of every offense,<sup>22</sup> instead, the provisions of most concern to financial intermediaries are considered.

A. *Section 22(1), Theft Act 1968*<sup>23</sup>

Parliament has long realized that there should be criminal penalties for those who facilitate the realization of stolen property. Accordingly, section 22(1) of the Theft Act 1968 provides that someone is guilty of handling stolen goods if he "dishonestly undertakes or assists in their retention, removal, disposal or realisation, by or for the benefit of another person."<sup>24</sup> This is a wide-ranging provision, and was successfully used to prosecute those who were chiefly responsible for laundering the proceeds of the Brinks Mat robbery.<sup>25</sup> However, it is restricted to the handling of goods which are, or which represent, stolen property.<sup>26</sup> This major limitation on its scope led to the introduction of further legislation in the 1980s and 1990s.

B. *The Proceeds of Crime Act 1995*

The remaining legislation discussed in this section highlights those provisions intended to criminalize the activities of those who assist in money laundering. Interestingly, however, the most recent legislation bolsters the law not against those who assist in laundering; rather, it continues the theory that asset forfeiture is an essential weapon in fighting financial crime.

The early 1990s saw a major overhaul of anti-laundering legislation. In 1995 there were new provisions aimed at those benefitting from the laundering, rather than the launderers themselves.<sup>27</sup> While not of direct relevance to financial intermediaries, the Proceeds of Crime 1995 Act (the Act) is nonetheless included here as the most recent example of the Government's

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21. For a comprehensive list, see Leonard Jason-Lloyd, *Money Laundering — the complete guide*, NEW L.J., Feb. 3, 1995, at 150.

22. *Id.*

23. Theft Act 1968, § 22(1) (Eng.).

24. *Id.*

25. BOSWORTH-DAVIES & SALTMARSH, *supra* note 17, at 108. The analysis here of the new legislation owes much to that contained in this guide.

26. Theft Act, *supra* note 23, § 22(1).

27. The Crime Act, *supra* note 1.



determination to continue to combat money laundering, this time by confiscating the end-product.

The courts for several years have had the power to order that the proceeds of crime be confiscated following conviction.<sup>28</sup> This power has been infrequently used. The Act broadens the powers of the court to make a confiscation order; more importantly, it makes it the duty of the court to make such an order in certain circumstances.<sup>29</sup>

Section 1 of the Act makes it the court's duty to confiscate the proceeds of a crime in every case in which written notice has been given by the prosecutor.<sup>30</sup> This applies to all indictable offenses and a limited number of summary ones.<sup>31</sup> Section 2 enables the court to make two assumptions about a defendant: first, that all property held by him on conviction is the proceeds of criminal activity;<sup>32</sup> secondly, that any property passing through his hands in the six years prior to the proceedings also represents the proceeds of criminal activity.<sup>33</sup> There is a (limited) safeguard for the defendant that the court can only make such an assumption where the prosecutor has given written notice that such an assumption is appropriate.<sup>34</sup> The defendant must also have shown a "pattern" of offending by previous similar convictions.<sup>35</sup>

The strength of these provisions lies in that they are mandatory, and will apply whenever a defendant has benefitted financially from his activity.<sup>36</sup> It will be interesting to chart the Act's usefulness over the coming years.

Another startling part of the Act is the ability of the court to demand information ascertaining the level of benefit derived from the criminal activity.<sup>37</sup> Not only can the defendant be required to disclose such information (facing further proceedings for contempt of court if he refuses); under section 11 the police can apply to a Circuit Judge for an order to permit the obtaining of material possessed by any institution which may be relevant.<sup>38</sup> Thus a

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28. See, e.g., Drug Trafficking Offences Act 1988; Criminal Justice Act, *supra* note 10.

29. The Crime Act, *supra* note 1, § 1.

30. *Id.*

31. *Id.*

32. *Id.* § 2.

33. *Id.*

34. The Crime Act, *supra* note 1, § 3.

35. *Id.* § 1.

36. *Id.* § 1A.

37. *Id.* § 11.

38. *Id.*

bank may be required to disclose statements. A later section ensures government departments responsibility to disclose such information if asked.<sup>39</sup>

Such asset forfeiture provisions though, are not enough. It is necessary to target in addition those who assist in the laundering. This section now turns specifically to those provisions.

### C. *The Drug Trafficking Act 1994*<sup>40</sup>

The Drug Trafficking Act 1994 (DTA 1994), which came into effect February 3, 1995, consolidates the Drug Trafficking Offences Act 1986.<sup>41</sup> The crucial section for financial institutions to note is section 50 of DTA 1994, which creates the offense of assisting another to retain the benefit of drug trafficking.<sup>42</sup> Anyone entering into an arrangement with another to facilitate an other's retention of drug proceeds, and who knows or suspects that the other is someone benefitting from drug trafficking, is guilty of an offense.<sup>43</sup>

Thus, any intermediary entering into transactions on behalf of a client suspecting that the relevant funds are the proceeds of drugs trafficking, faces criminal liability, an unlimited fine, and fourteen years in prison.<sup>44</sup> It is sufficient for the offense that the person assisted received payment in respect to a third party's trafficking: he need not have been directly involved himself.<sup>45</sup> It is a defense that the potential assistor disclosed his/its suspicion to a constable.<sup>46</sup>

### D. *Section 11, Prevention of Terrorism (Temporary Provisions) Act of 1989 (POTA 1989)*

The wording of this offense is similar to section 50, DTA 1994, but relates to financial assistance to terrorist organizations.<sup>47</sup> In addition, it should be noted that, as with drug money, it is an offense not to disclose a suspicion of financial assistance of

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39. The Crime Act, *supra* note 1, § 13.

40. Drug Trafficking Act 1994 (Eng.).

41. Drug Trafficking Offences Act 1986 (Eng.).

42. *See id.* § 50.

43. *Id.* § 51.

44. *Id.* § 54..

45. *Id.* § 51.

46. *Id.* § 52(1)(c).

47. Prevention of Terrorism (Temporary Provisions) Act 1989 (Eng.) [hereinafter POTA 1989].

terrorism.<sup>48</sup> The Northern Ireland (Emergency Provisions) Act 1991 also introduces various money laundering offenses.<sup>49</sup> These are very similar in scope to those contained in the anti-drug trafficking legislation and the CJA 1993, but relate to assisting proscribed organizations in Northern Ireland.<sup>50</sup>

*E. Developing the Legislation in the 1990s*

In 1989, the Home Affairs Committee of the House of Commons undertook a review of the Drug Trafficking Offences Act 1986, reporting in November of that year. The National Drugs Intelligence Co-ordinator estimated that there was at least £1800 million derived from drug trafficking in the financial systems within the United Kingdom.<sup>51</sup> This concerned the Committee, as did the view expressed in the United States that Britain was fast becoming home to an offshore banking system for drug money laundering.<sup>52</sup> The Committee's Report recognized the threat posed to the financial services industry by money laundering, and recognized, too, that action was necessary:

We recommend that the Government should instruct the Bank of England, as a matter of urgency, to examine the scale of the threat to the banking community posed by money laundering and any legislative or other changes required to counter it. . . . The Government should then come forward with the necessary amending legislation as a matter of priority.<sup>53</sup>

There was also global action, notably the creation by the G7 countries<sup>54</sup> of the Financial Action Task Force, to tackle money laundering. The separate activities in so many countries led in 1991 to the European Council's Directive "on the prevention of the use of the financial system for the purpose of money laundering."<sup>55</sup> It was to implement the United Kingdom's obligations regarding the Directive that the Criminal Justice Act 1993<sup>56</sup> and the Money Laundering Regulations 1993 were passed.<sup>57</sup> The Directive has

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48. *Id.* § 18(a).

49. Northern Ireland (Emergency Provisions) Act 1991 (Eng.).

50. *Id.*

51. BOSWORTH-DAVIES & SALTMARSH, *supra* note 17, at 116.

52. *Id.*

53. *Id.* at 119.

54. The Group of Seven (now Eight) Economic/Industrialized Nations.

55. EC Money Laundering Directive, *supra* note 4, at pmbl.

56. Criminal Justice Act, *supra* note 2.

57. Money Laundering Regulations 1993 (Eng.).

been described as the “most demanding initiatives yet proposed by any legislative body to combat the phenomenon of ‘funny money.’”<sup>58</sup> Certainly the CJA 1993 radically extends the criminal sanctions available against those involved in money laundering.

*F. The Criminal Justice Act of 1993*

The CJA 1993 provisions add to existing statutes: its most noticeable additions are to what is now the Drug Trafficking Act 1994<sup>59</sup> and the Criminal Justice Act 1988.<sup>60</sup>

1. *Section 51, Drug Trafficking Act 1994*<sup>61</sup>— This creates the offense of knowingly acquiring or possessing property derived from drug trafficking. The aim of the section is to make it difficult for traffickers to pass on their trafficking-derived property to be held by third parties. Crucially for financial intermediaries and professional advisers, subsection (6) defines “possession” of property as “doing any act in relation to it.” Thus criminal liability is not restricted to those who assist in a positive way, but extends to anyone who knows that a particular client is a drug trafficker and acquires or uses property which represents the proceeds of trafficking. It is also important to note that while it is a defense to show that one has given adequate consideration for the property<sup>62</sup> subsection (4) excludes the provision of services which are of assistance in the drug trafficking from the definition of “adequate consideration.”<sup>63</sup> This provision, therefore, catches the professional knowingly laundering drug money if he is paid for his services, because the money used for payment will “indirectly represent the proceeds of drug trafficking”<sup>64</sup> as required by the section.

2. *Section 52, Drug Trafficking Act 1994*<sup>65</sup>— This section includes arguably the most draconian piece of the new legislation, and the relevant provisions are therefore laid out in full:

52 (1) A person is guilty of an offence if:

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58. BOSWORTH-DAVIES & SALTMARSH, *supra* note 17, at 119.

59. Drug Trafficking Act, *supra* note 40.

60. Criminal Justice Act, *supra* note 10.

61. Drug Trafficking Act, *supra* note 40, § 51.

62. *See id.* § 51(2).

63. *Id.* § 51(4).

64. *Id.*

65. Drug Trafficking Act 1994, § 52 (Eng.).

- (a) he knows or suspects that another person is engaged in drug money laundering;
- (b) the information . . . on which that knowledge or suspicion is based came to his knowledge in the course trade, profession, business or employment; and
- (c) he does not disclose the information . . . to a constable as soon as is reasonably practicable after it comes to his attention.<sup>66</sup>

The offense is punishable with up to five years imprisonment.<sup>67</sup> Technically, the offense relates only to knowledge or suspicion of *drug* money laundering. Nonetheless, it imposes a serious burden on the financial sector to ensure that it has compliance systems in place, and to report any suspicions that it might have. The ramifications of this offence are considered further below,<sup>68</sup> but even at first glance the gravity of its implications are apparent. Merely to suspect that another is involved in drug money laundering, and not to disclose one's suspicions, amounts to an offense if those suspicions are acquired in the workplace.<sup>69</sup>

There is a defense<sup>70</sup> that the person concerned reported his suspicion to another authorized by the company to be the "reporting" or "compliance" officer.<sup>71</sup> In practice, this "reporting up the line" will be the usual way to comply with the legislation, rather than the employee directly informing the police. While this eases the burden for individual employees, it places an onerous level of responsibility on the reporting officer. If he fails to act on the information as soon as is reasonably practical he commits the offense himself. Regarding solicitors' firms, although there is a defense that the information is subject to legal privilege,<sup>72</sup> this is defined by reference to section 10 of the Police and Criminal Justice Act 1984, and has been interpreted very narrowly.<sup>73</sup>

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66. *Id.*

67. *Id.* § 52.

68. See discussion *infra* part IV.F.3.

69. See generally Drug Trafficking Act, *supra* note 40.

70. *Id.* § 52.

71. *Id.*

72. See *id.* § 52(2).

73. See *R. v. Central Criminal Court, ex parte Francis & Francis* [1989] 1 A.C. 346. See also Police and Criminal Justice Act 1984 (Eng.).

3. *Section 53, Drug Trafficking Act 1994*<sup>74</sup>— This section creates an offense of tipping-off someone who knows or suspects that the police are conducting an investigation into drug money laundering and discloses to any other person information which is likely to prejudice the investigation.<sup>75</sup> This wide-ranging provision, again, poses risks to financial intermediaries, in particular, those who are concerned at the dangers of civil liability and who wish to approach the court for directions under the principle laid down in *Finers (a firm) v. Miro*.<sup>76</sup> It remains to be seen how effective the derided system of the “Chinese Wall” is in large financial conglomerates. It is easy to imagine circumstances in which one department is co-operating with the police in their inquiries while accidental disclosure of that fact to another department would prejudice the investigation and result in the commission of an offense under this section.

4. *Section 93A, Criminal Justice Act 1988*<sup>77</sup>— This provision is intended to fulfill the requirement in article 1 of the Directive that legislation should prevent the laundering of the proceeds of any criminal conduct.<sup>78</sup> Anyone concerned with an arrangement facilitating the disposal, investment, or transfer of the proceeds of criminal conduct on behalf of another, knowing, or suspecting that that other has benefited from criminal conduct, is guilty of an offense.<sup>79</sup> There is the usual defense of disclosure to a constable.<sup>80</sup>

Again, this is a wide-ranging provision. It has, somehow(!), been calculated that “it is theoretically possible to commit an offence under section 93A in 216 different ways.”<sup>81</sup> Its scope is considered further below.

5. *Section 93B, Criminal Justice Act 1988*<sup>82</sup>— This creates the offense of acquisition, possession, or use of the proceeds of

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74. Drug Trafficking Act, *supra* note 40, § 53.

75. *Id.*

76. [1991] 1 W.L.R. 35 (C.A.).

77. Criminal Justice Act, *supra* note 10, § 93A.

78. EC Money Laundering Directive, *supra* note 4, art. 1.

79. *Id.*

80. *Id.* art. 1.3.

81. BOSWORTH-DAVIES & SALTMARSH, *supra* note 17, at 128.

82. Criminal Justice Act, *supra* note 10, § 93B.

criminal conduct.<sup>83</sup> It is otherwise identical to section 51 of the DTA 1994.<sup>84</sup>

6. *Section 93C, Criminal Justice Act 1988*<sup>85</sup>— This provision is designed to punish anyone who assists in hiding property from the English courts, or removing it from the jurisdiction.<sup>86</sup> It extends to any action designed to disguise or remove evidence, or to remove assets which forms the subject of a confiscation order.<sup>87</sup>

Critically, the mens rea for this offense includes the objective element of “knowing or having reasonable grounds to suspect.”<sup>88</sup> This is important for intermediaries: even if they did not actually know or suspect that they were assisting in the transfer of money that was “dirty,” the Court may infer that reasonable grounds for suspicion existed, and sentence them to fourteen years in prison. Intermediaries are, thus, placed under a positive duty to consider the probability of the dealings of their clients, the nature of the transactions and whether they form part of a meaningful commercial relationship, or whether they are in fact an elaborate way of secreting illicitly-earned funds outside the jurisdiction. It is suggested that failure to make such inquiries could in future entail criminal liability if the circumstances were sufficient to satisfy the objective mens rea criterion.

As a result, the significance of this section should not be under-estimated. If used by the authorities to its full potential, section 93C should swiftly end the “Nelsonian” blindness so willingly displayed by many professional advisers in previous years in, for instance, setting up off-shore companies. The section also criminalizes bank employees who help in the transfer of assets, if there are reasonable grounds to suspect that their provenance was illicit.<sup>89</sup>

There is a defense that disclosure was made to the police, either in advance of the transaction and that it took place with police consent, or that disclosure was made as soon as was reasonably practicable after the transaction.<sup>90</sup> If there is a reason-

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83. *Id.*

84. Drug Trafficking Act, *supra* note 40, § 51.

85. Criminal Justice Act, *supra* note 10, § 93C.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.* § 93C.

90. *Id.*

able excuse why disclosure was not made as soon as reasonably practicable, then again there is a defense.<sup>91</sup>

7. *Section 93D, Criminal Justice Act 1988*<sup>92</sup>— This section mirrors section 53, DTA 1994, creating an offense of tipping-off, but extending its scope beyond drug money laundering to cover the proceeds of any criminal conduct.<sup>93</sup> Informing anyone other than the proper authorities or the Reporting Officer of a suspicion of laundering is an offense if it is likely to prejudice a present or future investigation.<sup>94</sup>

G. *The Money Laundering Regulations 1993 (The Regulations)*<sup>95</sup>

The Regulations were designed to ensure that financial institutions have systems in place to combat money laundering. The Regulations require that anyone conducting “relevant financial business”<sup>96</sup> puts in place internal procedures through which laundering can be prevented.<sup>97</sup> These procedures can be summarized as follows:

- identifying anyone with whom a financial business is forming a “business relationship”;
- keeping records for five years of all transactions and a copy of the evidence that was produced to satisfy proof of identity;
- putting in place an internal reporting structure so that anyone with a suspicion of laundering can make a report to a designated officer of the company, ensuring that the designated officer has access to any records that will enable him to decide whether to report a suspicion to the National Criminal Intelligence Service;
- training staff to recognise money laundering and to be aware of their duties under the legislation, including the procedures put in place in compliance with the Regulations.<sup>98</sup>

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91. *Id.*

92. Criminal Justice Act, *supra* note 10, § 93D.

93. *Id.*

94. *Id.*

95. Money Laundering Regulation 1993 (Eng.) [hereinafter The Regulations].

96. As widely defined by Reg. 4, and including “investment business” within the meaning of the Financial Services Act 1986 (Eng.). See The Regulations, *supra* note 95, § 4.

97. The Regulations, *supra* note 95.

98. *Id.*



The new duties placed on financial institutions are onerous and were greeted with dismay in many quarters of the City of London.<sup>99</sup> Merely failing to put in place adequate staff training is now an offense, punishable with two years imprisonment.<sup>100</sup> Indeed, the philosophy behind the Regulations has been described as “[a]ssist the authorities or face prison.”<sup>101</sup> Regardless of the cost to financial institutions of compliance,<sup>102</sup> the thought of directors of a High Street bank being jailed because they failed to train their staff to spot money launderers is a novel one.

If the institution is unable to identify a client within a reasonable period, there is a strict requirement that the transaction does not proceed. This is at odds with article seven of the EC Directive, which provides that financial institutions should carry out a transaction without informing the police, if failure to proceed with it is likely to arouse suspicion and frustrate a subsequent investigation.<sup>103</sup> Institutions are in a dilemma: if they inform the police they risk prejudicing an investigation if delay creates suspicion. It is suggested that institutions report their suspicions anyway: article seven is not mirrored in the domestic legislation, and it may be difficult for the institution concerned to show the police why it did not make immediate disclosure, attracting liability under section 52, DTA 1994.

It is not just the specter of criminal liability, though, that should haunt financial intermediaries following the CJA 1993 and the Regulations. While it is perfectly understandable that such bodies should do all in their power to comply with the new legislation, it is vital that they remain alert to the abyss into which they may fall if they forget the dangers of civil liability: constructive trusteeship.

## V. The Dangers of Civil Liability

Intermediaries are today caught on all sides: a rapidly developing but uncertain civil law obligation, labelled constructive

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99. See Roger Fink, *UK Bankers Right to Worry about Directive*, FIN. TIMES, Nov. 8, 1994, at 16.

100. The Regulations, *supra* note 95, § 5.

101. Robert Finney, *UK Money Laundering Laws after the Reforms of 1993*, [1993] B.J.B.L. 530, 534.

102. Estimated by HM Treasury at £230,000 starting-up costs for a large Unit Trust company, and then £150,000 pa.

103. EC Money Laundering Directive, *supra* note 4, art. 7.

trusteeship, on one side and a plethora of wholly new criminal penalties on the other.<sup>104</sup>

The philosophy behind the new legislation mirrors that prevalent in securities regulation for years: "Know Your Client." The concept of Due Diligence is hardly a new one, yet the provisions of the CJA 1993 return it to the forefront and again raise the issue of the uneasy relationship between civil and criminal liability. The new legislation may appear to be well conceived when viewed in isolation on the statute book; however, an examination of the civil liabilities facing intermediaries reveals, perhaps, the reverse.

The essential problem is this: compliance with the criminal legislation exposes an intermediary to a greater risk of civil liability. The underlying principle is well-established from cases such as *Barnes v. Addy*<sup>105</sup> and *Selangor United Rubber Estates Ltd. v. Cradock (a bankrupt) (No. 3)*.<sup>106</sup> If X receives property that he knows is transferred to him in breach of trust, then he receives it qua constructive trustee, but, crucially for financial intermediaries, liability is not confined to "knowing receipt." Such an institution can also be fixed with liability if it knowingly assists in a breach of trust, as *Barnes v. Addy* itself shows.<sup>107</sup>

To the layperson, such an observation should not concern the honest intermediary, who could not possibly knowingly become involved in a commercial fraud. To the lawyer, however, it is the vexed question of what constitutes "knowledge" that has caused so much concern. The recent decision of the Privy Council in *Royal Brunei Airlines v. Tan*,<sup>108</sup> with its emphasis on dishonesty rather than knowledge as the key to liability, is to be welcomed. Nonetheless, the parameters of liability here are far from certain; while this makes it difficult to assert that a fixed level of knowledge will undoubtedly entail liability, it is submitted that the surrounding uncertainty only makes it more difficult for intermediaries to ascertain exactly where the risks lie.

This section begins by attempting to reach some tentative conclusions as to what level of knowledge is required to fix an institution with potential liability. It then looks at the Regulations, and at the Guidance Notes issued by the Joint Money Laundering

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104. Editorial, 1 J. INT'L PLAN. 55 (1992).

105. [1874] 9 Ch. App. 244.

106. [1968] 1 W.L.R. 1555.

107. [1874] 9 Ch. App. 244.

108. *Royal Brunei Airlines*, [1995] 2 A.C. 378.

Steering Group, and describes how much institutions are expected to find out about their clients. Then follows a comparison of the two: if, a bank or a firm of solicitors has, in its possession, the information about its client's activities required of it by the Regulations, the bank or firm assists its client in those activities, and it emerges that those activities may involve a breach of trust, will the bank or firm be in possession of sufficient information to be liable as a constructive trustee?

Actions seeking to impose constructive trust liability are on the rise.<sup>109</sup> The Chancery Division now constantly faces claims by liquidators and administrators to impose liability on directors and financial institutions allegedly involved in a breach of duty. Since 1989, in addition to the claims against the banks involved in the Barlow Clowes, Polly Peck and Maxwell scandals, there have been those against chartered accountants<sup>110</sup> and brokers.<sup>111</sup> It has been observed that the new activism by the courts, in using the constructive trust as a tool of asset recovery, marks a significant addition to the legal armoury against fraudsters and money launderers.<sup>112</sup> While this is, of course, correct, typically the principal defendant who has initiated the fraud will not have sufficient assets at his disposal to meet any substantial order made against him. As a result, as Sir John Mummery pointed out,<sup>113</sup> the administrators or liquidators turn instead to a financial institution, allegedly involved in the breach of duty, that will be able to meet a claim if found liable.<sup>114</sup> The dangers are particularly potent if the money has been successfully laundered, because the proprietary remedy of tracing is unavailable to the plaintiff. The only course of action for recovery of funds is thus to seek to make someone personally liable, with the knowing assistant being the obvious candidate. The dangers of a financial intermediary being joined as a defendant are thus very real, even if its conduct has been simply to "ask no questions" and otherwise falls short of being morally reprehensible. To most, this conduct seems dishonest in itself. It should be noted, though, that large areas of the banking industry and other financial intermediaries have until

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109. Sir John Mummery, *Liability for Involvement in a Breach of Fiduciary Duty*, 1 J. INT'L PLAN. 57, 66 (1992).

110. *Agip (Africa) Ltd. v. Jackson*, [1990] Ch. 265.

111. *Eagle Trust plc. v. S.B.C. Securities Ltd.*, [1992] 4 All E.R. 488.

112. See, e.g., Ben Strong, *Civil Asset Recovery Procedures: How Equity deters Fraud*, 13 COMPANY LAW. 44 (1992).

113. See Mummery, *supra* note 109.

114. *Id.*

recently flourished largely by adopting this approach. The “discreet” (as they would no doubt term it) service offered by many banks is very much at odds with the current judicial willingness to impose accessory liability.

A. *The Level of Knowledge Required for the Imposition of Constructive Trusteeship*

The question of the level of knowledge required to become fixed with liability qua constructive trustee is a vexed one, and there is uncertainty surrounding the conflicting dicta emerging from the courts in recent years. It is an established principle of equity that, where a person knowingly participates in another’s breach of trust, he will be regarded as standing in the same place as the trustee.<sup>115</sup> The position has been summed up as follows by Snell’s *Principles of Equity*:<sup>116</sup>

[Strangers to a trust will be liable] if they assist with knowledge in a dishonest and fraudulent design on the part of the trustees. The requisite knowledge has been described as knowledge of circumstances which would indicate to an honest, reasonable man that such a design was being committed or would put him on inquiry, which the stranger failed to make, whether it was being committed.<sup>117</sup>

While this is a useful summary, it is necessary to consider the recent cases in more detail, and to look in particular at the decision of Mr. Justice Millett in *Agip (Africa) Ltd. v Jackson*<sup>118</sup> and of the Privy Council in *Royal Brunei Airlines v. Tan*.<sup>119</sup>

In *Agip*, the oil company, Agip, had employed a dishonest accountant, Zdiri.<sup>120</sup> Zdiri was suborned into joining a Parisian crime syndicate, one member of whom was a French lawyer, C.<sup>121</sup> C approached Jackson, an accountant on The Isle of Man, who, on C’s behalf, created various companies on The Isle of Man and opened various bank accounts in England.<sup>122</sup> Zdiri then misappropriated large sums of money from Agip, which were promptly

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115. *Selangor United Rubber Estates Ltd. v. Cradock (a bankrupt) (no.3)*, [1968] 1 W.L.R. 1555.

116. E. SNELL, *PRINCIPLES OF EQUITY* (28 ed. 1982).

117. *Id.* at 192.

118. [1990] Ch. 265.

119. [1995] 2 A.C. 378.

120. *Agip*, [1990] Ch. 265.

121. *Id.*

122. *Id.*

laundered through The Isle of Man companies and London accounts created by Jackson, and disappeared.<sup>123</sup> Agip brought an action against Jackson, claiming, *inter alia*, that he had knowingly assisted in a fraudulent breach of trust.<sup>124</sup> No proprietary claim lay against him as a trustee in the strict sense of the word, rather it was asserted by Agip that he should be personally liable to make restitution as if he were a trustee, since he was "guilty of wilful and reckless failure to make the inquiries which honest men would have made in order to satisfy themselves that they were not acting in furtherance of the fraud."<sup>125</sup>

The question arising before Mr. Justice Millett, at first instance dealt with the state of knowledge required for such liability to be imposed.<sup>126</sup> The learned judge confirmed that to be liable as a constructive trustee for "knowing receipt," constructive notice of the breach of trust sufficed.<sup>127</sup> This, however, was a case concerning "knowing assistance," and different criteria were applicable.<sup>128</sup> To render a stranger to the trust liable for "knowing assistance," the breach of trust had to be a fraudulent one.<sup>129</sup> Logically, therefore, constructive notice on the part of the stranger could not make him liable, because it would be ludicrous to conclude that the principal had to be fraudulent to incur liability, while the assistant could be liable simply for negligence, "Dishonest furtherance of the dishonest scheme of another is an understandable basis for liability; negligent but honest failure to appreciate that someone else's scheme is dishonest is not. . . . The true distinction is between honesty and dishonesty."<sup>130</sup> This criterion for liability avoided difficult distinctions between different shades of knowledge.

Mr. Justice Millett continued by considering what amounted to dishonesty:

If a man does not draw the obvious inference or make the obvious inquiries, the question is, why not? If it is because, however foolishly, he did not suspect wrongdoing or, having suspected it, had his suspicions allayed, however unreasonably, that is one thing. But if he did suspect wrongdoing yet failed

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123. *Id.*

124. *Id.*

125. *Agip*, [1990] Ch. at 274.

126. *Id.*

127. *Id.*

128. *Id.*

129. This has recently been doubted by the Privy Council in *Royal Brunei Airlines v. Tan*, [1995] 2 A.C. 378.

130. *Agip*, [1990] Ch. at 292.

to make inquiries because he “did not want to know” or because he regarded it as “none of his business,” that is quite another. Such conduct is dishonest, and those who are guilty of it cannot complain if, for the purpose of civil liability, *they are treated as if they had actual knowledge*.<sup>131</sup>

The last nine words reveal that while Mr. Justice Millett claimed constructive knowledge was insufficient for the imposition of liability, he was prepared to treat the defendants “as if they had actual knowledge,” that for example, they were liable even though they did not have actual knowledge because they had failed “to draw the obvious inference.”<sup>132</sup> It is submitted that the line between this and constructive knowledge is an extremely fine one. Although the distinction between honesty and dishonesty as being the test for liability should be welcomed, avoiding as it does the difficulties of classifying different degrees of knowledge faced by Judge Peter Gibson in *Baden, Delvaux and Lecuit v. Societe Generale S.A.*,<sup>133</sup> it still requires some difficult inferences to be drawn. Its application has recently been confirmed by the decision of the Privy Council in *Royal Brunei Airlines v. Tan*.<sup>134</sup>

Mr. Justice Millett concluded with remarks that must have caused many financial intermediaries to ponder the implications of his judgment with considerable care:

Secrecy is the badge of fraud. . . . It is not necessary that [the stranger to the trust] should have been aware of the precise nature of the fraud or even of the identity of the victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party . . . . [The defendants] made no inquiries of the plaintiffs because they thought that it was none of their business. That is not honest behaviour. The sooner that those who provide the services of nominee companies for the purpose of enabling their clients to keep their activities secret realise it, the better. In my judgment, it is quite enough to make them liable to account as constructive trustees.<sup>135</sup>

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131. *Id.* at 293 (emphasis added).

132. *Id.*

133. [1983] B.C.L.C. 325.

134. [1995] 2 A.C. 378.

135. *Agip*, [1990] Ch. at 294.

It is unfortunate that the Court of Appeal<sup>136</sup> did not comment on these observations, even though it reached the same conclusions as Mr. Justice Millett. It is also unfortunate that Lord Justice Fox of that court muddied the waters by apparently contradicting Millett over the criterion for liability. Lord Justice Fox held that liability flowed not from dishonesty but from the degree of knowledge set out by Mr. Justice Ungood-Thomas in *Selangor United Rubber Estates v. Cradock*,<sup>137</sup> namely knowledge of circumstances which would put on inquiry an honest and reasonable man.<sup>138</sup> The decision of Mr. Justice Vinelott in *Eagle Trust plc v. SBC Securities Ltd.*,<sup>139</sup> however, has plastered over this gap, taking it as settled law that the test is one of honesty or lack thereof.

In *Royal Brunei Airlines v. Tan*,<sup>140</sup> the airline had appointed a travel agent to act as its general agent for the sale of passenger and cargo transportation.<sup>141</sup> The agent was required to account to the airline for all amounts received from such sales, and it was a trustee for the airline of the money.<sup>142</sup> The money, however, was paid into the agent's current account and used for the agent's other business purposes.<sup>143</sup> The defendant, Tan, was the managing director and principal shareholder of the travel agent, which became unable to pay the airline the sums owed.<sup>144</sup> The airline relied on liability for "knowing assistance" in bringing an action in equity against the defendant.<sup>145</sup>

Lord Nicholls, giving the judgment of the Privy Council, held that the touchstone of liability was dishonesty.<sup>146</sup> This meant simply not acting as an honest person would in the circumstances, and that was an objective standard. However, honesty had a strong subjective standard, because it described a type of conduct assessed in the light of what a person actually knew at the time. This definition of honesty reinforces the author's view that it is impossible to divorce the concepts of knowledge and honesty, however

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136. *Agip (Africa) Ltd v. Jackson*, [1991] Ch. 547.

137. [1968] 1 W.L.R. 1555.

138. *Id.*

139. [1991] B.C.L.C. 438.

140. [1995] 2 A.C. 378.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Royal Brunei Airlines*, 2 A.C. 378.

146. *Id.*

much the Privy Council seeks to move away from the former and towards the latter in its attempt to form the basis of liability. His Lordship said, in words that will go some way to assuage the fears of intermediaries, that carelessness was not dishonesty, which "for the most part" was to be equated with "conscious impropriety."<sup>147</sup> But the learned judge went on to state that an honest person did not deliberately close his eyes and ears, or deliberately not ask questions, lest he learned something he would rather not know, and then proceed regardless.<sup>148</sup> Furthermore, Lord Nicholls clearly had little time for those who argue that in many commercial situations that it can be difficult to ascertain the nature of the transaction, opining that an honest person should have little difficulty in knowing whether a proposed transaction, or his participation in it, would offend the normally accepted standards of honest conduct, "The individual is expected to attain the standard which would be observed by an honest person placed in those circumstances. It is impossible to be more specific."<sup>149</sup> His Lordship went on to say that the courts should move away from trying to define different shades of "knowledge." Knowingly was inept as a criterion when applied to the gradually darkening spectrum where the differences were of degree and not kind.<sup>150</sup>

However, knowledge and honesty are clearly inextricably linked or else there would be no danger to banks from finding out too much about their clients. The better view is that constructive knowledge is insufficient, but that actual knowledge of the fraud, and therefore dishonesty, can be imputed where the defendant failed to draw the obvious inferences from the circumstances, knew facts which would have put an honest and reasonable person on notice, and yet proceeded regardless. What is initially startling about *Agip* is that the defendant accountants, who had, at all times, acted in accordance with their clients' instructions and with no actual knowledge of any fraud, were made personally liable to account for \$518,823.<sup>151</sup> The case shows how adept equity has become at adapting the ancient concept of the trust to combat modern multi-jurisdictional fraud, and in this instance, to imposing liability on those who had assisted in that fraud by laundering its proceeds.

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147. *Id.*

148. *Id.*

149. *Id.*

150. *Royal Brunei Airlines*, 2 A.C. 378.

151. *Agip*, [1990] Ch. 265.



Although dishonesty is now seen as the key to liability, so that the dangers to essentially honest intermediaries seem to be receding, the position is still uncertain and the tenor of the Millett judgment in *Agip* demonstrates that the courts take a dim view of institutions who thrive on the confidentiality of their services. The blameworthiness of Mr. Jackson is not a relevant issue here.<sup>152</sup> The Millett decision is discussed here only to highlight the dangers to financial intermediaries of becoming involved in laundering the proceeds of fraud, and of learning too much about their clients' transactions.

The Money Laundering Regulations require institutions to gather increasing amounts of material about their clients in order to protect themselves from criminal liability, and yet the presence of such material means that they are left being forced to guarantee the integrity of every transaction with which they are involved, or face the consequences if any transaction turns out to be tarnished by fraud. Such bodies cannot deliberately resist finding out too much since even the omission to collate information is now an offense.<sup>153</sup>

Another case that raises similar specters to haunt financial intermediaries is *Finers (a firm) v. Miro*.<sup>154</sup> A firm of London solicitors acted on behalf of an American client and invested in various offshore trusts in the Caribbean.<sup>155</sup> One of the firm's partners overheard remarks about this client, as a result he grew suspicious that the money the firm was being asked to invest represented the proceeds of fraud.<sup>156</sup> He, therefore, applied to the court under R.S.C. Order 85<sup>157</sup> for directions in respect of the funds. He feared that if he continued to follow his client's instructions, his firm risked exactly the same liability as that imposed on Mr. Jackson in *Agip*.<sup>158</sup> There was a dilemma, though, for, on the other hand if he ignored his client's instructions, he risked a personal claim against him by the client for breach of legal privilege and confidentiality.<sup>159</sup>

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152. Although it seems possible that today he would be guilty of an offense under section 93C, Criminal Justice Act, *supra* note 10.

153. See The Regulations, *supra* note 95, § 5.

154. [1991] 1 W.L.R. 35 (C.A.).

155. *Id.*

156. *Id.*

157. SUP. CT. R. ORD. 85 (ENG.).

158. See *Finers*, [1991] 1 W.L.R. 35.

159. Several other claims could also arise for refusing to carry out the client's instructions and these are discussed further below, *infra* part V.C.

The Court of Appeal held that the prima facie case of fraud removed the client's claim to legal privilege: "fraud unravels all obligations of confidence."<sup>160</sup> This principle is well-established, and dates from 1856, when the Court of Appeal held in *Gartside v. Oughtram*<sup>161</sup> that "there is no confidence as to the disclosure of iniquity."<sup>162</sup> The Court went further, however. Not only was *Finers* released from its duties of confidentiality to its former client, it was placed under a positive duty to advise potential victims of the fraud of its suspicions.<sup>163</sup> As soon as the firm was aware of the possibility of fraud, if it wished to ensure freedom from constructive trustee liability, it had to search for those who may have had a claim and advise them accordingly.<sup>164</sup>

On its facts, a neat and satisfactory conclusion may have been reached in this case; the ramifications of their Lordships' decision, however, further increase the pressures on financial intermediaries. It is unfortunate that the Court did not see fit to give the reasoning behind its ruling, Lord Justice Balcombe contented himself with the observation that:

Without going into detail, it seems to me that the evidence here presented on behalf of the plaintiffs is such that it is entirely right that the plaintiffs should be directed to tell the liquidator of the existence of these proceedings so that he may decide whether he wishes to make any claim to those assets, or, if appropriate, against the plaintiffs themselves.<sup>165</sup>

Given the importance of his decision, it seems surprising that the detailed reasoning was excluded.

If the Regulations do require a sufficiently high amount of information about a client for the intermediary to be put on inquiry for the purpose of constructive trust liability, then the decision of the court in *Finers* means that the intermediary will also be required to seek potential victims of the breach, and face the risk of huge claims if it does not. If it grows suspicious, and makes a report under the Regulations, the fact that it felt compelled to make a report may mean that it is also obliged to seek the court's directions on informing would-be victims, or face the consequences.

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160. *Finers*, [1991] 1 W.L.R. 35, (Balcombe, L.J.)

161. (1856) 26 L.J. Ch. 113.

162. *Id.* at 114.

163. *Finers*, [1991] 1 W.L.R. at 35, 47.

164. *Id.*

165. *Id.* at 46.

*B. The Level of Knowledge Required by the Money Laundering Regulations 1993*

This, of course, is mere speculation unless the Regulations do, in fact, require enough information to be gathered to fix the intermediary with potential civil liability. The question of what the responsibility of an intermediary is when accepting a client's funds or assisting him in a transaction was considered above. The related questions of what an intermediary should find out about its client's affairs, and when it is proper for the intermediary to divulge what he knows, must now be discussed.

The ambit of the Regulations has already been mentioned.<sup>166</sup> What is at issue here is what, in practice, will be demanded of financial institutions in the way of additional knowledge about their clients. As a result, the Guidance Notes issued by the Joint Money Laundering Steering Group are considered as well as the Regulations themselves, because by Regulation 5(3), "In determining whether a person has complied with any of the requirements [of the Regulations], a court may take account of . . . any relevant supervisory or regulatory guidance which applies to that person."<sup>167</sup>

As previously noted, there are four primary obligations imposed on institutions by the Regulations. In the context of knowledge sufficient to create a danger of constructive trust liability, the particularly relevant regulations will be those pertaining to identification.<sup>168</sup> The philosophy behind the identification provisions lies at the center of the Regulations. Given that the purpose of laundering dirty money is to conceal not only the source but also the ownership of the proceeds of crime, the ability to identify exactly with whom one is transacting is crucial if laundering is to be successfully combated. As a result, Regulation 7 provides that if an institution cannot obtain satisfactory evidence of a new client's identity, it may not proceed further with a transaction.<sup>169</sup>

One provision, particularly interesting in the present discussion, is the identification procedures required for transactions on behalf of a third party.<sup>170</sup> Crucially, the frequency with which

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166. See *supra* part IV.G.

167. The Regulations, *supra* note 95, § 5(3).

168. Since this requires the intermediary to gather knowledge about the transaction.

169. The Regulations, *supra* note 95, § 7.

170. *Id.* § 9.

shell companies and trust companies are used in money laundering to conceal the beneficial ownership of assets, Regulation 9 makes clear that where an "applicant for business is or appears to be acting otherwise than as principal, . . . reasonable measures must be taken for the purpose of establishing the identity of any person on whose behalf the applicant for business is acting."<sup>171</sup> As a result, institutions will be unable to sidestep liability by maintaining that they checked the identity of the other party when that other party is merely an agent for the launderer. This would have otherwise been a major loophole, for as Rider has pointed out, the modern money launderer is unlikely to be involved as a member of a criminal organization.<sup>172</sup> There is often a seemingly legitimate "front man," who could normally pass off what he was doing, for example, setting up an offshore company, as just another routine transaction for another client.<sup>173</sup> Regulation 9 ensures that financial institutions look beyond the veneer of such transactions to see who is the real beneficiary.<sup>174</sup> They cannot claim that they thought they were dealing with a fellow professional, and thus were at no time suspicious.

Merely being aware of the identity of one's client would not, however, seem to give an intermediary so much information about the client and the client's business as to fix the intermediary with potential constructive trust liability. For that level of knowledge, it is submitted, the intermediary would need to know more than the identity of its client to be deemed wanting in probity, even by the exacting standards of the Chancery Division. Surely an intermediary would also need to be aware of the provenance of the funds in question, and the nature of any relevant transaction, before it could be expected to become suspicious under *Finers* principles and seek directions from the court.

If this reasoning is correct, then the Regulations do not *prima facie* require financial institutions to acquire dangerous levels of information. An examination of the compliance systems utilized by these institutions, however, makes clear that the dangers are there. The Regulations were greeted with so much hype in the financial world and institutions are so worried by the thought of criminal liability, that some institutions seem to be gathering far more information about their clients than is necessary under the

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171. *Id.*

172. Rider, *supra* note 11, at 34.

173. *Id.*

174. The Regulations, *supra* note 95, § 9.

Regulations. What they have presumably failed to realize is that in the rush to avoid criminal penalties by gathering such information, they are "putting their necks on the chopping board" as far as civil liability is concerned.

It is impossible to reach conclusions about how compliance is being effected across the board, but taking as an example the identification systems of one London law firm, this pitfall is immediately apparent. The firm starts by asking for the client's name and address, and for a bank reference. If the reference comes from an obscure bank "prudence suggests that we ask for sight of the client's passport." In respect to a corporate client, a copy of the Certificate of Incorporation, or the latest audited accounts should be obtained, preferably from the auditors. Obtaining these from the client's auditors provides an additional layer of comfort since the auditors have had to exercise due diligence themselves. As the Guidance Notes also stipulate, this firm's procedure makes clear that "[i]t would not be sufficient to rely on details provided by the introducer of the new client. The fact that a partner or other fee-earner may have known that introducer for some years does not mean that the introducer has been diligent in the investigation of the new client himself."<sup>175</sup> This is prudent given the comment of the Court of Appeal in *Agip*, "The respectability of the person making the introduction did not relieve Mr. Jackson from the obligation to make proper enquiries as to suspicious circumstances coming to his notice then or subsequently."<sup>176</sup>

The firm then moves on, however, to satisfy itself as to the identity of the funds, something not required by the Regulations. Arguably, it should be required, because merely identifying someone does not prevent him from laundering money. The firm asks how the client intends to fund the proposed transaction. If the client says bank borrowing, then this can easily be verified, but if the client says from his/its own funds, then it is necessary to ask the client where he or it earned or received that money from . . . . Since the innocent client may take offense from something not dealt with sensitively, a standardized question should be asked:

The proposed transaction will involve the expenditure of money by you/your company and I am therefore required to ask how you propose to finance the transaction.

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175. GUIDANCE NOTES, *supra* note 15, at ¶ 54 (iv).

176. *Agip*, [1991] Ch. at 547.

Such thoroughness is admirable although, despite the standardized question, it is perhaps easy to imagine a potential client taking offense! It seems fairly clear, however, that with such levels of knowledge, the firm would find it difficult to avoid claims for knowing assistance in the event that it emerged that the firm had become involved in laundering the proceeds of a breach of trust. The fee-earner has been required by the firm's guidelines to become aware of the identity of the client, has been required to become aware of the provenance of the funds, and has been told to be alert to transactions that do not make commercial sense. If he still proceeds to assist in a transaction, which subsequently emerges to be a laundering one, is that not an example of the "wilful blindness" of which Justice Millett was so critical in *Agip*?<sup>177</sup>

The way in which some intermediaries have reacted to the Regulations and to section 52 DTA 1994, then, has resulted in an over-hasty rush headlong into compliance with the criminal legislation without consideration of the civil law implications.

### C. *The Problem of Tipping Off*

If this approach to the new legislation is commonplace, then every time an intermediary discloses its suspicions, it must consider whether or not it has sufficient information about its client's activities to be fixed with liability as constructive trustee. It has been previously argued that some firms will have acquired such information. However, even if a firm which is fairly certain that it has not, what firm will risk a subsequent finding in court that it has? The consequences of mistakenly assuming that one's institution is ignorant enough to be in the clear would be horrendous, entailing potentially huge personal liabilities. Surely, any intermediary will be sufficiently concerned about its own position to approach the court for directions.

*Finers v. Miro*<sup>178</sup> was perceived by some as a case resulting in a procedure for financial intermediaries, enabling them to safeguard their position vis-a-vis civil liability by approaching the court for directions.<sup>179</sup> This conclusion, no doubt correct when viewed in isolation, demonstrates, nonetheless, a clear lack of understanding between those who practice criminal and civil law.

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177. See *supra* pp. 485-87.

178. [1991] 1 W.L.R. 35 (C.A.).

179. See generally Mummery, *supra* note 109.

The implications of section 52, DTA 1994 and section 93D of the CJA 1988 arguably prevent such an approach for directions. By section 52, DTA 1994, a person is guilty of an offense if "he knows or suspects that another person is engaged in drug money laundering; the information . . . came to his attention in the course of his . . . business; and he does not disclose the information or other matter to a constable as soon as is reasonably practical after it comes to his attention."<sup>180</sup> Thus, an intermediary who becomes suspicious of his client's activities is under a duty to report his suspicions immediately, and faces a five-year prison term if he does not.

One expert argues that this only relates to a suspicion of drug money laundering, and since there is no mandatory requirement to report a suspicion of "non-drug" money laundering,<sup>181</sup> section 52 does not raise any constructive trust problems for intermediaries. After all, the beneficial owner of the money is the drugs trafficker, who is scarcely likely to bring a claim in the Chancery Division.<sup>182</sup>

The author disagrees. It is difficult to conceive of circumstances in which an intermediary is so certain of his exact suspicions that he can say with any degree of confidence that, although he was suspicious that his client was involved in money laundering, he was absolutely positive that it was not drug-related laundering. Given the penalties for failing to make timely disclosure, is an intermediary really going to hold back from making a disclosure because he thinks that the funds being laundered are probably, the proceeds of a fraud? There will always be an inkling of doubt, and hence a suspicion, that the laundering might be of drug money. An expert, writing on a related issue, goes so far as to admit:

It seems very difficult to define . . . how any person, once their [sic] initial suspicions had been aroused in the prescribed circumstances [i.e. a suspicion of drug money laundering], could reasonably distinguish between one financial transaction, which they suspected was drug money laundering, and a later transaction which they could subsequently say with any degree of certainty was not drug money laundering.<sup>183</sup>

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180. Drug Trafficking Act, *supra* note 40, § 52.

181. Interview with Rowan Bosworth-Davies of Titmuss Sainer Dechert (Apr. 7, 1995). The author acknowledges gratefully the assistance derived from this conversation.

182. *Id.*

183. Rowan Bosworth-Davies, *Once disclosed, Twice shy*, MONEY LAUNDERING BULL., Mar. 1995, at 5.

If this is correct, then, by the same argument, it would be very difficult for a bank or other institution to assert that, while they initially suspected money laundering, they were convinced that it was not drug money laundering. Rather, given the way in which intermediaries are falling over themselves to comply with the new law, it is submitted that most intermediaries will contact NCIS<sup>184</sup> immediately.

It can equally be argued that although there is no mandatory requirement to report a suspicion of a client's activity if that activity is not suspected to be drugs-related, as soon as the intermediary has gone so far as to accept or process funds on behalf of that client, he has committed an offense under section 93A of the Criminal Justice Act 1988, regardless of whether the money is the proceeds of drug-dealing or any other crime. This is the crime of "assisting another to retain the benefit of [any] criminal conduct."<sup>185</sup> The only defense to prosecution under this section is that the intermediary's suspicions were disclosed to a constable. Thus, if the intermediary has had any dealings with the client, disclosure is essential even if drug money laundering that is suspected. Whichever view is taken, it seems prudent immediately to inform NCIS.

Again, it is this rush to comply with the criminal legislation that will see firms and banks in a subsequent dilemma about their civil liabilities. If they do not make their disclosure to NCIS "as soon as is reasonably practicable after it comes to [their] attention,"<sup>186</sup> they have committed an offense. Yet once they have made a disclosure to NCIS, as will now be seen, an application to the court on a *Finers* basis will almost certainly involve the offense of tipping-off.

By section 93D of the Criminal Justice Act 1988, "a person is guilty of an offence if he knows *or suspects* that a constable is . . . *proposing to act* in connection with an investigation which is being, *or is about to be*, conducted into money laundering; and he discloses to any other person information or any other matter which is likely to prejudice that investigation, *or proposed investigation*."<sup>187</sup> It is submitted that making an application to the court on the principles set down in *Finers v. Miro* will, *prima facie*,

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184. The National Criminal Intelligence Service (Eng.).

185. Criminal Justice Act, *supra* note 10, § 93A.

186. As required by section 52 of the Drug Trafficking Act, *supra* note 40.

187. Criminal Justice Act, *supra* note 10, § 93D (emphasis added).



amount to a breach of this provision. The suspicious client will be named as defendant to the proceedings, and thus will immediately be aware that he is under investigation by the authorities. The intermediary, by approaching the court to avoid civil liability has, as a result, undermined the criminal investigation and has unwittingly committed an offense under section 93D. It is difficult to avoid reaching such a conclusion. However benevolently the Act is construed in favor of the intermediary, the courts cannot ignore the wording of section 93D: any disclosure of one's suspicions to anyone other than NCIS is likely to prejudice NCIS's investigation, and will therefore constitute an offense.<sup>188</sup>

Is there no way to avoid this dilemma? One practitioner suggests that the solution is to make the *Finers* application to the court before making the report to NCIS.<sup>189</sup> He argues that until the NCIS report has been filed, no intermediary can "know or suspect that a constable is acting, or is proposing to act,"<sup>190</sup> which is the state of knowledge required before the tipping-off offense is committed, thus, starting a *Finers* application at that stage will not constitute tipping-off.<sup>191</sup>

With respect, if an intermediary knows that, within an hour of making his *Finers* application, he will be making a report to NCIS as required under section 52, surely he will "suspect that a constable is proposing to act?"<sup>192</sup> It could conceivably be argued that at the time of making the application the constable could not possibly be "proposing to act," because the constable at that time would not know anything about the affair. If this is the basis of the argument, then it is possible that it might prove a successful defense. The courts should do all that they can to help an intermediary who is caught in what is a particularly acute dilemma. It is perfectly understandable that an intermediary should want to protect himself on both civil and criminal flanks, and as long as he acts in good faith throughout, criminal sanctions should not be imposed.

The other problem in these circumstances is that if the *Finers* application is made before disclosure to NCIS, NCIS could argue that disclosure had not been made "as soon as is reasonably

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188. *See id.*

189. Interview with Mr. Miles Laddie of Denton Hall (Apr. 7, 1995). The author acknowledges gratefully the assistance derived from this conversation.

190. *Id.*

191. *Id.*

192. *See id.*

practicable after it comes to [the intermediary's] attention,"<sup>193</sup> thus constituting an offense under section 52. Although this remains a theoretical possibility, it is submitted that unless unnecessary delays had taken place before disclosure, the intermediary should not be held to have committed an offense. The intermediary could argue, with some justification, that it was not "reasonably practicable" to make disclosure to NCIS until the *Finers* application had been lodged. The problem, of course, is that a *Finers* application would almost certainly undermine a subsequent police investigation, and NCIS as a result would have a fairly jaded view of the activities of the intermediary and might not be prepared similarly to interpret the Act.

*D. Claims Against Intermediaries by Clients for Loss Suffered as a Result of Disclosure and Subsequent Refusal to Accept Instructions*

Assuming that the intermediary successfully negotiates the minefield of avoiding both criminal liability and a constructive trust claim, it is necessary to consider his liability to the suspected client in the event that his suspicions are groundless. What if, say, the intermediary (a solicitor) has five million pounds sitting in a client account to finance a property transaction for his client, purchasing some land which is to be developed and rapidly resold at a twenty percent profit. The day before contracts are to be exchanged, the solicitor suddenly grows suspicious about the provenance of the funds. He is concerned that they might be the proceeds of a drugs-related crime, and will be in breach of section 52, DTA 1994 if he does not make a disclosure to NCIS. He makes a *Finers* application to the court, immediately discloses his suspicions to NCIS, and until he hears further from NCIS refuses to follow his client's instructions in respect of the funds.<sup>194</sup> The client is unable to continue with the property transaction and the vendor finds another purchaser who develops the property and sells it six months later for six million pounds. NCIS then discontinues its investigations, informing the solicitor that his suspicions were groundless. The client has, by this stage, lost the chance to make a million pound profit, and has instructed new solicitors who bring on his behalf a legal malpractice action against the original firm.

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193. Drug Trafficking Act, *supra* note 40, § 52.

194. To do otherwise, as seen above, constitutes an offense. *See supra* part IV.F.2.

This is a distinct possibility. The legislation does provide certain immunity from suit for intermediaries that make disclosure, but it is submitted that this immunity is not as comprehensive as most commentators seem to think. It protects a firm only from an action for breach of confidence; a firm cannot be sued for the act of disclosure itself. Section 50, DTA 1994<sup>195</sup> provides:

(3) (a) the disclosure shall not be treated as *a breach of any restriction upon the disclosure* of information imposed by contract, or by any enactment, regulation, rule of conduct or other provision.<sup>196</sup>

What is not clear is whether this would protect a firm from the kind of action suggested in the circumstances above. On a strict interpretation of section 50, it would appear not. The disgruntled client would not be suing for the act of disclosure itself<sup>197</sup> but for breach of contract with a quantifiable loss of one million pounds. Neither are tort actions ruled out by the immunity. Thus it is theoretically possible that even if the client had not suffered a quantifiable monetary loss, it could still bring an action for defamation. An allegation of involvement in money laundering, that reached a market where a spotless reputation is of paramount importance, would obviously be highly defamatory with an equally high measure of damages.

Again, there is a worrying gap here between an intermediary's criminal and civil law obligations. Section 52 demands disclosure in circumstances where the civil law says that the bank should continue to act in accordance with the client's mandate.<sup>198</sup> Such is apparent from the case of *Lipkin Gorman v. Karpnale Ltd.*<sup>199</sup> In that case, a partner of a firm of solicitors fraudulently withdrew money from a client account to fund his compulsive gambling.<sup>200</sup> The question was whether the bank were liable for assisting him in this fraudulent breach of trust by allowing him to continue to withdraw funds.<sup>201</sup> At first instance, the Judge accepted the following propositions put to him by counsel:

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195. Section 93A makes a similar provision for those who make a disclosure under the Act: the Anti-Terrorist Acts also contain similar terms. See Drug Trafficking Act, *supra* note 40, § 93A. See also *supra* part IV.D.

196. Drug Trafficking Act, *supra* note 40, § 50 (emphasis added).

197. For example, a breach of confidence.

198. *Id.* § 52.

199. [1987] 1 W.L.R. 987.

200. *Id.*

201. *Id.*

- A bank is entitled to treat the customer's mandate at its face value save in extreme cases.
- The bank is not entitled to question any transaction which is in accordance with the mandate, unless a reasonable banker would have grounds for believing that the authorised signatories are misusing their authority.
- *Mere suspicion or unease do not constitute reasonable grounds and are not enough to justify the bank in failing to act in accordance with the mandate.*
- A bank is not required to act as an amateur detective.<sup>202</sup>

Thus, while section 52 mandates a bank to report its suspicions and to refuse to accept a client's instructions, if these propositions are good law, the bank cannot avoid civil liability for breaking its mandate with the client through "mere suspicion or unease."<sup>203</sup> Perhaps section 52 should be taken to have impliedly overruled this part of the judgment in *Lipkin Gorman*.

Some comfort can be derived from the decision of Judge Cruden sitting in the Hong Kong High Court in the case of *Nanus Asia Co. Inc. v. Standered Chartered Bank*.<sup>204</sup> In that case, Judge Cruden held that where a bank had actual knowledge that funds were the proceeds of a fraud from which arose a constructive trust, the exceptional situation arose of the bank ceasing to be under its contractual duty to comply with its customer's instructions.<sup>205</sup> It is submitted, however, that such actual knowledge will be rare.

The possibilities of liability mentioned here are highly speculative. It is clear, though, that the CJA 1993 does not adequately implement the EC Money Laundering Directive, which goes further in providing complete immunity, stipulating that disclosure in good faith should not "involve the credit or financial institution, its directors or employees in liability of any kind."<sup>206</sup> Bearing in mind that the Act was designed to implement the Directive, and that the interpretation of the Act is open to question,<sup>207</sup> arguably the Act should be interpreted in the light of the Directive and any action brought against an intermediary struck out where the intermediary has acted in good faith. It remains to

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202. *Id.*

203. *See id.*

204. [1990] 1 H.K.L.R. 392.

205. *Id.*

206. EC Money Laundering Directive, *supra* note 4, art. 9.

207. Did Parliament really intend to leave such a hole in the intermediary's immunity from suit?

be seen, however, how the courts will react to such an action if one is brought by a suspected client suffering loss.

## VI. Conclusion

The CJA 1993 and the Money Laundering Regulations have heralded a new regime in the war against money laundering. While it is too early to predict its usefulness, the new legislation shows that the Government intends to ensure that Britain does not become viewed as a haven for money laundering. It has, therefore imposed stringent obligations on financial institutions, which are particularly at risk of becoming tainted by laundering, in the hope that the threat of severe criminal penalties will ensure their cooperation.<sup>208</sup> The new legislation, viewed in isolation, is certainly capable of imposing criminal liability on those who assist in money laundering, and should be an effective weapon against such people if used to its full potential. To that extent, it is to be welcomed.

What Parliament has not adequately considered are the civil law ramifications of the new legislation. It is this oversight, coupled with the recent activism of the courts in imposing constructive trust liability, that has resulted in a trap of potentially huge magnitude which awaits the unwitting intermediary who does not comprehend the consequences of his suspicions.

Parliament can also be criticized for not providing the complete immunity contained in the Directive for institutions that make an erroneous disclosure. Arguably, the state should indemnify those who are groundlessly reported under the new legislation if, as a result, they have suffered loss. What is unacceptable is that financial intermediaries should be required to comply with criminal legislation when such compliance is not only wholly alien to their traditional commercial practices, but also leaves them vulnerable to a claim against them from their former clients for breach of contract.

This Article has sought to highlight some problems with the legislation. Many of them are speculative. It remains to be seen whether the Chancery Division and the Old Bailey<sup>209</sup> can strike a balance between jailing money launderers on the one hand, and releasing financial intermediaries from the horns of their particularly acute dilemma on the other. In the meantime, intermediaries

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208. See The Regulations, *supra* note 95.

209. The Central Criminal Court of England and Wales.

would do well to recall the words of Mr. Justice Millett in *Agip*:  
“Secrecy is the badge of fraud.”<sup>210</sup>

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210. [1990] Ch. 265.

