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# Contents

<b>SUMMARY</b>	<b>1</b>
<b>PREFACE</b>	<b>2</b>
<b>ABBREVIATIONS</b>	<b>3</b>
<b>1 INTRODUCTION</b>	<b>4</b>
1.1 Background	4
1.2 Questions At Issue	5
1.3 Method, Material and Outline	6
<b>2 THE CONTEXT OF MONEY LAUNDERING</b>	<b>8</b>
2.1 Functions of the Financial System in General	8
2.2 Crime as a Business	9
2.2.1 <i>In general</i>	9
2.2.2 <i>Definition</i>	10
2.2.3 <i>Modus Operandi</i>	11
2.3 The Rationale for Combating Money Laundering	13
<b>3 INTERNATIONAL REGULATION AND NATIONAL IMPLEMENTATION</b>	<b>16</b>
3.1 United Nations – The Vienna Convention	16
3.2 The Basel Committee Statement	17
3.3 FATF - 40 Recommendations	19
3.4 European Community – the Money Laundering Directives	21
3.4.1 <i>General remarks</i>	21
3.4.2 <i>The First Money Laundering Directive</i>	21
3.4.3 <i>The Second Money Laundering Directive</i>	23
3.4.4 <i>The Third Money Laundering Directive</i>	24
3.5 From rule to risk based approach	25
3.6 National implementation	26
3.6.1 <i>In general</i>	26
3.6.2 <i>Act on Measures Against Money Laundering (1993:768)</i>	26
Definition	26
Regulated activities	27
Non-participation	28
Customer Due Diligence	28

Investigatory and Reporting Duty	29
Tipping-off prohibition	29
Internal procedures and training	30
Criminalisation	30
<b>3.6.3 English implementation</b>	<b>30</b>
<b>4 BANK AND CUSTOMER – POSSIBLE CONFLICTS</b>	<b>32</b>
4.1 The notion of banking and customer	32
4.2 Bank Secrecy	33
4.2.1 Background	33
4.2.2 <i>Tournier v. National Provincial and Union Bank of England</i>	34
4.2.3 <i>Bank Secrecy – statutory secrecy provisions in Swedish legislation</i>	35
4.2.4 <i>Safe harbour provision</i>	37
4.3 Payment Services	37
4.4 Reasonable Suspicion	39
4.5 Non-participation	42
4.6 Case law	43
4.6.1 <i>Court of Appeal case Brodin vs. Nordea AB (T-7503-01)</i>	43
4.6.2 <i>Squirrel Ltd v. National Westminster Bank</i>	46
4.6.3 <i>K Ltd v. National Westminster Bank plc. (Revenue and Customs Commissioners and another intervening)</i>	49
4.6.4 <i>Tayeb v. HSBC Bank plc</i>	51
4.7 Civil Liability	55
4.7.1 <i>General remarks</i>	55
4.7.2 <i>Contractual liability to the customer</i>	56
4.7.3 <i>Tortious liability</i>	60
<b>5 CONCLUSIONS</b>	<b>61</b>
<b>BIBLIOGRAPHY</b>	<b>63</b>
<b>TABLE OF CASES</b>	<b>69</b>

# Summary

Financial services and cross-border financial activities have developed considerably due to the globalisation of the economy. The utilisation of these new opportunities has, however, attracted financial activities that relates to money laundering. Money laundering is a way to separate and conceal the proceeds of crime in order to reinvest or simply use it in the open economy, without drawing the attention of the authorities.

The regulatory initiatives stem first and foremost from FATF and the EU. Regarding the European Union and the three Money Laundering Directives, the national implementation has been fairly uniform, with administrative measures to combat this phenomenon. These measures include in particular the use of a suspicious transaction reporting system, whereby the regulated undertaking is obliged to investigate and report suspicious transactions that may be associated with money laundering. Coupled with the reporting duty is the duty not to participate or facilitate suspicious transactions in any way. The Swedish Act on Measures Against Money Laundering implements the aforementioned Money Laundering Directives. Almost all financial activities are now a part of the reporting regime. The extension of the reporting regime as well as a move from rule- to risk based customer due diligence may have adverse effects, even for the ordinary customer. One key feature of the customer due diligence is the subjective judgment of the regulated undertaking, which may render a transaction in one case as suspicious and in another case as legitimate. Since the regulation prohibits any facilitation of transactions when there is reasonable suspicion of money laundering, a wrongful assumption of suspicion may cause delay to a suspect transaction.

The basis and level for the suspicion is not defined by the regulation, only brief guidelines may serve as indicators of money laundering. This leaves considerable leeway for the bank in most cases. A “gut-feeling” seems to be sufficient in many cases.

Most obligations are superseded by the money laundering regulation. The duty of confidentiality is qualified in these cases, by a statutory exception. The recent time limits for cross border credit transfers are also subject to exception if the bank raises suspicion of money laundering.

The risk for the bank to face civil liability in case of a wrongful suspicion is probably limited to cases of intentional or grossly negligent reports. The few cases that have addressed this issue indicate that the bank has considerable leeway in disclosing and taking appropriate actions.

# Preface

During the autumn of 2005 I attended the Centre for Commercial Law at the Queen Mary University of London. The studies were part of a Scandinavian exchange program and were comprised of banking law in general. During these studies I became interested in money laundering in particular especially the civil/administrative part that the banks have to observe and comply to. One of my friends at the student dorm suddenly got his bank account cancelled. The bank stated in a fairly polite way, that they had been unable to check his identity and thus were forced to close down the account. That action was a result of the money laundering regulation and I became aware that this legal area of the banking law has consequences to the ordinary customer. After my return I read an article in the local newspaper with the headline "Fondkunder hos Banco reagerar på nytt idkrav"<sup>1</sup>. These events as well as my interest in general banking law have encouraged me to examine this expanding legal area.

A word of thanks to my supervisor, Professor Lars Gorton, for helping and assisting me. I would also like to mention my employer, Swedish Armed Forces, First Submarine Flotilla, especially Commander Jonas Haggren for giving me the time needed to complete this survey.

*Malmö, February 2008*

*Anders Wiklund*

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<sup>1</sup> Sydsvenska Dagbladet Snällposten, tisdagen 13 juni 2006.

# Abbreviations

AML	<u>A</u> nti- <u>M</u> oney <u>L</u> aundering
CDD	<u>C</u> ustomer <u>D</u> ue <u>D</u> iligence
CFT	<u>C</u> ombating the <u>F</u> inancing of <u>T</u> errorism
CIP	<u>C</u> ustomer <u>I</u> dentification <u>P</u> rocess
CTF	<u>C</u> ounter <u>T</u> errorist <u>F</u> inancing
CTR	<u>C</u> urrency <u>T</u> ransaction <u>R</u> eport
FATF	<u>F</u> inancial <u>A</u> ctions <u>T</u> ask <u>F</u> orce
FIU	<u>F</u> inance <u>I</u> ntelligence <u>U</u> nit
FSA	Financial Supervisory Authority
NCCTs	<u>N</u> on- <u>C</u> ooperative <u>C</u> ountries and <u>T</u> erritories
OCC	<u>O</u> ffice of the <u>C</u> omptroller of the <u>C</u> urrency
POCA	<u>P</u> roceeds <u>O</u> f <u>C</u> rimes <u>A</u> ct 2002
SAR	<u>S</u> suspicious <u>A</u> ctivity <u>R</u> eport
SEK	The Swedish Currency <i>Kronor</i>
U.N.	<u>U</u> nited <u>N</u> ations
Vienna Convention	United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances adopted in Vienna on 19 <sup>th</sup> December 1988

# 1 Introduction

## 1.1 Background

Traditionally the financial system has been subject to regulation and supervision, for several reasons. The banks in-built potential for instability is an issue that has been subject to regulation. The globalisation and the evolution of the Single Market in the European Union is another context that has called for an international development of the financial regulation. Financial services are dependent on the free movement of capital.

During the last twenty years there has been an increased focus on the use of the financial system for money laundering purposes. The need to launder illicit funds arises because criminals such as organised crime syndicates, drug traffickers and corrupt politicians have to quickly transfer and transform their dirty money into clean funds. There are two reasons for this. The first reason is to separate such funds from the crimes that generated them (generally referred as “predicate offences”) and thereby avoiding detection and criminal prosecution. The second reason is to protect those funds from seizure and confiscation by the law enforcement authorities, thereby allowing them to enjoy the fruits of their crimes.

A common way of putting a label on this problem is to use metaphors. *Combating* money laundering and the *war* against terrorist financing are two examples on the use of a military metaphor. I think there are close points of similarity with an unconventional war since the organised crime may be viewed upon as a financial guerilla, utilising the civil environment and the financial system for conducting its illicit operations. The current war against organised crime, and money laundering in particular, involves intelligence gathering and target acquisition by the use of the financial institutions. The gatekeeper solution, whereby the financial institutions are obliged to report suspicious transactions is one approach many countries have adopted. The banks are thus more or less responsible for detecting and preventing these operations. The government’s responsibility is to evaluate this information and deploy their limited resources accordingly, since the money laundering offences are an exclusive matter for the financial police to investigate and to prosecute. The financial cost involved with the responsibilities on the financial industry is regrettable but unavoidable. Wars are always costly.

The measures that have evolved to combat this phenomenon encompass different types of regulations, ranging from criminal law, civil law to self-regulation and business practices. At the international level, there has been a mixture of hard law and soft law. The hard law consists of international treaties adopted by for instance the United Nations and the European Community. The soft law consists of various recommendations, guidelines, codes and best practices issued by different international organisations and financial supervisory bodies. The soft law may be looked upon as “putting

flesh and bones”<sup>2</sup> on the general principles that the hard law sets out. On the national level it has been up to the individual countries to implement this mixture of hard law and soft law through national regulation and effective compliance. Likewise, the financial institutions and other entities and persons implement such rules in their internal policies, operations and systems.

Two systems have evolved, the objective and the subjective model. The objective model involves mandatory reporting of transactions in excess of a threshold amount. The U.S. have adopted a Currency Transaction Report system (CTR), which leaves less to the discretion of the regulated entities or persons and may be regarded as to promote uniformity and consistency in enforcement. The downside is the inefficiency. Between 1987 and 1995 77 million CTRs were filed to the authorities. Only about 3000 led to prosecution for money laundering offences. In the end only 580 guilty verdicts was produced. Thus, the ratio of 99 999 CTRs to one guilty verdict is not promoting the objective model.<sup>3</sup>

The subjective model is governed by a Suspicious Transaction Reporting system (STR), which is based on subjective judgment of a combination of factors. These factors range from the personality of the customer to his behaviour, the type and terms of the transaction asked for and whether the transaction is a usual one or not. The majority of states worldwide have adopted a system based on the subjective model. One obvious concern is the ambit of “suspicious”, whereby legitimate transactions may be impeded.

## 1.2 Questions At Issue

In the financial system the banks and other financial intermediaries are central as they provide and manage the payments systems. The payor gives the bank a payment message with the instructions to effect payment in favour of the payee.<sup>4</sup> To categorize the relationship between the customer and the bank the term *mandate* is often useful to outline the authority for a bank to act in a particular way. Once it is binding on the bank, the bank must act or be in breach of contract. Acting outside any authority so conferred, this will not be binding on the customer and the bank will be liable for any loss.

The bank is as the financial intermediary central for this survey. A pivotal issue in money laundering prevention is the decision, whether an activity, a person or funds are legitimate or not. This classification is performed by the bank as it acts with diligence. By “knowing” its customers the bank may have to take proactive measures if they suspect that a money laundering

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<sup>2</sup> Morais, p 602.

<sup>3</sup> See the article “Mugging Privacy in the Assault on Crime” by Lawrence B. Lindsey, <http://www.cei.org/pdf/2372.pdf> (as by March 29, 2007)

<sup>4</sup> Cranston, *Principles of Banking Law*, 2002, p 233.



offence is evident. The regulation is harsh and involvement may cause criminal liability as well as reputational damage. The regulation acts as an incentive not to be associated with money laundering in any way.

The other focal point of this survey is the flip side of this coin, the customer. Most of the customers are not involved in money laundering and the interest to have access to dependent financial services is of the greatest importance.

The question at issue is to examine the money laundering regulation in general and the reporting regime in particular. A duly situation may be the case where a transaction, that a bank regards as suspicious and thus are obliged to report and stop, turns out to be legitimate and the customer is subject to a pure economic loss. What is the ambit and the range of the current money laundering regulation in this particular aspect? Is there any possibility to claim a pure economic loss for legitimate transactions that are stopped because of a mere suspicion? Is there a balance so that legitimate business and commercial activities are not unnecessarily impeded?

### **1.3 Method, Material and Outline**

I have applied a traditional legal method in this survey. The main body is descriptive and since this area of the banking law is comprised of both public law and private/civil law, I have chosen to see the interaction between these two perspectives.

The survey will examine the Swedish regulation in this area. Due to the lack of relevant cases, the survey will look into common law and the few cases that address the question at issue. The Swedish and English regulation is similar due to the influence of international regulatory initiatives and measures taken by the European Community.

The material used in this survey consists first and foremost of international and national legal acts. Since the national implementation is based on international agreements I have chosen to briefly present the relevant international regulatory initiatives. Guidelines and relevant business practices are also examined.

The doctrine regarding the regulation is not extensive, but the works of Graham & Bell as well as Ross Cranston have been useful throughout the analysis. Other valuable resources have been the preparatory works of the money laundering legislation in Sweden

The analysis is divided into four chapters. An introduction, international and national legislation, bank – customer issues and finally the conclusive remarks. The first chapter presents the context of the problem with money laundering. The modus operandi of money laundering is presented along with the rationale for taking measures against it.

The second chapter consists of a brief presentation of the international efforts and relevant guidelines that have addressed this issue. The money laundering regulation on the national level has developed from these international counter-measures, so I have chosen to make a brief orientation of the most important legal sources. The latter part of this chapter presents the national implementation in Sweden of these treaties. Special attention will be given to the due diligence requirements and the mandatory reporting of suspicious transactions, which the bank is subject to perform in relation to the customer. This is important in order to outline the public obligations and to analyse the scope and ambit of the provisions that might impede the business relations between the bank and the customer.

The third chapter presents the relationship between the bank and the customer, in particular the code of practice in dealing with account holders and transactions like payment services. The obligations towards the customer, such as the duty of confidentiality, and issues of liability and breach of contract are examined. Cases that relate to this issue are presented along with a general discussion of the preparatory works of the Swedish money laundering regulation and the uncharted area which this results in.

Finally, the last chapter comprises the concluding remarks of this survey.

# 2 The Context of Money Laundering

## 2.1 Functions of the Financial System in General

The financial system plays an important role in every economy. No economy would work without the possibility to access financial services like payments, to have credit facilities, sign-up for insurance or simply to save money. In order for the economy to work it is vital and a necessity to have financial services to some degree and often the financial system is described as the infrastructure of the economy. Traditionally the financial system has been given three important functions.<sup>5</sup>

The first function is to allocate capital from individuals and companies who have a surplus to those who have a shortage. This is often provided by different intermediaries like banks, insurance companies and pension funds. They are acting on different markets to match the borrowers with the lenders. This will reduce the transaction costs and boost the efficiency.<sup>6</sup>

The second function of the financial system is risk management. This is often done either by reducing or even eliminating the financial risk, or by allocating the risk. Intermediaries, like banks, are often using “risk-pooling” as a method of reducing the financial risk.<sup>7</sup> If a bank is lending money to a large number of companies, non-dependent of each other, the bank can offer a much more stable pay-off than if a single company were to invest the money by themselves in a single project. This is basically how an insurance company works. Individuals, who are often considered to be risk-averse, will create a demand for risk-pooling, just as they create a demand for insurances. The risk-averse individual who has to choose between two alternatives, with the same expected outcome, will choose the alternative which has the highest probability of the expected outcome.<sup>8</sup>

The third function is to provide a payment system.<sup>9</sup> An effective and secure payment system provides an infrastructure for the economy. The objective is to lower the transaction costs<sup>10</sup> through swift and secure methods of payments. The relation between buyer-seller often involves an intermediary like a bank. If the seller has to worry about the intermediary’s credibility it

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<sup>5</sup> *Green paper*, SOU 1998:160, p 109.

<sup>6</sup> Falkman, p 35.

<sup>7</sup> *Ibid*, p 38.

<sup>8</sup> Cooter&Ulen, p 44.

<sup>9</sup> Falkman, p 40.

<sup>10</sup> Cooter&Ulen, p 91.

will most certainly affect the transaction costs. Therefore the quality of the “infrastructure” is a vital part of the financial system.

## 2.2 Crime as a Business

### 2.2.1 In general

The acquisition of, and control over, wealth is the motivation for most serious crimes.<sup>11</sup> Many criminal activities have been organised in one way or another. The meaning of organised crime is often dependent on the context where the expression occurs. Just as an ordinary business, organised crime tries to exploit new markets and this often involves a cross-border activity. Other sorts of criminal activities are simply not feasible without proper training, capital and coordination. This in turn demands more resources in order to enhance the possible outcome. One way of getting access to more resources is to organise and conduct criminal activity in larger scale.<sup>12</sup> For several hundred years criminal organisations have plagued the world. Some examples are the Italian Mafia, the Chinese Triads and the multi-ethnic crime scene in U.S. with the Cosa Nostra, Chinese groups and Eastern European criminal syndicates.

All activities that have an economic undercurrent are using the financial infrastructure to gain access to financial services and the possibilities to move capital are essential to all these financial activities. The link between money and crime is a unilateral issue. However, since crime pays, there has been an increased opportunity for criminals to use the financial system in order to manage the proceeds of crime, just like a legitimate business. The organised crime in the U.S. has started to conduct business within the construction sector as well as the textile and transportation industry.<sup>13</sup> By the widening the risk is allocated to more than one activity. As somebody stated, “it is only the actual activities that are illegal”.<sup>14</sup> In Sweden organised crime often revolves around different ethnic groups and motorcycle gangs.

There are several incentives for money laundering. Organised crime operates, exploits markets and move capital freely in and between other countries. Criminal organisations are not limited in the same jurisdiction as the law enforcement agencies often are. Thus, the globalisation has called for new solutions concerning the way crime is perceived and approached by those charged with fighting it.

Criminals do not work for free and money plays an important role in any activity, whether it is lawful or unlawful as it motivates and facilitates

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<sup>11</sup> Rider, *Recovering the proceeds of corruption*, p 9.

<sup>12</sup> *Green paper*, Ds 1997:51, p 151.

<sup>13</sup> *Green paper*, Ds 1997:51, p 159.

<sup>14</sup> *Green paper*, Ds 1997:51, p 158.

actions.<sup>15</sup> As all businesses, criminal organisations need to reinvest in order to sustain growth. Usually the profits from crime arrive as cash and is thus inviting the authorities' attention. The two options the criminal has are therefore;

1. Keeping the profits in cash and finding a way to use it without drawing the attention of the law enforcement.

This first option is only useful for minor sums of cash since spending and using larger sums may draw unwanted attention to the actions. Cash may be physically hidden but this will not earn interest. A third possible action that may be used when dealing with cash is to buy high-value assets such as property, jewellery or artworks.

2. Transferring the wealth into a non-cash form that might make it appear more legitimate.

This second option is far more useful. By introducing the cash into the mainstream financial system, the "crime industry" can manage the assets in a far more undetected way. Instead of handling the profits in large amounts of notes, the criminal can transform the profits into an electronically recorded credit in a bank account. By a series of transactions the possibility to follow the trail of the money is diminished. After a period of time, a reintroduction of the money into the economy will be as ostensibly legitimate as possible and the wealth may be openly used by the criminal. The financial system used in money laundering is the oxygen of crime. It is also above all the financial industry that is suffering from economic crime and commercial fraud.

## 2.2.2 Definition

FATF<sup>16</sup> has defined money laundering as "the conversion or transfer of property, the concealment or disguise of its true nature or source or the acquisition, possession or use of property knowing it to be criminally derived"<sup>17</sup>.

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<sup>15</sup> Gallant, p 138.

<sup>16</sup> Financial Actions Task Force, established by the G7 in 1989 to examine the flow of illegal money and of money laundering methods.

<sup>17</sup> The full definition laid down by FATF is as follows:

1. The conversion or transfer of property, knowing that such property is derived from a criminal offence, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of its actions;
2. The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from a criminal offence, and
3. The acquisition, possession or use of property, knowing that such property was derived from a criminal offence or from an act of participation in such offence.

## 2.2.3 Modus Operandi

Money laundering is a series of actions in order for the criminal to spend and use the money safely and avoid suspicion and detection. The modus operandi can be described as the recycling of criminally derived funds through normal financial system operations with the view to make the funds available for future legitimate or illegitimate use while, at the same time, disguising their true source to protect them from seizure.

A common misunderstanding is that money laundering only encompasses the dealing with cash.<sup>18</sup> Many forms of crime produce quantities of cash in relatively low denomination. Another false belief is that it only concerns the proceeds of drug-related crime.<sup>19</sup> A more balanced rationale for money laundering is the need for “unaccountable funds”, whereby the true source of the funds is obscured. The process is somewhat different depending on the purpose for the illicit funds.<sup>20</sup> If the funds are to be used for reinvesting in crime it is important that the transactions do not establish a connection with other risk activity. The funds will not have to appear to originate from a legitimate source, since it is circulated in the crime business. But if the funds are to be used in common financial transactions, for instance in penetrating a organisation or a financial institution, the funds will not only have to be unconnected with the activity that generated it, it will also have to appear as legitimate and are thus mingled with legitimately earned funds.<sup>21</sup>

The money laundering process typically follows three stages, “wash, dry and fold”<sup>22</sup>. This is of course a simplification, but I will still use it to frame the following discussion.

*Placement* involves the physical disposal of bulk cash proceeds from their location of acquisition to avoid attention.<sup>23</sup> High turnover and relatively low investment enterprises that are outside the conventional banking system are often used to consolidate cash. This stage of the money laundering process involves logistical obstacles and a high probability of detection. Placement is often performed through the financial accounts of cash-based retail services such as restaurants and laundries, often these establishments are a cover business established for money laundering.<sup>24</sup> By mixing the legitimate money of the cover business with the illicit funds from the criminal activity the money launderer lowers the probability of detection. Typically the use of casinos have been the preferred choice for money laundering, but nowadays this gambling industry falls within the regulation in most countries. However, in some countries it is largely an unregulated business and thus a

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<sup>18</sup> Finansinspektionens rapport 2006:17, p 5.

<sup>19</sup> Rider, p 1.

<sup>20</sup> Rider, p 2.

<sup>21</sup> Graham, p 6.

<sup>22</sup> Rueda, p 173.

<sup>23</sup> Graham, p 5.

<sup>24</sup> Rueda, p 174.

loop-hole for money laundering.<sup>25</sup> Another example of a practically untraceable method is the Peso Exchange.<sup>26</sup>

*Layering* encompasses the separation of illicit proceeds from their source through the use of complex financial transactions to disguise their audit trail. This part of the money laundering consists of a series of parallel transactions which entails the creation of many layers of artificial or quasi-artificial transactions between the dirty money and the ultimately laundered money. Layering typically involves the movement of funds from one financial institution to a series of others.<sup>27</sup> The illicit funds enter the conventional banking system either directly, or indirectly via a company or a legal entity in this jurisdiction. Once the bulk cash has been transformed into a more useable form, the funds are transferred or smuggled into an offshore facility. The first and foremost reason for this cross-border transfer is to place the funds beyond legal reach of the authorities of the jurisdiction where the activity giving rise to the profits occurred. Even if the relevant laws are applicable on extraterritorial basis, significant practical obstacles await authorities in the following investigation. Non-compliant jurisdictions or jurisdictions with a high degree of secrecy are often attractive. A popular method is to use a legitimate import-export business and simply over-invoicing goods sold by a legitimate offshore company, not very seldom controlled by the money launderer.<sup>28</sup> The money launderer is buying and selling commodities repeatedly, paying trade losses with illicit funds and receiving in exchange a check legitimised as trading profits. The result is that the connection between the illicit activity that generated the illicit funds and the apparently legitimate trading activities are extinguished. The use of futures brokers, as they act as principals and not in their clients name, is also an obstacle the authorities are facing in an investigation.<sup>29</sup>

*Integration*<sup>30</sup> involves the conversion of the proceeds into apparently legitimate business earnings through normal financial or commercial operations in the real economy. This stage typically involves measures to acquire ostensible legitimacy to the funds. Integration is achieved when a legitimate banker, lawyer or fiduciary would not suspect the origins of the money, not even after performing a thorough due diligence of the “customer”. In other words, during the integration stage the money is successfully reintroduced in the regular economy. A reintroduction of the

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<sup>25</sup> See especially Rueda, p 177, where Aruba is considered as a haven for money laundering since the eleven casinos are not encompassed by the islands’ anti-money laundering legislation.

<sup>26</sup> See Rueda, pp 174. The Peso Exchange basically relies on the interaction between drug traffickers and Colombian businessmen. The brokers of the Peso Exchange pair up drug traffickers who want to repatriate U.S. drug profits with businessmen who want to purchase U.S. goods. The businessmen pay in Peso to the trafficker and the trafficker pays in dollar for the goods. The broker gets a commission for the arrangement.

<sup>27</sup> Lacey & Crutchfield, p 268.

<sup>28</sup> Systematic overpricing and underpricing of products entering and leaving the U.S. is a method that enables the transfer of sums of money abroad upon proof of documents and fraudulently avoids taxes at home when the goods are eventually sold.

<sup>29</sup> Rueda, p 179.

<sup>30</sup> Lacey & Crutchfield, p 268.

washed money is often performed in order to make them appear as legitimate, and winnings or a loan can be an ostensibly legitimate acquisition.<sup>31</sup> Another common investment is the acquisition of real estate property. “Real estate flips” involve a wide variety of methods are available<sup>32</sup>, but one popular method has been the use of credit cards issued by an offshore bank. The card account information will generally be protected by the same rules that protect the underlying bank account. By arranging fake loans from an offshore controlled corporation, the criminal’s business is receiving a loan that is a non-taxable asset as well as deductible in terms of interest. Once the loan has been incurred the borrower repays to himself. The illegal funds are deposited in a foreign financial institution as security for domestic loans.<sup>33</sup>

## 2.3 The Rationale for Combating Money Laundering

The close interaction between organised crime and money laundering is obvious. Four main principles have been suggested as reasons for combating money laundering.

First and foremost is the need to prevent criminals to benefit from their actions. Crime must not pay. If it does, the criminals might finance additional crime to finance and expand their activities and the level of crime is ultimately increased.

Secondly, this underground activity and use of the financial system for a criminal purpose has the potential to undermine the individual financial institutions, and ultimately the integrity of the entire financial sector.<sup>34</sup> Systemic issues have been central to the regulation of banks. Risk is defined in this aspect as a probability that a certain, unpleasurable, event occurs.<sup>35</sup> Systemic risk is the risk for disturbances to the financial system, affecting its function.<sup>36</sup> It is dependent partly of the probability of a sudden and unexpected event occurs and partly of the effects of such event. It means that if the probability is very limited that something happens, but the effects are large, it still represents a systemic risk. Based on the view that externalities, out of systemic reasons, can cause significant social costs to the system as a whole, there have been several<sup>37</sup> reasons why a regulation and supervision should exist regarding banks.

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<sup>31</sup> *Green paper*, Ds 1997:51, p 129.

<sup>32</sup> See the website <http://www.crimes-of-persuasion.com/Criminals/integration.htm> for more information about integration techniques in the area of money laundering.

<sup>33</sup> Lacey, p 268.

<sup>34</sup> See the Basel Statement of Principles

<sup>35</sup> *Green paper*, SOU 1998:160, p 193.

<sup>36</sup> Falkman, p 31.

<sup>37</sup> Goodhart, p 13. See also Cranston, p 67, concerning the systemic risk and the need for safeguards to protect the banks in particular. The three central reasons are;



The third reason is to prevent the undermining of public confidence of the legal system and the financial system. The unchecked laundering of illicit funds may, in turn, promote additional economic crime.

The fourth reason to take measures against money laundering is the actual threat against society as a whole. Corruption and accumulation of financial power to organised crime may endanger national economies and democratic systems.

From the financial intermediary's point of view there are several reasons for complying with the money laundering regulation. The new Basel Capital Accord requires banks to align their capital more closely with three underlying risks: credit, market and operational risk. Operational risk has been defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events."<sup>38</sup> Operational risk includes the risk for loss due to certain events, including internal and external fraud, robbery, forgery system failures and *money laundering*<sup>39</sup>.

The obvious risk for criminal or civil liability is of course also an incentive for compliance. The risk for the intermediary to get fines or even get their license withdrawn is a measure that can constrain banks in their business relations and perhaps promote a more thorough approach towards the KYC principles that is promoted by the regulation. Perhaps an even greater incentive is the reputational damage if employees are prosecuted for laundering proceeds of crime.<sup>40</sup> In 2004, Riggs Bank and Citigroup were subject to civil money penalties of \$25 million and criminal penalties of \$16 million. The OCC found that Riggs Bank "failed to implement an effective anti-money laundering program. As a result, it did not detect or investigate

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1. The bank's central position in the financial system, especially in managing the clearing and payments system
  2. The interconnectedness between banks, where one bank can directly cause problems to another bank. This contagious effect can turn a solvent financial institution into insolvency, since a panic may drive down the current value of those assets that are marketable.
  3. The nature of bank contracts, where assets and debts have different risk and liquidity. The unbalance between the debts and the assets regarding the measure of liquidity can contribute to turn a solvent bank into insolvency if the credibility is questioned.

<sup>38</sup> See <http://www.bis.org/publ/bcbs107b.pdf> paragraph 644.

<sup>39</sup> Emphasis added.

<sup>40</sup> The prosecution and later the conviction of two employees in the Bank of New York can serve as an example. Lucy Edwards, a London-based vice president of the Eastern Europe branch of Bank of New York along with her husband Peter Berlin, arranged via a complex scheme of wire transfers a steady flow of illicit funds from Russia to the U.S. In 1999, Berlin opened two accounts at the Manhattan branches of the Bank of New York that were used in connection with an illegal money transferring business. Operating in conjunction with a Moscow bank, employees of a Queens, N.Y.-based company, the name on the accounts, would move funds via wire transfer each day using BoNY electronic software. This transfer allowed Russian citizens and businesses to move funds out of Russia without paying customs duties and taxes.

Bank of New York admitted its guilt and paid \$12 millions to an unnamed recipient and another \$26 millions in fines to avoid prosecution for money laundering charges.

suspicious transactions and had not filed Suspicious Transaction Reports as required under the law.”<sup>41</sup> In September 2004 regulators in Japan ordered Citigroup to close its private bank operations due to violations which included concerns about failure of AML internal system controls. Citigroup acknowledged these deficiencies and the value of the company’s shares declined by 2.75% the week following the announcement by the Japanese regulators. Riggs paid the ultimate price since they were taken over by PNC Bank.<sup>42</sup>

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<sup>41</sup> See <http://www.occ.treas.gov/ftp/eas/EA2004-44.pdf>

<sup>42</sup> Johnston & Carrington, p 52.

# 3 International Regulation and National Implementation

## 3.1 United Nations – The Vienna Convention

In December 1984 the U.N. General Assembly unanimously adopted a resolution<sup>43</sup> in which the U.N. Economic and Social Council was requested to instruct the Commission on Narcotic Drugs to prepare a draft convention against “illicit traffic in narcotic drugs which considers the various aspects of the problem as a whole and, in particular, those not envisaged in existing international instruments”<sup>44</sup>. The following conference in Vienna in February 1988 resulted in the adoption of the Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention). Earlier agreements<sup>45</sup> encompassed the production of narcotics and the subsequent diversion of drugs into the marketplace. The Vienna Convention recognised for the first time that the central component in combating the drug trafficking organisations was to undermine the financial strength of these organisations. The international scale of the problem was also recognised by the Vienna conference, which was attended by 106 countries as well as some intergovernmental organisations like the European Community and the Council of Europe. The Vienna Convention entered into force on November 11, 1990, and by the February 21 2007 it had attracted 181 parties.

The Vienna Convention sets forth several obligations on the participating countries. Article 3 obliges the countries to criminalise a comprehensive list of activities connected to drug trafficking; Article 3.1a lists several drug related offences such as production, cultivation and possession of drugs as well as the management and the financing of these offences. Without the penalisation it is not possible to prosecute criminals and to use means of coercion (for example seizure and confiscation)<sup>46</sup>

Although the term “money laundering” is not used in the convention, Article 3.1b<sup>47</sup> has identified the constituent elements of money laundering which form the basis for all subsequent legislation.<sup>48</sup>

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<sup>43</sup> See U.N. Resolution 39/141 of 14<sup>th</sup> December 1984.

<sup>44</sup> U.N. Resolution 39/141 of 14<sup>th</sup> December 1984, para. 3.

<sup>45</sup> Other agreements in this area include the 1961 U.N. Single Convention on Narcotic Drugs, as amended by a 1972 Protocol, which provided for international controls over the production and availability of opium and its derivatives. The 1971 U.N. Convention on Psychotropic Substances extends the concept of supply side control to a wide range of synthetic drugs.

<sup>46</sup> Velthuysen, p 370.

<sup>47</sup> U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, Art. 3.1 b

Article 5 of the Vienna Convention requires party States to enact domestic regulation to provide the confiscation of all forms of property, proceeds or instrumentalities used in or derived from covered offences. Necessary steps must be taken to enable authorities to trace, identify, seize and forfeit the proceeds of drug trafficking. Article 5(3) requires the party States not to shield materials, that are needed in forfeiture procedures, from discovery.<sup>49</sup>

The Vienna Convention is the first detailed measure and global approach to address and combat the problem with money laundering. Although it is primarily a Convention with an emphasis on combating the proceeds of narcotics trafficking, it is still widespread and an indicator if a country has taken the legal responsibility to address the problem<sup>50</sup>, and may be viewed upon as a landmark in international money laundering control.

## 3.2 The Basel Committee Statement

The Basel Committee<sup>51</sup> is an important regulatory forum for banking supervision. The legal status of the issued statements is non-binding and do not contain any measures to promote compliance. Yet, the success of the Basel Committee and its guidelines to promote international standards for effective banking supervision is unrivalled.

In 1988 the Basel Committee adopted its Statement of Principles on money laundering<sup>52</sup>. It is an ethical and objective document that stresses the importance for the banks' gate-keeping obligations. All banks should make "reasonable efforts to determine the true identity of all customers requesting the institution's services."<sup>53</sup> The basic purpose with these principles is to encourage the banking sector, through a fairly general statement, to ensure

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- (i) The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph (a) of this paragraph, or from an act participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions
  - (ii) The concealment or disguise of the true nature, source, location, disposition, movements, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph (a) of this paragraph or from an act of participation in such an offence or offences.

<sup>48</sup> Leong, p 145.

<sup>49</sup> Art. 5.3; "In order to carry out the measures referred to in this article, each Party shall empower its courts or other competent authorities to order that bank, financial or commercial records be made available or be seized. A Party shall not decline to act under the provisions of this paragraph on the ground of bank secrecy."

<sup>50</sup> Noble & Golubic, p 114.

<sup>51</sup> The central bank governors of the Group of Ten countries formed the Basel Committee on Banking Supervision in 1974. It consists of four main working groups and meet four times a year. See <http://www.bis.org/bcbs/index.htm>.

<sup>52</sup> See <http://www.bis.org/publ/bcbsc137.pdf> "Prevention Of Criminal Use Of The Banking System For The Purpose Of Money Laundering".

<sup>53</sup> Ibid, section II.

that banks are not used to hide or launder funds acquired through criminal activities.<sup>54</sup>

A more detailed set of guidelines was issued in October 2001 concerning the customer due diligence.<sup>55</sup> The guidelines set forth a wide aspect of Know-Your-Customer (KYC) guidelines, where the application is not restricted to money laundering efforts. Sound practices in the area of KYC are crucial for estimating banking risks in general.<sup>56</sup>

The paper identifies four risks that are associated with inadequate KYC standards; reputational, operational, legal and concentration risks.<sup>57</sup>

Reputational risks<sup>58</sup> is a major threat to all financial intermediaries. Maintaining the confidence of the creditors, depositors and the general marketplace is crucial for conducting business. Inadverse publicity may cause significant loss in confidence and threaten the integrity of the bank.

Operational risk<sup>59</sup> involves the direct or indirect loss resulting of inadequate or failed internal processes, people and systems or from external events. In the KYC context the operational risk lies within failure of implementing practices for due diligence.

The legal risk<sup>60</sup> involved with KYC is the possibility to be subject to law suits concerning the failure to observe and implement mandatory KYC standards. Criminal liability, fines and special penalties may be the result by not observing mandatory KYC guidelines.

The concentration risk<sup>61</sup> applies on both the assets side and on the liability side of the balance sheet. Regarding the KYC context the concentration risk is concerned with the prudential regulation that limits a bank's exposure to single borrowers. If the bank does not know who the customers are or their relation to other customers, the bank will not be able to measure the concentration risk. On the liabilities' side, the concentration risk is associated with funding risk. A sudden withdrawal by a large depositor may threaten the bank's liquidity, therefore a close relationship with large depositors is vital, especially for small banks.

This emphasizes the need for implementing sound and effective KYC procedures for managing the risks involved in conducting business.

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<sup>54</sup> Graham & Bell, p 29.

<sup>55</sup> See <http://www.bis.org/publ/bcbs85.pdf>

<sup>56</sup> Ibid, para. 4.

<sup>57</sup> Ibid, para 10.

<sup>58</sup> Ibid, para. 11.

<sup>59</sup> Ibid, para. 12.

<sup>60</sup> Ibid, para. 13.

<sup>61</sup> Ibid, para. 14.

### 3.3 FATF - 40 Recommendations

The Financial Action Task Force on Money laundering (FATF) was established at the G-7 summit in 1989. It is an intergovernmental body between the current 33 members<sup>62</sup>. The G-7 leaders vested the FATF with the following mandate:

“to assess the results of the cooperation already undertaken to prevent the utilisation of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the statutory and regulatory systems as to enhance multilateral legal assistance.”<sup>63</sup>

In 1990 the FATF published its 40 recommendations on money laundering countermeasures. It is intended to constitute a “minimal standard in the fight against money laundering”<sup>64</sup>. The 40 recommendations of the FATF prescribes that each country should criminalise drug money laundering, as set forth in the Vienna Convention. However, the legislation should not be confined to drug related money laundering. All money laundering based on serious offences should be encompassed by national legislation.<sup>65</sup> Echoing the Basel Statement the FATF-40 prescribes the importance of effective customer identification procedures (CIP). In 1996 the FATF-40 were revised and recently various Interpretative Notes<sup>66</sup> have been issued to clarify the application of specific recommendations.

The recommendations form a framework that is adaptable to individual jurisdictions. Articles 1-7 refer to the criminal justice system and law enforcement such as the adoption of the Vienna Convention as well as mutual legal assistance in money laundering cases. Articles 8-29 focus on the financial system as a whole, and banks and non-bank financial institutions in particular. Due diligence measures as well as record-keeping are some of the specific requirements of these recommendations. Know your customer provisions, aimed at eliminating anonymous accounts, are the cornerstone in the customer due diligence. Articles 13 and 14 address money laundering threats arising from complex transactions and new and developing technology. Article 16 deals with reporting of suspicious transactions and general compliance. Articles 17-20 consist of measures to deter from money laundering and terrorist financing. Articles 21-22 involves inconsistent compliance and articles 23-25 deals with regulatory issues.

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<sup>62</sup> The FATF consists of 31 member countries and two regional organisations. See <http://www.fatf-gafi.org> (as by the 2<sup>nd</sup> of March 2007)

<sup>63</sup> See the introduction in FATF Annual Report 1990, <http://www.fatf-gafi.org/dataoecd/20/16/33643019.pdf> (as by the 2<sup>nd</sup> of March 2007)

<sup>64</sup> Ibid, p 16.

<sup>65</sup> Ibid, p 17.

<sup>66</sup> These notes were adopted the 22<sup>nd</sup> October 2003, see <http://www.fatf-gafi.org> (as by the 2<sup>nd</sup> of March 2007)

The three main tasks that comprises the work of FATF is:

- Monitoring the implementation of the AML regulation
- Reviewing trends, techniques and counter-measures and possible implications for the FATF-40.
- Promoting the adoption and implementation of FATF-40 by non-member countries.

Concerning the compliance of member countries a general obligation involves series of steps, from an obligation to make periodic reports on progress to plenary meetings to, ultimately, the threat to suspend the membership of the non-compliant member country. The perhaps most important tool is towards non-members. By issuing a “black-list” of countries with serious problems regarding compliance, these countries received a warning that counter-measures might be taken. In 2000 this black-list<sup>67</sup> consisted of some 15 countries<sup>68</sup>, and in 2001 an additional 8 countries<sup>69</sup> out of the total 47 jurisdictions that were reviewed were considered to have detrimental standards regarding AML issues. Immediately these countries started to improve their standards and regulation. By the 13<sup>th</sup> December 2006 none of these 23 countries were regarded as NCCTs. The “Name and Shame”<sup>70</sup> approach has been an important and powerful tool in enforcing compliance.

Like the Basel Statement the FATF recommendations have no binding effect. Yet, their force and authority stem from both the U.S and the European Community. It is thus the most important regulation in the area of anti-money laundering since the guidelines provide more detail than any other document so far. The Basel Committee and the statements conclude that financial institutions play an important role in combating the money laundering. The FATF-40 gives body and detail to the financial institutions role by expressing detailed guidelines how to “know” their customers.<sup>71</sup> Another additional step that is stressed is the implementation and the need for a leverage of expertise in detecting anomalous transactions and to engage appropriate authorities.<sup>72</sup>

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<sup>67</sup> NCCT, Non Cooperative Countries and Territories.

<sup>68</sup> *Antigua & Barbuda, Bahamas, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Guernsey, Isle of Man, Israel, Jersey, Lebanon, Liechtenstein, Malta, Marshall Islands, Mauritius, Monaco, Nauru, Niue, Panama, Philippines, Russia, Samoa, Seychelles, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines and Vanuatu.* (The 15 jurisdictions identified as NCCTs at that time are in italics.)

<sup>69</sup> *Costa Rica, Czech Republic, Egypt, Grenada, Guatemala, Hungary, Indonesia, Myanmar, Nigeria, Palau, Poland, Slovakia, Turks & Caicos Islands, United Arab Emirates, Ukraine and Uruguay.* (The 8 jurisdictions identified as NCCTs at that time are in italics.)

<sup>70</sup> Zagaris, p 141. The sanctions associated with being catagorised as a NCCT is primarily focused on punishing entities located within the NCCTs by establishing enhanced due diligence requirements for financial institutions that deal with them and notification to their business partners that they may be money launderers, see FATF Recommendation 21.

<sup>71</sup> Noble, p 122.

<sup>72</sup> *Ibid*, p 122.

## 3.4 European Community – the Money Laundering Directives

### 3.4.1 General remarks

In forming a single financial market, the European Union has taken significant steps toward removing the barriers that impede the free movement of goods, services and workers among nations.<sup>73</sup> This integrated financial market also calls for a financial system with adequate protection and stability. However, by the creation of the Single Market, an integrated financial services system and the freedom of movement of capital money launderers could exploit the new opportunities and a community approach to this threat was important. Alternatively, if individual member states took initiatives, this could have an adverse effect on the Single Market.<sup>74</sup> To address both concerns, the possibility to exploit the integrated financial services system that the Single Market created and problems with ad hoc measures that might contravene and result in adverse effects, the solution was to combat this issue through a community approach.

### 3.4.2 The First Money Laundering Directive<sup>75</sup>

One initial point of concern was that if financial and credit institutions were subject to money laundering, this posed a risk towards the stability and soundness of the institutions and the public confidence for the financial system may be reduced.<sup>76</sup> The First Money Laundering Directive lays down minimum standards, which means that each country may implement more stringent rules.

In 1991 the First Money Laundering Directive introduced a definition of money laundering, based on the definition given in the 1988 U.N. Vienna Convention. The First Money Laundering Directive called on the member states to prohibit such money laundering, at least when it involves proceeds of drug trafficking.<sup>77</sup> Following the work of FATF and the 1990 recommendations, the First Money Laundering Directive introduced a series of obligations for credit and financial institutions. Customer Identification Procedures as well as record-keeping and the refraining from transactions they knew or suspected were linked with money laundering, were some of these obligations.

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<sup>73</sup> Mortman, p 429.

<sup>74</sup> Council Directive 91/308/EEC, in the preamble.

<sup>75</sup> Council Directive of 10th of June 1991 on prevention of the use of the financial system for the purpose of money laundering, 91/308/EEC.

<sup>76</sup> *Supra* note 62.

<sup>77</sup> *Ibid*, Art 1 third indent and Art 2 respectively



Article 1 of the First Money Laundering Directive defines credit and financial institutions<sup>78</sup> as well as the actual offence of money laundering<sup>79</sup>. Article 2 is prescribing that the member states are obliged to criminalise the money laundering offence. Article 3 requires the identification of customers and beneficial owners when entering into business relations and when transacting business at or above €15000. Article 4 imposes obligations to retain certain records for specified periods<sup>80</sup> so that they may later be used in investigations concerning money laundering. Article 5 and 6 imposes due diligence duties on the financial institutions covered, including an obligation to examine with special attention any transaction thought likely to relate to money laundering. Apart from these due diligence requirements article 7 also specifically prohibits credit and financial institutions to participate in and carrying out transactions likely to be associated with money laundering. Article 8 imposes a prohibition for tipping-off the customer or any other person that an investigation is under way, in order to create an opportunity for the competent authorities to perform investigations effectively. Article 9 gives some leeway for the principal of the credit- and financial institution regarding the secrecy obligation towards the customer. If a suspicious transaction is reported in good faith, the principal or the institution in question cannot be held liable for this action.

However, by imposing a duty on the financial institutions to report suspicious transactions to the *competent national authorities*<sup>81</sup> the subsequent measures also called for cross-border information exchange between these competent national authorities.

Proactive measures like the reporting of suspicious transactions as well as the prohibition for tipping-off customers that are subject to investigation also took a step further in comparison to the FATF-40 at the time.<sup>82</sup> Article 8 of the Directive prohibits disclosure to the customer that an investigation

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<sup>78</sup> Credit and financial institutions with a branch office are subject to the regulation even if the main office is located outside the EU.

<sup>79</sup> The definition follows the definition given in the Vienna Convention, see supra note 32.

<sup>80</sup> The directive prescribes a minimum period of 5 years after the business relation has ceased.

<sup>81</sup> Council Directive 91/308 Art 1 gives the definition that “competent authorities” means the national authorities empowered by law or regulation to supervise credit or financial institutions. This left it to the member states’ discretion to designate the “competent authorities”. Three different models of reporting systems evolved;

- (1) The Independent/Administrative model, where financial institutions report suspicious transactions typically to the Ministry of Finance.
- (2) The Police model, where suspicions are transmitted to the police/intelligence agency
- (3) The Judicial model, in which the Public Prosecutor is the receiver of the suspicious transactions reports.

This diversity has led to several cooperative obstacles and ultimately a third pillar decision called for the member states to set up a cooperation between the Financial Intelligence Units. See especially the article “The EU legislative framework against money laundering and terrorist finance: A critical analysis in light of evolving global standards” by Valsamis Mitsilegas and Bill Gilmore.

<sup>82</sup> Mitsilegas & Gilmore, p 120. FATF amended its position to require members to introduce mandatory suspicious transactions reporting systems.

is being carried out, while legal immunity is provided for disclosures of information about customers to the authorities. Article 11 requires internal control measures and AML training procedures by credit and financial institutions. Originally the Directive obliged member states to implement the provisions of the Directive by 1<sup>st</sup> of January 1993, but it was not until 1996 that it was fully implemented.

### 3.4.3 The Second Money Laundering Directive<sup>83</sup>

On 4<sup>th</sup> of December 2001 the First Money Laundering Directive was somewhat altered and amended. One concern was the use of unregulated businesses for money laundering purposes, i.e. currency exchange offices and money remittance offices.<sup>84</sup> In comparison to the First Money Laundering Directive, which prescribed an obligation to perform customer due diligence, through identification procedures, and to report suspicious transactions to the competent authorities, the Second Money Laundering Directive widened the scope of the relevant businesses and activities that should be made subject to the provisions. The use of non-financial businesses for conducting money laundering needed legal attention and the directive called for the extension of the professions and non-financial businesses believed to be vulnerable to abuse by money launderers. Real estate agents, dealers in high-value goods such as precious stones, metals or works of art; auctioneers, whenever payment is in cash and in an amount of €15000 or more, and casinos are nowadays included in the relevant activities that are subject to the money laundering regulation.

The other important amendment that the Second Money Laundering Directive put forward was the widening of the predicate offences. The First Money Laundering Directive only obliged the Member States to criminalise money laundering coupled with the proceeds of drug offences. Due to the work of FATF the definition of the money laundering offence now encompassed a much wider range of predicate offences.<sup>85</sup> Article 1E of the Second Money Laundering Directive defines criminal activity as “any kind of criminal involvement in the commission of a *serious crime*<sup>86</sup>”. Article 1.E also leaves it up to the discretion of the Member states to designate any other offence as a criminal activity for the purposes of this directive.<sup>87</sup>

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<sup>83</sup> Directive 2001/97/EEC.

<sup>84</sup> Ibid, preamble in paragraph 5.

<sup>85</sup> Directive 2001/97/EEC, preamble in paragraph 7-8.

<sup>86</sup> Ibid, emphasis added, Article 1.E defines serious crime as at least;

1. Any of the offences defined in Article 3(1)(a) in the Vienna Convention
2. The activities of criminal organisations as defined in Article 1 of Joint Action 98/733/JHA(12)
3. Fraud, at least serious, as defined in Article 1(1) and Article 2 of the Convention on the protection of the European Communities’ financial interests (13)
4. Corruption
5. An offence which may generate substantial proceeds and which is punishable by a severe sentence of imprisonment in accordance with the penal law of the Member state

<sup>87</sup> Ibid, Article 1.E last paragraph.

The member states were to bring the amendments into force by the 15<sup>th</sup> of June 2003.

### 3.4.4 The Third Money Laundering Directive<sup>88</sup>

By the events on September 11, 2001, the international community took several measures to combat terrorism. One of these measures was taken by FATF in 2003, with the eight additional recommendations, to set a standard for combating the financing of terrorism. The work for implementing these additional standards called for a revision of the Money Laundering Directives. Besides this, the consolidation of the First Money Laundering Directive was needed due to the substantial amendments and alterations that had been done.<sup>89</sup> Thus, the Third Money Laundering Directive was enacted in October 26, 2005.

Just like the First and Second Money Laundering Directives, the Third Money Laundering Directive is influenced by the FATF-40 Recommendations. The Third Money Laundering Directive contains the same keystones as the earlier directives, i.e. the regimes of Customer Due Diligence and Suspicious Transaction Reports. The headline<sup>90</sup> indicates that the directive also contains measures against the financing of terrorism. The Directive is divided into five chapters.

Chapter I comprises Articles 1-5, which deals with purpose, application and definitions. Article 1 uses in substance the same definition of money laundering that is given by the Second Money Laundering Directive. Article 2 regulates the application of the directive whereby trust and company services providers are now covered by the directive. Article 3 provides some new definitions<sup>91</sup> such as “politically exposed persons”. Article 4 provides an obligation to extend the regulation to other professions or categories of undertakings that are likely to engage in activities related to money laundering purposes. Article 5 provides the possibility to enact stricter provisions than given by this directive.

Chapter II (art. 6-13) is a central part of this directive as it provides a risk-based approach regarding the measures against money laundering. In particular the Customer Due Diligence duty is central for this new risk-based approach, with either simplified or enhanced customer due diligence. This new approach towards risk-based customer due diligence is found in article 13.

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<sup>88</sup> Directive 2005/60/EC.

<sup>89</sup> Ibid, in the preamble, paragraph 45.

<sup>90</sup> Directive 2005/60/EC of the European parliament and the council of 26 October 2005 On the prevention of the use of the financial system for the purpose of money laundering and *terrorist financing*

<sup>91</sup> Art 3(6-10).

Article 13.1 stipulates that:

“Member states shall require the institutions and persons covered by this Directive to apply, *on a risk-sensitive basis*<sup>92</sup>, enhanced customer due diligence measures, in addition to the measures referred to in Articles 7, 8 and 9(6), in situations which by their nature can present a higher risk of money laundering or terrorist financing, and at least in the situations set out in paragraphs 2, 3, 4 and in other situations representing a high risk of money laundering or terrorist financing which meet the technical criteria established in accordance with Article 40(1)(c).”

Articles 6-10 deals with the general provisions, for example articles 11-12 provide exceptions and situations where simplified customer due diligence may be conducted.

### **3.5 From rule to risk based approach**

An essential element of rule-based systems is that they work best when applied to matters that are not context or case-sensitive.<sup>93</sup> In a rule-based system, if something is prohibited (or required), then it should be prohibited in all contexts and all cases. Rule-based decision making is straightforward. As soon as something meets the conditions specified in the rule, then the action specified in the rule should be taken. The road traffic regulation is an example of a rule-based system. Exceeding the speed limit is prohibited in all cases and in all contexts. Neither the skill of the driver, the safety of the car or the conditions of the road have bearing on compliance with this rule.

As I have described earlier money laundering operates through the financial system and the actual financial activity can in one context be entirely legal and in another context be illegal. A decision, whether a transaction constitutes money laundering or not, requires information and knowledge of the participants and the processes involved in the transaction. A rule-based AML regulation, however, has often turned the financial agencies into defensive reporting, whereby information overload and reduced investigative capacity are the result. By extending the regime of the AML regulation to businesses that previously have been excluded, these problems have become obvious and called for another approach. As seen above the works of FATF have been the prevailing strategy in AML and CTF issues. In FATF-40 issued in 2003, Recommendation 5 specifies that financial institutions should apply customer due diligence measures on a “risk-sensitive basis depending on the type of customer, business relation or transaction” and that where there are low risks financial institutions can apply reduced or simplified measures. In short, a retail customer with few and standardised transactions such as the salary reception and rent payment requires less caution than a cash-intensive business or private banking client with assets distributed internationally.

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<sup>92</sup> Emphasis added.

<sup>93</sup> Ross & Hannan, p 108.

Recommendation 24 specifies that countries should extend AML/CTF monitoring and compliance to designated non-financial institutions “on a risk sensitive basis”. As a result of this shift in the FATF-40 Recommendations, the Third Money Laundering Directive now promotes a differentiated approach regarding the flexibility and sensitivity of the AML regime.

In Sweden the implementation of the Third Money Laundering Directive has yet to be done. The needed alterations and measures concerning these matters are discussed thoroughly in the Green Paper “Implementation of the Third Money Laundering Directive”<sup>94</sup> (My translation).

## **3.6 National implementation**

### **3.6.1 In general**

In Sweden the regulation has been two-fold regarding the money laundering regulation. Money laundering may be countered by criminalising the actual offence. Concerning the criminalisation, two principal offences are provided by the Swedish Criminal Code, Chapter 9, section 6a and 7a. These provisions are beyond the scope of this survey.

Since money laundering utilises the financial system administrative measures that protects the stability is the focal point of most counter measures. Concerning the administrative measures, the regulation also deals with issues that aim on preventing the use of the financial system for money laundering activities. The most important regulation in this aspect is the Act on Measures against Money Laundering (1993:768). This act came into force January 1, 1994, and has been altered several times due to implementation of the Money Laundering Directives and the rapid development of the FATF Recommendations. Other important regulations in this matter are the relevant guidelines issued by the FSA.

### **3.6.2 Act on Measures Against Money Laundering (1993:768)**

This act implements the First and Second Money Laundering Directive as well as the FATF-40 and the Vienna Convention. It is an administrative act to promote and impose certain obligations on financial institutions regarding measures against money laundering.

#### **Definition**

The first section provides a definition of money laundering

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<sup>94</sup> *Green Paper* SOU 2007:23.

1§ “Med penningtvätt avses i denna lag sådana åtgärder med avseende på egendom som har förvärvats genom brott, som kan medföra att denna egenskap hos egendomen fördöljs, att den brottslige får möjlighet att undandra sig rättsliga påföljder eller att återskaffandet av egendomen försvåras, samt sådana åtgärder som innefattar förfogande över och förvärv, innehav eller brukande av egendomen.

Med penningtvätt avses även åtgärder med annan egendom än som avses i första stycket, om åtgärderna är ägnade att dölja att någon har berikat sig genom brottslig gärning.”<sup>95</sup>

The definition was adopted in accordance with the definition given in the First Money Laundering Directive and the Vienna Convention. The second paragraph of this section was amended in 1999. The definition now encompasses property that has been acquired through other means than crime, for instance through transactions that involve tax evasion.

## Regulated activities

Section 2 provides the scope of the regulation through a catalogue of the undertakings that are covered by the act. The provisions of the Swedish Criminal Code apply to all persons. This act applies to certain credit and financial institutions and other business sectors that are likely to be subject to money laundering. The undertakings that are subject to the Banking- and Financial Services Act (2004:297) are included<sup>96</sup> as well as for example; casinos<sup>97</sup>, real estate brokers<sup>98</sup>, accountants<sup>99</sup> and tax advisors<sup>100</sup>.

In section 2a lawyers and associate solicitors are covered by the regulation in some particular situations, e.g. when they assist and carry out transactions for a client regarding buying and selling real estate, managing the client’s money, bonds, shares and other assets and the opening and managing of bank accounts. Section 2b covers legal and natural persons that are merchandising or auctioning antiques, art, jewellery valuable metals or scrap, if payment is in excess of €15000.

The scope of this provision has been widened considerably to encompass practically any undertaking offering any sort of financial service.

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<sup>95</sup> 1§ “The term money laundering used in this act refers to measures regarding property derived from any offence, for the purpose of concealing the illicit origin of the property, enabling the criminal to evade legal consequences or to obstruct the reacquiring of such property, and such measures that include the disposal, acquisition, possession or use of the property. Money laundering also refers to measures involving other property than referred to in the first paragraph, if the measures are devoted to conceal the enrichment through an illicit act.” (My translation)

<sup>96</sup> Act on measures against money laundering (1993:768), §2.1

<sup>97</sup> Ibid, §2.9

<sup>98</sup> Ibid, §2.8

<sup>99</sup> Ibid, §2.10

<sup>100</sup> Ibid, §2.11

## Non-participation

It is prescribed in the first section that conducting an offence as stated in the first section may constitute criminal liability due to the provisions in the Swedish Criminal Code Chapter 9 section 6a and 7a. In addition to this, Section 3 of the Act on Measures against Money Laundering prescribes that among the relevant financial businesses that are covered by the act, these businesses are also prohibited to participate and facilitate transactions that are likely to be associated with money laundering. The non-participation encompass a wide range of activities that may constitute a transaction<sup>101</sup> and just like Section 2 almost all kinds of activities that concern a financial service are covered.

One interesting question that was discussed in the preparatory works was the possibility that fully legitimate transactions were impeded and stopped due to a wrongful assumption of money laundering:

*”Sveriges Redovisningskonsulters Förbund har framfört att kompensation för uppkommen skada måste kunna utgå till den som förvägras göra en transaktion som sedemera visar sig vara helt legitim. Jag är emellertid inte beredd att föreslå någon särskild regel om rätt till skadestånd i sådana situationer. Eventuell skadeståndsskyldighet får provas enligt de allmänna skadeståndsreglerna.”*<sup>102</sup>

Due to the extension of the regulated businesses in the Second Money Laundering Directive the Act on Measures against Money Laundering needed some attention and alterations. The possibility of potential liability was briefly discussed in the preparatory works that addressed these alterations.<sup>103</sup> *The Association of Swedish Real Estate Agents* made a proposal that in addition to the provisions in section 10 there should be no liability for pure economic loss due to the fulfilment of the reporting duty. The proposal was not considered more thoroughly.

## Customer Due Diligence

Section 4 states an obligation to identify anyone entering into a business relation with a relevant regulated business. There is also an obligation to identify customers in case of transactions in excess of €15000. If a transaction is less than €15000, there may still be an identification requirement if the transaction is or is likely to be associated with another transaction and the total transactional value is in excess of €15000.

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<sup>101</sup> Government bill 1992/93:207, p 14.

<sup>102</sup> Ibid, p 15. *”The Association of Swedish Accounting Consultants* has proposed that compensation for actual damages must be granted for anyone that is refused to perform a transaction that turns out to be fully legitimate. I am however not ready to propose any particular clause that indemnifies the suffering customer. Liability has to be considered using the usual liability rules.” (My translation)

<sup>103</sup> Government bill 2003/04:156, p 47.

In section 4a there is an exemption to the identification requirement, if the customer is a regulated business within the EC or a country with equivalent regulation. It is not necessary to perform identification if the transaction involves an account holder that prior has been identified in accordance to the provisions of this act.

## Investigatory and Reporting Duty

A key piece of the Act on Measures against Money Laundering is the investigatory and reporting duty in case of suspicion of money laundering. It is especially in case of non-compliance with this duty that liability can result. Sections 9-10 are obliging the persons and entities that are subject to this regulation to investigate all transactions when there is reasonable suspicion for money laundering. All information which can indicate money laundering shall be forwarded to the National Police Authority. Additional information shall be forwarded at the authorities' discretion.

§9 "Den fysiska eller juridiska personen skall granska alla transaktioner som skäligen kan antas utgöra penningtvätt. Den fysiska eller juridiska personen skall därvid lämna uppgifter till Rikspolisstyrelsen eller den myndighet som regeringen bestämmer om alla omständigheter som kan tyda på penningtvätt.[...]"<sup>104</sup>

This disclosure is protected through section 10, which provides:

10§ "En fysisk eller juridisk person som lämnar uppgifter med stöd av 9§ får inte göras ansvarig för att ha åsidosatt tystnadsplikt, om den fysiska eller juridiska personen hade anledning att räkna med att uppgiften borde lämnas. [...]"<sup>105</sup>

## Tipping-off prohibition

Section 11 states the prohibition for tipping off the customer subject to the disclosure.

11§ "Den fysiska eller juridiska personen, dess styrelseledamöter eller anställda får inte röja för kunden eller för någon utomstående att en granskning har genomförts eller att uppgifter har lämnats enligt 9§ eller 9c§ eller att polien genomför en undersökning.[...]"<sup>106</sup>

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<sup>104</sup> §9 "The physical or legal person shall investigate all transactions when there is reasonable suspicion of money laundering. The physical or legal person shall thereby disclose all circumstances that may indicate money laundering to the National Police Authority or the authority at the Government's discretion. [...]" (My translation)

<sup>105</sup> 10§ "A physical or legal person who disclose information on the basis of section 9 cannot be held liable for breach of confidentiality, if the physical or legal person had reason to take into account that the information should be disclosed. [...]" (My translation)

<sup>106</sup> 11§ "The physical or legal person, its directors or employees are prohibited from disclosing to the customer or any outsider that an investigation has been performed or



## Internal procedures and training

Section 13 prescribes an obligation to adopt adequate procedures and training to combat money laundering.

## Criminalisation

Section 14 states:

§14 “Till böter döms den som uppsåtligen eller av grov oaktsamhet

1. åsidosätter gransknings- eller uppgiftsskyldigheten enligt 9§, eller
2. bryter mot meddelandeförbudet i 11§<sup>107</sup>

The act creates two principal offences related to money laundering.

1. Failure to disclose offences according to section 9
2. Tipping off

Since, in a narrow sense, these two offences are not money laundering given by the definition in the first section, they are offences in a broader sense closely connected with money laundering.

### 3.6.3 English implementation

The English money laundering regulation is fairly similar to the Swedish equivalence. It is founded on the Proceeds of Crimes Act, an act which encompasses both administrative measures and the principal criminal offences. Regarding the implementation of the money laundering directives in the United Kingdom it is important to bear in mind the fact that the law has not, prior to the introduction of the Criminal Justice Act 1988, required a citizen to report a crime, if he or she did not wish to do so. When the first regulatory requirements became statutory, the requirements were not especially demanding. Mandatory disclosures were limited to drug money laundering if the suspicion appeared in lieu of a profession or an office. The rest of the suspicious transactions were not subject to mandatory disclosures, but were discretionary and provided a statutory defence against prosecution, if later investigated. The government soon realised that it was not practical to distinguish drugs from non-drugs proceeds and thus new predicate offences were introduced by the Criminal Justice Act 1993.

In 2000, the UK Cabinet office reviewed the AML-regulation and identified weaknesses in the system. The criminal law in relation to the money laundering regulation needed reformation and consolidation and a single regulation was created. The purpose of the act is to rationalise and harden

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information has been disclosed in accordance with section 9 or 9c or that the police is investigating the matter.[...]" (My translation)

<sup>107</sup> §14 "Anyone is fined who knowingly or by gross negligence

1. neglects the due diligence requirements in section 9 or
2. violates the tipping-off prohibition" (My translation)

the confiscation regime that already existed.<sup>108</sup> One factor that was identified as contributing to the low level of recovery was the low level of suspicious transactions reporting among lawyers and accountants.<sup>109</sup> The Proceeds of Crime Act 2003 makes it mandatory to disclose all offences where there is suspicion of money laundering. The regulation is not aimed solely for the regulated sector, but applies for all citizens who might find themselves involved in a suspicious transaction. It extends the definition of money laundering to all crimes and include three principal offences namely:

- (1) concealing or transferring criminal property<sup>110</sup>
- (2) entering into or becoming concerned in money laundering arrangements<sup>111</sup>, and
- (3) acquiring, possession and use of criminal property<sup>112</sup>

These principal offences all carry a maximum of 14 years imprisonment, which is more than most predicate offences. This underlines the seriousness and severity of the offence. There are further criminal offences related to money laundering, including the failure to disclose knowledge or suspicion of money laundering, tipping off and prejudicing an investigation.

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<sup>108</sup> Marshall, p 358.

<sup>109</sup> Ibid, p 358.

<sup>110</sup> POCA, section 327.

<sup>111</sup> POCA, section 328.

<sup>112</sup> POCA, section 329.

# 4 Bank and Customer – Possible Conflicts

## 4.1 The notion of banking and customer

Before outlining the relationship of the bank and the customer and the possible conflicting obligations in the context of money laundering it is important to define and examine the range of activities that are coupled with this relationship.

Defining the bank often involves the defining of the actual business related to “banking”.<sup>113</sup> The meaning of “banking” was examined in the common law case *United Dominions Trust Ltd v. Kirkwood*<sup>114</sup> where three characteristics were identified.<sup>115</sup> More general attempts to define banking often revolves through contextual approaches.<sup>116</sup> Statutory definitions of banking encompass in one end the formal approach, as an entity, which is recognised as a bank by a governmental authority, and in the other end the list-of-activities approach. The Banking and Financial Business Act (2004:297), section 3, has defined banking as:

- 3§ “Med bankrörelse avses rörelse i vilken det ingår
1. betalningsförmedling via generella betalningssystem, och
  2. mottagande av medel som efter uppsägning är tillgängliga fordringsägaren inom högst 30 dagar [...]<sup>117</sup>

This act implemented the Credit Institutions Directive<sup>118</sup>, which gives the definition of a credit institution as “taking deposits (or other repayable funds) from the public and granting credits on its own account”<sup>119</sup>. Core banking<sup>120</sup>, in short, may be regarded as public deposit taking and granting credits on its own account as well as providing customers with payment services.

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<sup>113</sup> Cranston, p 4.

<sup>114</sup> *United Dominions Trust Ltd. v. Kirkwood* [1966] 2 Q.B. 431 (CA)

<sup>115</sup> In the case the three characteristics found in bankers were

1. the acceptance of money from and collection of checks by their customers and place them to their credit
2. the honouring of checks or orders drawn on them by their customers when presented for payment and debit their customers accordingly
3. to keep current accounts in their books in which the credits and debits are entered

<sup>116</sup> Cranston, p 5.

<sup>117</sup> 3§ “General banking involves business which encompasses

1. conveyment of payments through the general payments systems, and
  2. reception of deposits which are available after 30 days of notice of withdrawal [...]
- (My translation)

<sup>118</sup> Council Directive 2000/12/EEG

<sup>119</sup> *Ibid*, Article 1.1.

<sup>120</sup> Cranston, p 9.

The “customer” has been described as anyone who deals with a bank in relation to a banking service.<sup>121</sup> In common law the term “customer” appears in various statutes<sup>122</sup>, but is not defined more thoroughly. The customer may be a person or an entity, and the service may be to provide an account for the customer or to perform a transaction. It is thus the relationship that defines the customer and central for this relationship is the contract.<sup>123</sup>

## 4.2 Bank Secrecy

*“Secrecy is the badge of fraud”*<sup>124</sup>

### 4.2.1 Background

Most, if not all, financial intermediaries will owe a duty of confidentiality to their customers and clients. The legal duty of confidentiality which banks owe their customers is a well-known practice. Confidentiality serves several purposes within the banking and financial sector. One purpose is that information is of market value and often commercially sensitive, requiring the bank not to disclose the information to competitors and jeopardise the customers business. On a larger scale the privacy principle ensures the maintenance of liquidity and efficiency in commerce and trade and unfair competition is avoided.<sup>125</sup> Another purpose of treating the customers with a great deal of protection is the public trust. The commercial success of banks relies heavily on the fulfilment of their customers’ expectations. Customers, both private and commercial, value to keep their finances confidential and if a financial institution, like a bank, were to disclose confidential information, this would pose a threat to the public trust for the bank. A bank that discloses account information is likely to lose its customers’ trust and ultimately the stability, safety and soundness may be effected due to the loss in public confidence.<sup>126</sup> Details of transactions such as payments, the state of customers’ accounts, personal information are some aspects of confidential information. Since the relationship is founded on confidence, the duty of confidentiality is interconnected with the integrity of the customer and the thus the basis of the banker-customer relationship, requiring special treatment.

This duty has been recognised in common law in the case *Tournier v. National Provincial and Union Bank of England*, [1924] 1 K.B. 461. This

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<sup>121</sup> *Ibid*, p 129.

<sup>122</sup> Bills of Exchange Act 1882 and the Cheques Act 1957.

<sup>123</sup> See especially the case *Foley v. Hill* [1848] 2 HLC 28, 9 ER 1002, where the House of Lords held that the banker-customer relationship was acknowledged as a debtor-creditor relationship, but a bank could also be regarded as a fiduciary or a trustee in other circumstances.

<sup>124</sup> Sir John Chadwick (born 1941), British Judge. *Independent* (London, July 26, 1990)

<sup>125</sup> Williams, p 27.

<sup>126</sup> *Ibid*, p 27.

case has been much cited and helps in understanding the nature of a bank's duty of confidence. A brief presentation of this case may therefore serve to outline the obligation to preserve confidential information of a customer's business.

#### **4.2.2 Tournier v. National Provincial and Union Bank of England**

The locus classicus of the duty of confidentiality is the Court of Appeal's decision in *Tournier v. National Provincial and Union Bank of England*.

The plaintiff, Tournier, was a customer of the Finsbury Pavement, a branch of the defendant bank. In April 1922 the customer's account was overdrawn. In April 8 1922 Tournier (T) signed a document agreeing to pay off in weekly instalments. After only three weeks T ceased to make any further payments. At the time of this arrangement T entered a three-months employment as a traveller and salesman with a firm called Kenyon & Co. A check was drawn in his favour by a company called Woldingham Traders, who were also customers of the same branch of the defendants' bank. T did not pay that check into his account, instead the cheque was eventually returned to the defendants for payment by the London City and Midland Bank. A manager of a branch of the defendants' bank made an inquiry to the London City and Midland Bank who their customer was for whom payment of the cheque had been collected. The manager was told that it was a bookmaker of the name Lloyd. Afterwards the manager called Kenyon & Co. and had a conversation, asking for Tournier's private address and told them that he was indebted to the bank. T had not replied, despite the fact that several letters had been written to him. In consequence of that conversation Kenyon & Co refused to renew Tournier's employment when the three months agreement expired.

T brought this action for (1) slander and (2) for breach of an implied contract that the defendants would not disclose to third persons the state of Tournier's account or any transactions thereto.

The court examined carefully the second head of the claim and concluded that the confidentiality between the bank and the customer was a legal area that was "only very partially investigated branch of the law"<sup>127</sup> and had been traditionally regarded as arising out of a moral duty. Judge Bankes further concluded that "At the present day I think it may be asserted with confidence that the duty is a legal one arising out of contract, and that the duty is not absolute but qualified."<sup>128</sup>

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<sup>127</sup> *Tournier v. National Provincial and Union Bank of England*, [1924] 1 K.B. 461, 471.

<sup>128</sup> *Ibid.*, 471-472.

The qualifications were classified as<sup>129</sup>:

- a) Where disclosure is under compulsion of law
- b) Where there is a duty to the public to disclose
- c) Where the interests of the bank require disclosure
- d) Where the disclosure is made by the express or implied consent of the customer

The most important qualification, for present purposes, is that a bank is at liberty to disclose information where such disclosure is under compulsion of law. A bank may therefore disclose confidential information relating to a customer to a third party where it is required to do so by a statutory provision or by order of the court.<sup>130</sup>

It is also indicated in the judgment that the bank has the burden of proof for deriving the disclosure to one of these qualifications.

“In the present case I think that the information obtained by Mr Fennell as the result of his inquiry of the London City and Midland Bank was covered by the privilege of the customer, *and that the bank are liable for any disclosure of that information which may have caused damage to the plaintiff unless the bank can bring the disclosure of the information so derived under one of the classified qualifications*<sup>131</sup> I have already referred to.”<sup>132</sup>

Prior to this case, there was much uncertainty in English law as to the existence of a duty of non-disclosure.<sup>133</sup> The case went some way to resolve this issue and still serves as the governing principle in common law for the bank’s duty of non-disclosure.

### **4.2.3 Bank Secrecy – statutory secrecy provisions in Swedish legislation**

*“Let us presently go sit in council  
How covert matters may be best disclosed  
And open perils surest answered”*<sup>134</sup>

Many European jurisdictions have established the duty of secrecy through legislation.<sup>135</sup> In Swedish legislation, the provision that govern a bank’s duty of secrecy is found in the Banking and Financial Business Act (2004:297). Chapter 1, section 10 provides:

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<sup>129</sup> Ibid, 473.

<sup>130</sup> Graham & Bell, p 166.

<sup>131</sup> Emphasis added.

<sup>132</sup> *Tournier v. National Provincial and Union Bank of England*, [1924] 1 K.B. 461, 475.

<sup>133</sup> Williams, p 28.

<sup>134</sup> Sir William Shakespeare, in the play *Julius Ceasar*, act 4, sc. 1.

<sup>135</sup> Williams, p 28.

10§ “Enskildas förhållanden till kreditinstitut får inte obehörigen röjas. I det allmänna verksamhet tillämpas i stället bestämmelserna i sekretesslagen (1980:100)”<sup>136</sup>

This provision encompasses all individuals and entities that in relation to a bank are customers.<sup>137</sup> A precondition for establishing a duty of secrecy is the existence of a contractual relation in a broad sense. The term “customer” is defined not only as current and consecutive business relations, but also as temporary business relations and individuals that only have been negotiating with the bank without success are thus encompassed. The notion of customer is therefore wider in the banking secrecy context.<sup>138</sup>

The bank secrecy is not strict, since only disclosure without legal cause is prohibited.<sup>139</sup> Authorised disclosures may be done when it is needed, in order to carry out the commission of a customer.<sup>140</sup> It may also be done with a customer’s consent, either expressed or implied.<sup>141</sup> The third possibility for an authorised disclosure is when it concerns strictly internal information within the bank, e.g. from a principal to the executive board and only on a need-to-know basis.<sup>142</sup> The fourth possibility for authorised disclosures is by compulsion of law.<sup>143</sup> This exemption is in the context of this survey the most important.

One of these legal duties is the provision in section 9 of the Act on measures against money laundering (1993:768).

§9 “Den fysiska eller juridiska personen skall granska alla transaktioner som skäligen kan antas utgöra penningtvätt. Den fysiska eller juridiska personen skall därvid lämna uppgifter till Rikspolisstyrelsen eller den myndighet som regeringen bestämmer om alla omständigheter som kan tyda på penningtvätt.[...]”<sup>144</sup>

In the preparatory materials<sup>145</sup> of this provision it is also expressly stated that:

”Tystnadsplikten är dock inte absolut. Bestämmelserna i 9§ bryter tystnadsplikten. En underrättelse som lämnas med stöd av en författning kan

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<sup>136</sup> 10§ ”The relations of individuals to a credit institution may not be disclosed without legal cause. In the public sector, however, the provisions of the Secrecy Act (1980:100) apply.”. (My translation)

<sup>137</sup> Government Bill 2002/03:139, p 477.

<sup>138</sup> Government Bill 2002/03:139, p 483.

<sup>139</sup> See Cranston *European Banking Law The Banker-Customer Relationship*, p 175. The author comments the somewhat vague expression “without legal cause” as it is not defined in the preparatory legislative materials. For a more thorough examination of the banking secrecy please consult *Banksekretess* by Håkan Nial.

<sup>140</sup> Government Bill 2002/03:139, p 478.

<sup>141</sup> *Ibid*, p 479.

<sup>142</sup> *Ibid*, p 479.

<sup>143</sup> *Ibid*, p 479.

<sup>144</sup> See note 102 *supra*

<sup>145</sup> Government Bill 1992/93:207, p 22.

aldrig anses vara obehörig. Däremot krävs det att de i lagen uppställda förutsättningarna för underrättelse föreligger.”<sup>146</sup>

#### 4.2.4 Safe harbour provision

As I described in the previous section the KYC rules and the duty to disclose information of suspicious transactions mandates the relaxation of the banking secrecy.<sup>147</sup> In addition to these exceptions, there is also a safe harbour provision in the Act on Measures against Money Laundering, in order to promote the banks to exercise these duties without fearing civil or criminal liability.<sup>148</sup>

10§ “En fysisk eller juridisk person som lämnar uppgifter med stöd av 9§ får inte göras ansvarig för att ha åsidosatt tystnadsplikt, om den fysiska eller juridiska personen hade anledning att räkna med att uppgiften borde lämnas. [...]”<sup>149</sup>

This provision provides protection from civil liability due to a breach of confidentiality, not only the statutory confidentiality but also protects from claims due to contractual agreements regarding confidentiality. It is not easy to define the application of this rule. Protected disclosures are most likely disclosures that comply to the standard set by the provision. This means that the provision do not cover potential liability for actions based on unfounded suspicions.<sup>150</sup>

### 4.3 Payment Services

The definition of a transaction is an act, or a series of acts involving business negotiations, e.g. buying and selling, and resulting in a change of legal rights and duties of the participants. Transaction includes sale, exchange, grant, lease, surrender, re-conveyance, etc.<sup>151</sup>

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<sup>146</sup> “The duty of confidentiality is not without exceptions. The provisions of section 9 break the duty of confidentiality. A disclosure that is made by compulsion of law cannot be regarded as unauthorised. However, the relevant prerequisites for disclosure must exist.”.

(My translation)

<sup>147</sup> Mortman, p 463.

<sup>148</sup> The safe harbour provision provides some comfort for the financial institution that discloses a suspect activity in *good faith*. FATF-40, Recommendation 16, states; “If financial institutions suspect that funds stem from criminal activity, they should be permitted or required to report promptly their suspicions to the competent authorities. Accordingly there should be legal provisions to protect financial institutions and their employees from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory, or administrative provision, if they report in good faith, in disclosing suspect criminal activity to the competent authorities, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.”

<sup>149</sup> See note 103 *supra*.

<sup>150</sup> Regarding the U.S. regulation and the application of the safe-harbour provision please consult Hall, p 665, where the author comments the somewhat mixed case law.

<sup>151</sup> Curzon, *Dictionary of Law*, p 424.



Regarding the bank, in terms of its role as a financial intermediary, the most important involvement in a transaction is the remittance of money through payment services. Payment services have also been subject to regulation within the European Union by the Directive 97/5/EEC, a regulation with a clear consumer and competition objective:

“it is essential for individuals and businesses, especially small to medium-sized enterprises to make cross-border credit transfers rapidly, reliably and cheaply from one part of the Community to another”<sup>152</sup>

This Directive imposes transparency requirements and minimum obligations on payments not exceeding €50,000.<sup>153</sup> The national implementation in Sweden of this directive is the Act on Payment Services Within the EEC (1999:268) (My translation). This act deals with payment services up to €50 000<sup>154</sup>, which are confined geographically within the EEC<sup>155</sup>. The bank must provide a written indication of the time needed for payment to be credited to the payee’s bank and the time needed from receipt by the payee bank for the payment to be credited to the payee’s bank<sup>156</sup>; the manner of calculation of any commission, fees and charges<sup>157</sup>; the value dates<sup>158</sup>; and details of the complaint procedures<sup>159</sup>. Another important obligation is the execution of payment within the time agreed, but in absence of agreement the payor bank must pay the payee bank within five business days<sup>160</sup>, and the payee bank must credit the account by the end of the following day<sup>161</sup>. How does this regulation interact with the AML Regulation?

In the preamble of the Directive on cross border credit transfers it is stated:

“whereas this Directive is without prejudice to Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering”<sup>162</sup>

The money laundering regulation prevails in all kinds of situations when the transaction is impeded due to AML measures. In the preparatory works<sup>163</sup> of the Act on Payment Services Within the EEC this issue was considered and Section 7 and 9 eventually received a clarification<sup>164</sup>:

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<sup>152</sup> Directive 97/5/EEC of the European Parliament and of the Council of 27 January 1997 on cross border credit transfers, in the preamble paragraph 2.

<sup>153</sup> Cranston, *Principles of Banking Law*, p 276.

<sup>154</sup> Act on Payment Services within the EEC (1999:268), Section 1, paragraph 2.

<sup>155</sup> *Ibid*, Section 1, paragraph 1.

<sup>156</sup> *Ibid*, Section 3, paragraph 1.

<sup>157</sup> *Ibid*, Section 3, paragraph 2.

<sup>158</sup> *Ibid*, Section 3, paragraph 4.

<sup>159</sup> *Ibid*, Section 3, paragraph 6.

<sup>160</sup> *Ibid*, Section 7, paragraph 1.

<sup>161</sup> *Ibid*, Section 9, paragraph 1.

<sup>162</sup> Directive 97/5/EEC, in the preamble, paragraph 8.

<sup>163</sup> Government Bill 1998/99:53, p 60.

<sup>164</sup> Government Bill 1998/99:53, p 61.

“[...] Den bank som beställaren/betalningsmottagaren anlitar är inte bunden av den angivna tidsfristen eller överenskommen tidsfrist om den vidtar åtgärder med stöd av lagen (1993:768) om åtgärder mot penningtvätt.”<sup>165</sup>

## 4.4 Reasonable Suspicion

It is the pivotal concept of suspicion that triggers the reporting requirement where there is any risk that a person may be assisting another to retain the benefit of criminal conduct.<sup>166</sup>

What amounts to a *suspicious transaction*?

Article 6 of the First Money Laundering Directive makes provision for the reporting duty of suspicious transactions:

“Member States shall ensure that credit and financial institutions and their directors and employees cooperate fully with the authorities responsible for combating money laundering:

- by *informing those authorities*, on their own initiative, of *any fact which might be an indication of money laundering*,
- by furnishing those authorities, at their request, with all necessary information, in accordance with the procedures established by the applicable legislation.

The information referred to in the first paragraph shall be forwarded to the authorities responsible for combating money laundering of the Member State in whose territory the institution forwarding the information is situated. The person or persons designated by the credit and financial institutions in accordance with the procedures provided for in Article 11 (1) shall normally forward the information.

Information supplied to the authorities in accordance with the first paragraph may be used only in connection with the combating of money laundering. However, Member States may provide that such information may also be used for other purposes.”

This provision concerns the reporting duty and may be viewed upon as a measure to promote implementation of national regulation. It is very general and provides no uniform standard of what amounts to a suspicious transaction and this lack has led to a variation between the different jurisdictions in the EU.

Section 9 of the Act on Measures against Money Laundering (1993:768) provides a statutory obligation to investigate “all transactions when there is reasonable suspicion for money laundering” (My translation).

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<sup>165</sup> “[...] The bank that the payor/payee engages is not bound by the designated time limit or the agreed time limit if the bank take measures on the basis of the Act on Measures against Money Laundering (1993:768).” (My translation)

<sup>166</sup> Bewsey & Fischer, p 16.

This provision only obliges the bank to examine and the prerequisite for reasonable suspicion has to be found elsewhere. The preparatory materials<sup>167</sup>, mentions that the ground for suspicion is to be based on the *character* and the *scale* of the transaction. The *behaviour of the customer* is also mentioned as a circumstance that might be considered.<sup>168</sup> These grounds for suspicion are of course very general and the more detailed and specific guidelines have to be found elsewhere.

From a general point of view, the requirement of reasonable suspicion requires first and foremost:

*suspicion*, and secondly,

*reasonable ground* to support this suspicion.

The Oxford English Dictionary defines suspicion as:

- (1) The feeling or state of mind of one who suspects: imagination or conjecture of the existence of something evil or wrong without proof, apprehension of guilt or fault on slight grounds or without clear evidence [...]
- (2) Imagination of something (not necessarily evil as possible or likely; a slight belief or idea of something, or that something is the case: a surmise; a faint notion; an inkling [...]
- (3) Surmise of something future; expectation [...]
- (4) A slight or faint trace, very small amount, hint, suggestion (of something)

With regard to this literal definition the threshold seems to be rather low, if not indeed very low.<sup>169</sup>

Assessment of reasonable ground to suspect is plainly an objective standard, that is a person's honest belief is not relevant when considering whether he had reasonable cause for his belief.<sup>170</sup> This test is simply whether in the light of all information available there are objective grounds for suspecting that the transaction in question involves the proceeds of criminal conduct. Having reasonable suspicion presupposes the existence of facts or information which would satisfy an objective observer that the person concerned might have committed the offence.

Concerning the compliance of the money laundering regulation and supervision of financial services and businesses, the Swedish Financial Supervisory Authority (FSA) has the responsibility to promote sound

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<sup>167</sup> Government Bill 1992/93:207, p 19.

<sup>168</sup> Ibid, p 21.

<sup>169</sup> Ibid, p 18. Support for this low threshold can be found in the English Privy Council case of *Hussein v. Chong Fook Kam* [1970] A.C. 942.

<sup>170</sup> See Bewsey, p 18.

standards.<sup>171</sup> The FSA issues instructions of two different types, either general guidelines or regulations. The general guidelines are of a comply-or-explain type and the regulations are of a comply type. The general guidelines are therefore of dual nature, since the banks can decide not to comply, as long as they have valid reason.

In this particular matter the FSA has issued FFFS 2005:5<sup>172</sup>, which gives detail and clarifies the obligations set forth by the Act on Measures against Money Laundering, in particular the duty to report suspicious transactions and the customer due diligence. FFFS 2005:5, Section 11, establishes certain routines for detecting activities related to money laundering in accordance with the *undertaking*<sup>173</sup>.

11§ ”En handläggare ska, om det i ett kundärende *finns skäl att anta förekomsten av en transaktion som utgör penningtvätt eller finansiering av särskilt allvarlig brottslighet*, omgående anmäla ärendet till en överordnad i enlighet med företagets rapporteringsordning för närmare granskning enligt 9 § första stycket penningtvättslagen respektive 8 § första stycket finansieringslagen.[...]”<sup>174</sup>

This section also provides examples of transactions that may justify closer scrutiny and investigation;<sup>175</sup>

- cash transactions or other transactions which are large or deviate from the customer’s normal behaviour and /or deviate in comparison with the category in which the customer is included;
- large numbers of transactions during a certain interval which do not appear normal for the customer or the category in which the customer is included;
- transactions which cannot be explained on the basis of what is known regarding the customer’s financial position;
- transactions which may be assumed to be without justification or financial purpose;

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<sup>171</sup> The FSA acts under the authority given by a Governmental Decree (1996:596).

”Instructions for the FSA”. Section 2 in this decree prescribes; “The major assignment for the FSA is to contribute to the stability and effectiveness of the financial system.”. (My translation)

<sup>172</sup> Finansinspektionen’s Regulations and General Guidelines Governing Measures against Money Laundering and Financing of Particularly Serious Crimes in Certain Circumstances.

<sup>173</sup> Undertaking refers to legal or natural persons, see FFFS 2005:5, section 3.

<sup>174</sup> 11§ ”In the event a customer gives cause to assume the existence of a transaction constituting money laundering or financing of particularly serious crimes, an official shall, immediately notify the matter to a superior in accordance with the undertaking’s reporting routines for closer scrutiny pursuant to section 9, first paragraph of the Act on Measures against Money Laundering. [...]”. (FSA official translation)

<sup>175</sup> FSA 2005:5, 11§. (official English translation)

- transactions where the geographic destination deviates from the customer's normal transaction patterns;
- where the customer requests unusual services or products without providing a satisfactory explanation therefore;
- transactions to or from undertakings or persons who may be deemed to be acting for the purpose of concealing underlying, actual ownership or rights relationships;
- large cash deposits on account through automatic deposit machines which are thereafter immediately disposed of; and
- large loans which are repaid shortly after the loan has been granted where such has not been agreed upon granting of the loan.

There is not a simple answer of the question concerning what amounts to a suspicious transaction. The criteria is not defined in the international documents and it would not be possible to make a list of what constitutes a suspicious transaction, since the ingenuity of the launderers would quickly make such a list incomplete. The national legislation provides only very brief guidelines of patterns and circumstances for potentially suspicious transactions. A subjective judgment of one or several objective circumstances is probably needed for justifying closer scrutiny and investigation of the suspicious transaction.<sup>176</sup>

However, the lower limit for suspicion seems to be fairly low in the wording "*any fact which might be an indication of money laundering*". Neither the wording "*all transactions when there is reasonable suspicion for money laundering*" nor "*the event a customer gives cause to assume the existence of a transaction constituting money laundering*" gives reason to believe anything else. The Canadian term *Unusual Transaction Reports* is probably a more accurate idiom.<sup>177</sup>

## 4.5 Non-participation

Coupled with the duty to report suspicious transactions is the prohibition to participate or facilitate suspicious transactions. The prohibition to participate or facilitate suspect transactions is provided by the First Money Laundering Directive, Article 7:

"Member States shall ensure that credit and *financial institutions refrain from carrying out transactions which they know or suspect to be related to money laundering*<sup>178</sup> until they have apprised the authorities referred to in

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<sup>176</sup> Calissendorff, p 568.

<sup>177</sup> Gallo & Jukes, p 330. The Netherlands have a similar system with Disclosure of Unusual Transactions, see Ping, p 255.

<sup>178</sup> Emphasis added.

Article 6. Those authorities may, under conditions determined by their national legislation, give instructions not to execute the operation. Where such a transaction is suspected of giving rise to money laundering and where to refrain in such manner is impossible or is likely to frustrate efforts to pursue the beneficiaries of a suspected money-laundering operation, the institutions concerned shall apprise the authorities immediately afterwards.”

The Act on Measures against Money Laundering, Section 3, implements this provision:

3§ ”Att förfaranden som avses i 1§ kan vara straffbara som penninghäleri eller penninghäleriförseelse framgår av 9 kap. 6a och 7a §§ brottsbalken. [...]”<sup>179</sup>

It is important to keep the duty to investigate and the duty to report and not participate separated. After an investigation has been launched the outcome may lead to the conclusion that there are no reasons to believe that money laundering is evident. The other outcome is of course that there are reasonable suspicion for money laundering and thus a mandatory disclosure and non-participation is the only available course of action for the bank.

## 4.6 Case law

Not many cases have examined the range of the money laundering regulation. In Sweden only one case has at least “touched” this issue. The precedential value is limited, but two rather distinguished scholars presented their legal opinion on the matter. However, since this case is not “clean”, I have chosen to look into three common law cases that have addressed this issue and they at least illustrates the potential dilemma the bank may be facing in different situations.

### 4.6.1 Court of Appeal case Brodin vs. Nordea AB (T-7503-01)

Leasing AB Arctos (Arctos) decided to purchase the stocks in the company Backstage i Göteborg AB (Backstage). This purchase was to be financed by a loan in total of 13 500 000 SEK from the company Byleno KB (Byleno). On December 11, 1996, a principal debt agreement was signed between the debtor Arctos and the creditor Byleno. The debt was to be repayed the same day. Two brothers, Hans and Lars Brodin, had supplied the money.

On this day, Hans Brodin, Ulf Eriksson (the executive director for Arctos) and Peter Teurnberg (representative for Backstage) met at the office of

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<sup>179</sup> 3§ ”Activities referred to in section 1 may constitute criminal liability for receiving or handling of illicit due to the provisions of the Criminal Code, Chapter 9 sections 6a and 7a.”. (My translation)

Nordea in Stockholm to finish the deal. Prior to this meeting, the bank Östgöta Enskilda Bank had issued a bill of exchange in total of SEK 32 874 350 for the drawer Backstage, which in turn conveyed the bill of exchange to Arctos. The representative of Arctos collected the bill of exchange at the Nordea office and instructed the bank to carry out payments in total of SEK 31 785 780. One of these payments was to be carried out by issuing a bill of exchange in favour of B to settle the debt to Byleno. The Nordea office eventually made a mistake and the bill of exchange issued in favour of B only read SEK 13 905 instead of SEK 13 905 000. This mistake was evident when B tried to collect the bill of exchange at another bank office, JP Bank. B went back to the Nordea office to have the bill of exchange corrected. Upon the return to the office the cashier admitted making the mistake and voluntarily proposed that instead of issuing a new bill of exchange the bank would remit the money to JP Bank. However, due to the bank's arising suspicions of money laundering further transactions were stopped and already executed transactions were reversed. The bill of exchange issued by Östgöta Enskilda Bank was confiscated. Hans Brodin, Ulf Eriksson and Peter Teurnberg were taken into custody.

Later, the investigation did not render any further measures by the authorities and the bill of exchange was returned to Arctos. However, since Arctos had been declared bankrupt the bill of exchange (SEK 32 874 350) was claimed for covering the deficiency.

Before the District Court of Stockholm, Hans Brodin (B) claimed Nordea to pay SEK 13 905 000 as well as SEK 1 816 000 along with interest. According to B, Nordea was instructed by Arctos to pay upon receipt of a bill of exchange SEK 13 905 000 to B. The bank had accepted this commission by issuing the bill of exchange in favour of the drawee B. Due to a mistake by the cashier at the bank the intended amount was only SEK 13 905. Upon the return to the office the cashier voluntarily proposed that instead of issuing a new bill of exchange the bank would remit the money to JP Bank.

According to the claimant the bank had, by accepting this commission from Arctos to issue a bill of exchange in favour of B, an irrevocable and independent obligation to pay the intended amount to B. Due to the bank's negligence to execute the transaction the claimant had suffered an indirect economic loss since B loaned the money from his brother Lars Brodin.

The defendant, Nordea, did not recognise itself to be liable towards B, since the bank did not accept to issue any bill of exchange other than the one that accounted for SEK 13 905. The transactions were only preliminary and not finalised and consequently no debt existed towards Arctos. The claimed damage was a pure economic loss and thus only compensated if it was caused by a criminal act. The bank's actions were limited to the actions that the money laundering regulation prescribes.

The investigation showed that the following events occurred;

1. The bill of exchange was presented to the bank. The account of Östgöta Enskilda Bank was debited.
2. The amount was credited to the account of Arctos.
3. SEK 13 905 was credited the Nordea's bill of exchange account.
4. SEK 31 785 780 was debited the account of Arctos.
5. The bill of exchange of SEK 13 905 was returned for correction
- 5.A Transactions are aborted and finalised internally to make debit and credit meet. The cashier was instructed not to receive any further instructions from the customer
6. Transaction no. 1 was reversed. The preliminary booking at Östgöta Enskilda Bank was cancelled.
7. Transaction no. 2 was reversed. The debit of the account of Arctos was reversed.
8. Transaction no. 4 was corrected, the withdrawal from the account of Arctos was reversed.

After these actions the internal balance of the bank's debit and credit was restored.

The District Court of Stockholm found that the claim was based on Arctos instruction to Nordea to pay B the amount of SEK 13 905 000. However, since the bank Nordea misunderstood this instruction, the bill of exchange only accounted for SEK 13 905. Consequently, the court concluded that the bank's obligation to B did not encompass anything else than the actual amount of SEK 13 905, although it was incorrect. No other obligation could be asserted.

In respect of Arctos the bank had a principal obligation to execute the commission correct, but due to their arising suspicions of money laundering this never happened. Whether this suspicion was unfounded or not did not effect any obligation to a third party like B. Neither any obligation towards B nor any claimed negligence could serve as a ground for holding the bank liable.

The claimant applied to the Court of Appeal in Stockholm. The claim was substantially the same with the exception for the earlier claim of the indirect loss.

The court of appeal did not recognise the relationship between B and Nordea as contractual. B did not have an account at Nordea and an instruction from Arctos to Nordea could neither result in an independent entitlement for B.

Regarding the secondary claim, the court of appeal found that no contractual relationship existed between Nordea and B and consequently the liability had to be limited to a tortious liability. Pure economic losses were only limited to criminal acts and statutory provisions. Since the bank had a duty to act due to the money laundering regulation and no evidence of their



actions could be shown to have caused the damage the court found no grounds to support the claim.

Since the court did not recognise no other obligation than the bill of exchange of SEK 13 905 between B and Nordea, the court never considered whether Nordea acted in a negligent way or not when they reversed the transactions. One of the managers at the Nordea office gave a testimony where he expressed that if the company were to be blamed for anything it was by accepting the customers' instructions and by beginning to execute these dubious transactions.<sup>180</sup>

#### **4.6.2 Squirrel Ltd v. National Westminster Bank<sup>181</sup>**

The first common law case I have used in this survey illustrates the dilemma a customer may face when the suspicion has arisen and the bank must act accordingly.

Squirrel Ltd, a small company involved in the business of buying and selling mobile telephones, was formed in 2002 and the business grew substantially in October 2004. The company held an account at the National Westminster Bank plc (NatWest) with almost 200 000£ in the account. On 15<sup>th</sup> of March 2005 NatWest froze Squirrel's account without any notice. Squirrel tried to discuss the matter with NatWest but to no effect. On the 18<sup>th</sup> of March 2005 NatWest wrote a short letter to the managing director of Squirrel, Mr Ike Khan, where the bank declined to unblock the account without any explanation for its decision. As a consequence, Squirrel applied on 24<sup>th</sup> of March 2005 to the Chancery Division for relief and the unblocking of their accounts on the foundation of three reasons:

- i. No notice was given to Squirrel regarding the action
- ii. Access to the accounts has been denied
- iii. To request an order of disclosure for NatWest's actions

Mr Ike Khan appeared on behalf of the company and said the reason for their application was that the action of NatWest had deprived Squirrel's access to all financial resources. The company was not able to pay lawyers and Mr Khan's primary concern was to be able to make payments for the purpose of maintaining business.

NatWest said that it wished to comply but were forced to block the account due to the provisions of section 328 (1) of the Proceeds of Crime Act (POCA). The anti tip-off provisions prevented any disclosure of the reasons for acting in this matter.

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<sup>180</sup> T 458/97, p 9.

<sup>181</sup> Squirrel Ltd v. National Westminster Bank plc. 1 W.L.R. 637 [2006]

On 30<sup>th</sup> of March 2005 HM Customs and Excise (the commissioners) applied to intervene in the proceedings. The application concerned the scope and effect of the provisions of section 328 (1) of POCA.

*Questions at issue*

POCA, section 328 (1), provides:

“A person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person.”

The court concluded that the provision was of particular concern especially to banks. If the bank suspects or has the necessary knowledge in relation to “criminal property” the bank commits a crime. The questions at issue in this case are thus

- 1) What is the meaning of criminal property?
- 2) What amounts to relevant suspicion?

Regarding the first question the definition of “criminal property” is given in section 340 (3) POCA, which states:

“Property is criminal property if;

- (a) it constitutes a person’s benefit from criminal conduct or it represents such a benefit (in whole or part and whether directly or indirectly), and
- (b) the alleged offender knows or suspects that it constitutes or represents such a benefit”

The court concluded that the application of this section required two conditions; a criminal conduct and that the property in consideration should be a person’s benefit from such conduct. Nothing of the material laid down before the court could lead to the conclusion that the credit balance on Squirrel’s account was “criminal property”. No evidence of a criminal offence existed and as far as NatWest was concerned it did not claim to be in a position to determine whether a criminal offence has been committed or not.

Judge Laddie concluded that NatWest was not free to operate Squirrel’s account. However, even if the account does not contain criminal property and no offence has been committed, section 328 (1) POCA puts an innocent third party under pressure to provide information to the relevant authorities. To avoid liability there is a safe-haven for the bank provided by the statutory defence in section 328 (2) POCA:

“But a person does not commit such an offence if:

- (a) he makes an authorised disclosure under section 338 and (if the disclosure is made before he does the act mentioned in subsection 1)) he has the appropriate consent
- (b) he intended to make such a disclosure but had a reasonable excuse for not doing so
- (c) the act he does is done in carrying out a function he has relating to the enforcement of this Act or of any other enactment relating to criminal conduct or benefit from criminal conduct.

An authorised disclosure under section 338 includes disclosure to a constable or a customs officer. Appropriate consent is defined in section 335, and two possibilities exist; First, the constable or customs officer may simply consent to the transactions, section 335 (1). Second, consent will be treated as have been given if the party has made an authorised disclosure and has not received within seven working days, notice from the relevant constable or customs officer that consent to the transaction is refused. If such notice of refusal is given then a further 31 calendar days (the moratorium) must pass before the transaction can be actioned.

The combined effect of these provisions is to force a party in NatWest's position to report its suspicions to the relevant authorities and not to move suspect funds or property either for seven working days or, if a notice of refusal is sent by the relevant authority, for a maximum of seven working days plus 31 calendar days. Furthermore, the anti-tip off provisions of section 333 of POCA prohibits the party from making any disclosure which is likely to prejudice any investigation which might be conducted following an authorised disclosure under section 338.

The way these provisions work is illustrated by this case. Once NatWest suspected that Squirrel's account contained the proceeds of crime it was obliged to report that to the relevant authority, in this case to the commissioners. It was also obliged not to carry out any transaction in relation to that account. That remains the position unless and until consent to the transactions is given by the commissioners or, if it is not, the relevant time limits under section 335 have expired. In the meantime, it is not allowed to make any disclosure to Squirrel which could affect any inquiries the commissioners might make. Obviously, telling Squirrel why it had blocked its account would constitute a prohibited disclosure.

Judge Laddie concluded that the action and behaviour of NatWest in this particular case was "unimpeachable". NatWest had done precisely what this legislation had intended it to do. Judge Laddie expressed some sympathy for the position that Squirrel found itself to be in, but since the commissioners had intervened in the proceedings Squirrel now knew why the account had been blocked. Thus, there was no need for relief in this matter.

Regarding the ambit of suspicion the court referred to a case where Lord Devlin stated;

“Suspicion in its ordinary meaning is a state of conjecture or surmise where proof is lacking: “I suspect but I cannot prove.” Suspicion arises at or near the starting-point of an investigation of which the obtaining of prima facie proof is the end.”<sup>182</sup>

Two conclusions can be drawn upon this case. First, the bank will not be held liable as long as it do exactly as it is intended to do. This case shows that once suspicion has arisen the bank must report to the relevant authorities and must not participate or facilitate the transaction by any means. Secondly, the level for suspicion and thus the threshold for acting accordingly seems to be low.

### **4.6.3 K Ltd v. National Westminster Bank plc. (Revenue and Customs Commissioners and another intervening)<sup>183</sup>**

In this judgment, the court considered the position when a bank is obliged to freeze a customer’s account where there is suspicion of money laundering, and the information that the customer is entitled to demand as to the reasons for the freezing of the account.

K Ltd had a business account since July 2001. On 18 August 2005 it made two transactions. One transaction concerned a contract to purchase a consignment of mobile telephones from Fones Centre Ltd (Fones) for £200,000 plus VAT, in all £235,000. The other transaction concerned a contract to sell the same telephones to a Swiss company for £215,200. The VAT paid on the purchase would be reclaimable since the purchase was made for export. This meant that the customer would make a profit of £20,000 on the transactions. About the same time the customer’s director, Mr H, explained to the manager, Mr Gibson, that he would need to make a substantial payment to Fones. On 22 August the Swiss purchaser paid £215,200 into the customer’s account at the bank. From an account in the Netherlands Antilles and on the same day Mr H instructed the bank by fax to pay Fones £235,000. On 23 August Mr Gibson wrote to Mr H saying that the bank could not currently comply with his instructions and could not enter into any further discussion on the matter. The customer immediately put the matter in the hands of its solicitors who, after letters before action, applied to the court for an injunction on 6 September. The court adjourned the application until 9 September and a formal notice of application was issued by the customer on the following day. Meanwhile the bank, after consultation with Revenue and Customs, caused a letter of 6 September to be sent by its solicitors to the effect that it had made a disclosure to the Revenue and Customs. On 9 September the judge refused the application on the basis of the provisions of POCA and, once the bank stated that it

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<sup>182</sup> Squirrel Ltd. v. National Westminster Bank plc. [2006] 1 W.L.R. 637, p 641.

<sup>183</sup> K Ltd v. National Westminster Bank plc. [2007] 1 W.L.R. 311.

suspected money in the customer's account was criminal property, that was an end of the matter.

The claimant, K Ltd, argued that the bank, by refusing to honour its customer's instructions, was acting in breach of the contract of mandate, whereby the bank had agreed to honour its customer's instructions. The judge should have restrained the bank from continuing to act in breach of contract and should have granted the injunction sought. If the bank was going to rely on any suspicion that the money in the customer's account was criminal property, it should have given admissible evidence to the court of any such suspicion. If there had been admissible evidence before the court, the maker of the statement could be cross-examined on the question whether he did actually entertain a suspicion and whether there were any grounds for such suspicion. Finally the claimant argued that if the court was powerless to question whether the bank did have any suspicion, the customer was deprived of his rights according to article 6 and 1 in the Human Rights Convention.

The bank, National Westminster Bank Plc., submitted that they had sent a letter which served as proof of their suspicion. On that basis it was clear that that they did entertain a relevant suspicion. Once the bank did entertain such a suspicion, it would be a criminal offence for them to perform the required transaction, no court should grant an injunction which required a defendant to act illegally. It was not contemplated by the Parliament that a banker (or anyone else) should be cross-examined as to whether a suspicion was entertained. Suspicion was an ordinary English word on which no guidance was needed from the court.

The court concluded that if a statute renders the performance of a contract illegal then the contract would be frustrated and both parties would be discharged from having to make further performance. However, if the statute only makes it temporarily illegal to perform the contract, the contract would be suspended until the illegality is lifted. During the period of the suspension, no legal right exists on which a claim to equitable relief could be granted so as to enforce performance.

The concept of suspicion was considered and, referring to a recent case<sup>184</sup> which concerned the equivalent provision of the Criminal Justice Act, the court applied the same interpretation in both criminal and civil cases. Consequently, the court found that the relevant person holding the alleged suspicion:

“[...] must think that there is a possibility, which is more than fanciful, that the relevant facts exist. This is subject, in an appropriate case, to the further requirement that the suspicion so formed should be of settled nature.”<sup>185</sup>

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<sup>184</sup> Regina v. Da Silva[2007] 1 W.L.R. 303.

<sup>185</sup> Ibid, paragraph 16.

This review of the notion of suspicion did not consider, however, the decision in *Squirrel Ltd v. National Westminster Bank Plc*.

Instead, by reference to the decision in *R v Da Silva*, the court concluded that a vague feeling of unease would not suffice, but there were no requirement that the suspicion should be “clear or firmly grounded and targeted on specific facts or based upon reasonable grounds”<sup>186</sup>.

The reference to the suspicion being of a settled nature is to counter the situation where there may have been a suspicion at one stage but, on reflection, it was honestly dismissed from the relevant person’s mind as being “unworthy or as contrary to such evidence as existed or as being outweighed by other considerations”<sup>187</sup>.

The claimant submitted that it was far too easy for banks to assert a suspicion which was in fact groundless. In this case the only reasons for the transaction to be suspect was that it concerned mobile telephones and that the payment by the Swiss purchaser came from an offshore account. Those circumstances, the claimant argued, were just not enough to amount to a proper suspicion in law.

The court found, however, that the bank employee either suspects or he does not suspect. If he does suspect, he must inform the authorities pursuant to the provisions in POCA. These provisions cannot be side-stepped.<sup>188</sup> In achieving a workable balance between the conflicting interests, the provisions offered a limited interference, in most cases only for a time limit of seven working days, which the court found acceptable.

The appeal was on these grounds dismissed as the court found that the bank had lawfully and properly complied with the governing provisions.

This case confirms the relatively bank-friendly view that the *Squirrel* case laid down. Regarding the notion of suspicion, the bank does not need to lay down much evidence to entertain a suspicion of money laundering. In my opinion this decision goes a bit too far and I cannot see how the adequate balance between the conflicting interests is satisfied merely by leaving it to the authorities discretion for a limited period of time.

#### **4.6.4 Tayeb v. HSBC Bank plc<sup>189</sup>**

This case is interesting since it examines the range a bank can act within concerning these matters. Or, to be more specific, it illustrates when the bank has done too much to exculpate itself from a possible criminal liability.

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<sup>186</sup> *Ibid*, paragraph 16.

<sup>187</sup> *Ibid*, paragraph 17.

<sup>188</sup> *K Ltd v. National Westminster Bank Plc*. [2007] 1 W.L.R. 311, paragraph 21.

<sup>189</sup> *Tayeb v. HSBC Bank Plc & Anor* [2005] 1 C.L.C. 866.

The claimant, Tayeb (T), a Tunisian national did not have permanent residence in the United Kingdom. T had various members of his family who lived in Derby, and also had a degree in architecture and a profession as an architect, but his business interests lay in the field of computer and information technology. In Tunisia T owned and managed a top level internet domain name “.ly”, which relates to Libya. In that connection, in 2000, he owned a database of registered internet names ending in “.ly”. Anyone who wanted to use one of those names had to pay a fee to T.

Eventually he agreed to sell this database to GPTC, a Libyan firm. On September 21, 2000, the price of £944,114.23 (the sterling equivalent to \$1.5 million), due under contract of sale was remitted on the order of GPTC by Barclay’s Bank through CHAPS for the credit of a savings account opened by T with HSBC.

Mr Eshhati, the representative of the purchaser GPTC, and T spoke to Mrs Matthews at the Victoria Street branch of Barclay’s Bank, just to confirm that Mr Eshhati’s account had the credited amount of \$1.5 million. After this confirmation Mr Eshhati instructed her to effect a payment to T’s account by a CHAPS transfer. Mr Eshhati signed a CHAPS transfer form, instructing Barclays to effect the transfer. This sum arrived automatically that day at HSBC’s Derby branch, at 13.57. The HSBC District Service Center at Birmingham then authenticated the sort code and customer account number and, having done so, at 14.03 HSBC activated the logical acknowledgment (“LAK”) which had the effect of informing Barclay’s Westminster that the transfer had been received and credited to T’s account.

After that T was informed that his account had been credited he went to a meeting at a nearby hotel to meet the representatives of GPTC and their solicitor. He was handed a document which was signed on behalf of GPTC which evidenced the terms of the agreement. It was titled “Domain Transfer Agreement” which made provision for the transfer of the database to GPTC.

Later in the day one of HSBC’s employees, W, whose suspicions were aroused as regards the background and object of the payment, froze the amount in question. W had a “gut feeling” that the transaction did not seem right. Either it was money laundering or the money was being used for some improper purpose. At 16.14 W placed an inhibit marker on the account, which had the effect that HSBC would not accept any payment instructions in respect of the account. He did not, however, report it to the money laundering compliance officer or to his immediate supervisor.

On September 22, 2000, T went to Manchester to investigate the University facilities having in mind that his brother might study there. While in Manchester he called at HSBC’s King Street branch and attempted to withdraw £5000 from his account. T was advised that he could not draw the funds there but would have to go to the London Street branch in Derby for that purpose. He arrived at that branch on the same afternoon and saw Lesley Cope. She confirmed to him that the transfer had gone through but

told him that in view of the large amount of the transfer W wanted to see him at the Victory Road, Derby Branch. T went to the Victory Road branch and with him was a friend who spoke better English than he did.

No unambiguous opinion exists concerning what passed at the meeting.

According to T, W wanted to know the nature of the transaction. T explained and produced the agreement bearing the signatures of the representatives of GPTC and himself. T also produced a copy of Mr Eshhati's CHAPS transfer order dated 21 September. Since the documents were his only copies Mr Wigham took photocopies and returned the documents. According to T, W seemed satisfied with that explanation and at no time informed him the proposed return of the funds to Barclay's Bank.

According to Mr Wigham (W) he wanted to be convinced that the transaction was genuine before he would be prepared to allow T to have access to the funds. Upon T's arrival W asked for an explanation as to the source of the funds. T then explained that the funds came from a contract that was yet to be completed with GPTC. A draft contract was produced. It was on plain paper and unsigned, approximately 13-14 pages long and not the same document that T described in evidence as the agreement of 21 September 2000. When W asked to be permitted to photocopy it, T told him that it was confidential and not yet signed. Since no senior colleagues were present W discussed the matter with a junior colleague who had been present at the meeting. After a referring the matter to HSBC's fraud office and was thus advised that he had to make the final decision. Mr Wigham returned and informed T that he felt uncomfortable about the situation and the source of the funds. Accordingly, he would be returning the money to Barclay's Bank for the credit of the payer. Up to that point T had been unaccompanied, but after awhile a person joined the meeting. W repeated his unease and T and his fellow left the meeting a bit agitated since the funds were to be returned. .

Following this meeting, at 14.44, the bank returned the funds to Barclay's Bank by a CHAPS transfer. The transfer form was, however, not designed for this purpose as it was headed "Customer Request/Authority to Remit Funds". It was signed by W, who described himself as Assistant Manager of the Victory Road branch, under the rubric "Please make the above payment out and debit my/our account". This was faxed to HSBC's District Service Centre at 14.09 and transmitted through the CHAPS system and the money found its way back to Mr Eshhati's account at Barclays. Interest for one day was initially credited T's account, but, according to W, was cancelled on the basis that HSBC had never accepted the transfer. Thereafter, on 28 September 2000, W closed T's account and transferred the £10 credit balance without interest to the bank's unclaimed balances account.

Some 22 months passed without any further contact between T and the bank. On July 22, 2002, T returned to the Derby branch of HSBC to advise the bank of a pending transfer of £7.5 million into his account, but T was informed for the first time that his account had been closed. After T's threat



of legal action the bank reopened the bank account. On July 27, 2002, T contacted the representative of the purchaser of his database and asked him to recover the monies which had been retransferred. T was told that the monies had been returned to the purchaser and that it would be impossible to recover them. T took no further steps to recover the monies. The position appeared to be that the purchaser received delivery of the domain name database but, having initially remitted the price to HSBC, had, by the retransfer, received a windfall payment equivalent to the price.

T issued proceedings against the bank, claiming a debt in respect of the money transferred to his account.

In defence, the bank argued that its suspicions of money laundering activities justified its conduct; although the course it took was not prescribed by the money laundering legislation, it was justified by ordinary banking practice. Not only was there the risk of committing an offence under the Criminal Justice Act 1988 if the money were not retransferred, but there was also the risk of being held liable as a constructive trustee if the funds were the product of a fraudulent transaction. It was common ground that the circumstances surrounding the transfer to T's account justified the bank in being suspicious, although, as it turned out, the origin of the payment was completely innocent and honest.

The court examined the CHAPS system and the rules surrounding it. The CHAPS rules make specific provision for the return of unapplied transfers and for applied transfers made in error. The rules make no other specific provision for the reversal of credit entries following authentication.

Although the bank may be placed in a difficult position vis-à-vis its customer including tipping off on the one hand and liability as a constructive trustee on the other, there exist procedures which it is entitled to deploy in order to protect its position in both respects. These procedures do not necessarily lead the bank to disengage from the transfer and they certainly do not normally involve the retransfer to the payor, a course which would be most unlikely to protect the rightful beneficiary of the fund and which might well involve tipping off those criminally responsible.

By placing a marker on an account merely postpones the bank's responses to instructions from the account holder to a indefinite period. The court found that the principal debt and the credit balance remain intact, however.

Therefore, Tayeb was entitled to judgment in debt in the sum with interest.

The case emerged in a time when there was some indecision and unease among banks regarding the risk of being held as a constructive trustee and accessory criminal liability.

## 4.7 Civil Liability

*"I do the wrong, and first begin to brawl.  
The secret mischiefs that I set abroad  
I lay unto the grievous charge of others."*<sup>190</sup>

### 4.7.1 General remarks

Liability arises under two categories;

-Contractual

-Tortious

In Sweden, the relationship between contractual and tortious liability is sparsely outlined by the Damages Act (1972:207), Chapter 1, Section 1:

1§ "I denna lag meddelade bestämmelser om skadestånd tillämpas, om ej annat är särskilt föreskrivet eller föranledes av avtal eller i övrigt följer av regler om skadestånd i avtalsförhållanden."<sup>191</sup>

In Sweden, there are fairly limited possibilities to make claims in tort for pure economic losses. The governing principle in the Damages Act, Chapter 2, Section 4 limits the liability for pure economic losses to criminal actions if there are no contractual relationship whatsoever between the parties.<sup>192</sup> A development has however extended the range of tortious liability and nowadays situations with quasi-contractual relationships may render a court to recognise pure economic losses.

Regarding the relationship between the bank and the customer, it is important to bear in mind that the bank may have a general obligation to accept deposits from customers.<sup>193</sup> In Sweden, this duty is statutory but in other jurisdictions the duty is not statutory, but only emanates from business practice. In other jurisdictions, the bank has no duty at all to accept deposits.<sup>194</sup>

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<sup>190</sup> Sir William Shakespeare, in the play Richard III, act 1 sc.3.

<sup>191</sup> 1§ "The provisions of this act apply, unless something else is prescribed in other statutes, by cause of contractual provisions, or in other respects of governing provisions in contractual relationships." (My translation)

<sup>192</sup> Lehrberg, p 282.

<sup>193</sup> The statutory duty to accept deposits is nowadays found in the Act on Deposit Guarantees (1995:1571) (My translation). Section 11b states: "An institute that offers to receive deposits according to the definition in section 2 is obliged to accept deposits from anyone, except in situations when there is valid reason for denying." (My translation)

<sup>194</sup> See [https://eprints.soas.ac.uk/75/1/Mikolajki\\_2002.pdf](https://eprints.soas.ac.uk/75/1/Mikolajki_2002.pdf), describing a case when two Lesotho nationals were appointed Visiting Fellows, to undertake research at the Institute of Advanced Legal Studies in London. They received two cheques, to be paid into a London bank account. Each of the four main retail banks in England declined, however, to open accounts, despite the IALS references and explanations and the fact that the cheques would be drawn on the account of University of London.

In Swedish law there are exceptions<sup>195</sup> to this duty and in this context the duty not to participate in money laundering is of course prevailing. The Act on Measures against Money Laundering (1993:768), Section 3, along with the Swedish Criminal Code Chapter 9, Sections 6a and 7a provides the legal barrier for the bank and its employees to accept a deposit if there is reasonable suspicion for money laundering.<sup>196</sup> There is no legal possibility to put an end to the business relationship with the depositor/customer by closing the account.<sup>197</sup> There are on the other side no legal duty to accept a transaction or to conduct a payment service on the customer's instructions, due to the aforementioned non-participation duty.

Thus, the issue of potential liability has to be considered from the point that a customer has requested a particular financial service, i.e. a transaction, and the bank has accepted and entered into a valid and enforceable contract with the customer.

## 4.7.2 Contractual liability to the customer

Due to a wrongful suspicion of money laundering, a transaction may be temporarily prevented and thus be carried out with delay. Another possible course of action is that a transaction is not carried out at all and a financial loss occurs due to a missed opportunity.

The contract pervades the relationship, modifying the bank's duties and even exculpates the bank in some particular situations. Financial services are immaterial by its character, since they do not involve or are associated with physical objects. The legal borders of immaterial services have not been thoroughly regulated in Swedish law. Analogies from the Consumer Services Act, Purchase Act and Commission Act have served as governing principles in this area. The FSA has also been a source for implementing principles and standards.

In finding the source for potential liability one has to take into account the duty of care. In general the bank is in a better position than the customer. The contract is often based on standard agreements which puts the bank in a favourable position.<sup>198</sup> A duty of reasonable care and skill runs through contract law and may be viewed upon as implying a responsibility to act in accordance with good practice.<sup>199</sup> The emerging standard which the bank has to observe in this particular aspect is the customer due diligence.<sup>200</sup> The

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<sup>195</sup> See the preparatory works of the Act on Deposit Guarantees (1995:1571), Government Bill 2002/03:139, p 260.

<sup>196</sup> Lehrberg, p 60.

<sup>197</sup> The Swedish Bankers' Association has also expressed their view on this matter, see [http://www.bankforeningen.se/upload/nyhetsbrev\\_nr\\_2\\_april\\_2007.pdf](http://www.bankforeningen.se/upload/nyhetsbrev_nr_2_april_2007.pdf), p 7. See also the U.S. case Ricci v. Key Bancshares of Maine, Inc., 768 F.2.d 456, in which the court penalized a bank for wrongfully terminating an account after filing an inaccurate criminal referral under the old reporting system.

<sup>198</sup> Hellner, *Speciell Avtalsrätt II*, 1:a häftet, p 225.

<sup>199</sup> Cranston, p 198.

<sup>200</sup> Sevenius, p 500.

legal notion of acting with due diligence is best described as being the opposite to act in a negligent way. Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case.

In my opinion this must be the base in which potential liability has to be founded upon. On one hand the customer due diligence is the standard that the bank has to observe due to the money laundering regulation. It provides a standard for the assumption that a transaction is either legal or illegal. The bank must act in accordance with a certain standard, otherwise it may be held liable under the administrative regulation, or even under criminal law.

On the other hand the customer due diligence may serve as a standard, yet very flexible but still a standard, regarding civil liability. What a court would constitute as good banking practice would most certainly have its focal point on the actual performed CDD.

Determining the content and level of the customer due diligence standard is uncertain due to the few cases that have addressed this matter. The level for suspicion seems to be low, but most certainly must the bank derive its suspicions to a noticeable and objective circumstance.<sup>201</sup> Defensive reporting should not be encouraged. In Swedish law there are, however, no codified liability rule for wrongful reports. The only guidance that exist is the aforementioned, rather sparse, statement from the preparatory works, by using “usual liability rules”.<sup>202</sup>

In my opinion there may be an analogy with the situation concerning the accountant’s role in conducting the audit of a company. The accountant, just like a bank, carry out an immaterial service on the commission of a customer. The customer puts his or her trust and confidence in the execution of the commission and thus there rests a duty of care on the accountant, just like the bank. The Company Act (2005:551) Chapter 9, Section 42 establishes a general obligation for the accountant to report acts of crime, i.e. money laundering, in lieu of the audit.

42§ “En revisor skall vidta de åtgärder som anges i 43§ och 44§, om han eller hon finner att det kan misstänkas att en styrelseledamot eller den verkställande direktören inom ramen för bolagets verksamhet har gjort sig skyldig till brott enligt någon av följande bestämmelser [...] Brottsbalken, 9 kap, 6a§ [...]”<sup>203</sup>

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<sup>201</sup> Calissendorff, p 568.

<sup>202</sup> Government bill 1992/93:207, p 15.

<sup>203</sup> 42§ “An accountant shall take measures according to sections 43 and 44, if he or she find reason to suspect that a chairman of the executive board or the executive director in lieu of the business have committed following criminal actions: [...] Criminal Code, Chapter 9 §6a [...]”

This duty is coupled with a statutory liability rule for wrongful reports of money laundering;<sup>204</sup>

2§”En revisor, lekmannarevisor eller särskild granskare är ersättnings-skyldig enligt de grunder som anges i 1§. Han eller hon skall även ersätta skada som uppsåtligen eller av oaktsamhet vållas av hans eller hennes medhjälpare. I de fall som avses i 9 kap 44§ denna lag och 9§ lagen (1993:768) om åtgärder mot penningtvätt svarar dock revisorn *endast för skada på grund av oriktiga uppgifter som revisorn eller revisorns medhjälpare har haft skäligen anledning att anta var oriktiga. [...]*”<sup>205</sup>

This gives the accountant some leeway concerning wrongful suspicions of money laundering. Reprehension is limited to cases to which any person, given the same factual circumstances, would have concluded that the information was untrue and could not be a basis for further actions. This culpable behaviour is close to intentional or grossly negligent.

German law has addressed the issue of determining the threshold of culpable behaviour. Liability for a false report of a suspicion of money laundering is limited to cases of gross negligence or intention.<sup>206</sup> The general differentiation between mere and gross negligence is relevant, where gross negligence requires that the duty to act with due diligence is breached in a particularly severe way. This means that the obliged person did not consider what would have been obvious to everybody in this situation. Also, the specific personal circumstances of the person acting must be taken into account.

Based on this reasoning, if the bank acts due to the money laundering regulation and reports a suspicious transaction this disclosure would have to comply with the requirement “reasonable suspicion”. The threshold level for suspicion has been defined as very low by the legislation, which more or less sets the literal meaning as the standard.<sup>207</sup> Any indicator would suffice and examples are given by the FSA guidelines referred to in paragraph 4.4. This is also supported by case law, for instance the Squirrel case which contemplated suspicion as “a state of conjecture or surmise where proof is lacking”. The decision in the K Ltd case supports this view. This can by no means be sufficient, however, since the suspicion needs a reasonable ground, i.e. an objective circumstance or at least an actual basis which can support the suspicion. The bank has most likely the burden of proof for deriving its suspicions to this reasonable ground.<sup>208</sup> The question, whether

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<sup>204</sup> Company Act, Chapter 29, Section 2.

<sup>205</sup> 2§ “An accountant, layman accountant or special investigator is liable in accordance with the provisions in section 1. He or she is also liable for damages caused by intent or negligence by his or her associates. Regarding the cases referred to in this act, chapter 9 section 42 and in the Act on Measures against Money Laundering (1993:768), section 9, the accountant is *only liable for damages due to misrepresentations which the accountant or the accountant’s associate had reason to suspect were untrue. [...]*” (My translation)

<sup>206</sup> Blöcker, p 224. Section 12 of the Money Laundering Act provides this limitation.

<sup>207</sup> See paragraph [4.4].

<sup>208</sup> See notes 164 and 180 *supra*.

the suspicion is reasonable or not, is dependent on the factual circumstances and if the circumstances offers support to the suspicion. Consequently, the objective circumstance is vital for any closer scrutiny and the bank's appropriate actions.

If the suspicion meets this above mentioned requirement, the safe-harbour provision protects the bank for their actions to disclose the information and the path for the suffering customer to make legal claims due to a breach of confidentiality is very limited. In addition to this, the duty not to participate renders that the bank is "off the case" at the authorities discretion. This legal vacuum postpones any further actions until further notice from the authorities. The absence of reported decisions involving claims against intermediaries may suggest that the risks of civil action consequent upon delay should not be overstated.

If the suspicion do not meet the requirement, in cases of actions taken by the bank on merely suspicion, without any support on the basis of objective and factual circumstances, this would equate as an unfounded suspicion. A duly situation would place the bank in a more difficult position regarding a possible claim from the suffering customer. First of all, the action taken by the bank will not be protected by any safe harbour provision.<sup>209</sup> The disclosure may be regarded as a breach of confidentiality. Secondly, the bank may face claims due to a delayed or missed business opportunities.

In a case referred to in the UK FSA's Money Laundering Guidance Notes the issue of careless disclosures was dealt briefly.<sup>210</sup> The staff of the bank considered that a customer's debit/credit turnover was excessive and reported their suspicions to the NCIS. They were particularly concerned because he was a frequent traveller, and had used his credit card in a number of countries, including Holland and Indonesia. A police officer made inquiries of the customer's manager at work, who, feeling that the issue were too serious to ignore, raised them with the customer. The customer, understandably, wanted to know the source of the allegations against him. When he complained to the bank, the evasiveness of the staff (they were worried about tipping him off) of course made matters worse. This customer was a solicitor working for a local authority, and was not inclined to let matters rest. He was able to explain the transactions on his account without difficulty, and he argued that the bank should have taken care in investigating the situation before they made a disclosure. The bank was still not helpful, and he took his complaint to the Banking Ombudsman. At this point the bank took legal advice and concluded that they might be in difficulty if they allowed the matter to proceed to the Ombudsman or even the court because their suspicions might have been allayed if staff had examined the source of the funds. The bank paid compensation to the customer for their incorrect handling of the case and for the "excessive zeal of the untrained officer".<sup>211</sup>

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<sup>209</sup> See note 136 *supra*. See also paragraph 4.2.4.

<sup>210</sup> <http://www.jerseyfsc.org/pdf/guidanceforfinancesectors.pdf>, p 130-132.

<sup>211</sup> See also Wadsley, p 129.

Concerning actions that a bank take after notifying the authorities, the case in Tayeb shows that the bank face a difficult balance act with potential liability due to the tipping-off prohibition on one side and on the other side liability to the customer if it does not protect the customer's rights. One conclusion that can be drawn upon this case is that the bank must not do too much by trying to disengage from the underlying contract. After notifying the authorities of their suspicion the non-participation duty creates a "vacuum" which postpones any instructions from the customer to the bank for a limited time period. The reversal of already accepted transactions is thus a far more risky business for the bank.<sup>212</sup>

### **4.7.3 Tortious liability**

Concerning the potential tortious liability, for example in case of remittal of money through the payment system, money laundering victims may take actions against the bank that are involved in money laundering in some way. For a claim in tort for pure economic loss, Swedish law requires an illegal act, further a financial loss, a casual relationship between the injuring act, as well as fault on the injuring party. The criminal action in case of money laundering is the lack of due diligence in connection of financial transactions and the violation of the tipping-off prohibition.<sup>213</sup> Neither the legal doctrine nor the case law has produced any decisions in this regard. However, in the Brodin case referred to in paragraph 4.6.1 the Court of Appeal found that no casual relationship existed between the bank's actions and the injury.

Based on the limited legal material one can at least conclude that the possibilities for the suffering customer to claim damages in tort are very limited.

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<sup>212</sup> See especially the case T 458/97 (District Court of Stockholm decision, cited in Court of Appeal T7503-01, p 10. In the case Brodin v. Nordea AB the District Court of Stockholm concluded that the bank still owed the contractual party an obligation to perform and fulfil the commission given by the contract.

<sup>213</sup> See Act on Measures against Money Laundering, section 14 paragraph 1 and 2.

## 5 Conclusions

The close relationship between the bank and the customer has been the focal point of this survey. One aspect of this relationship is the banking secrecy. The duty of confidentiality has been subject to some attention from the regulator, with the obvious concern not to be able to detect and prevent illicit funds from being used in the financial system. These compulsory disclosures are reactive rather than proactive, since the aim has been to create a paper trail of the movement of the suspect funds. This aspect of the money laundering regulation do not pose, in my opinion, any significant problems for the ordinary customer since much of the needed assessments are done on information that are part of the ordinary KYC routines that most banks already perform in lieu of their business.

The regulatory initiatives, where the financial intermediary is obliged to investigate and report suspicious transactions, is a move from reactive to proactive measures. By applying a pressure on the financial intermediary, not to be engaged in or associated with, any kind of suspicious transactions, many suspect transactions will never occur. This “filter” do not pose much risk for the financial intermediary, since no contract will never be settled and thus no ground for potential liability exists. The move from rule to risk based customer due diligence has some drawbacks, though. The private sector in contrast to the FIU do not have the same ability and resources to conduct investigations and to determine whether a transaction is legal or not. The information exchange between the FIUs and the banks are also subject to closer attention. By using a risk based approach the bank must have an ability to quantify the “risk”, which most likely is not an easy task.

Regarding the banking secrecy and the needed disclosures and limitations of the confidentiality, the statutory provisions of the Act on Measures Against Money Laundering (1993:768) provides a protection from claims from the customers that have been subject to mandatory disclosures. The precondition is of course that reasonable suspicion for money laundering is evident.

If the customer and the bank have concluded a contractual agreement the risk for potential liability is much greater. The regulation is prohibiting the bank to participate in any way in a transaction when there is reasonable suspicion for money laundering. By applying pressure on the banks to promote diligence and frequent reporting, the outcome may well be that the banks are more cautious. The flip side of the coin is, however, that it may also result in unfounded and wrongful reports, perhaps done in good faith, but the innocent customer is nevertheless affected. English case law has rendered the level for suspicion to be very low. In my opinion there are some drawbacks with this imbalance and to achieve a proper balance the suffering customer must be recognised, either by the legislator or by the courts.



After a disclosure has been made, the safest course of action for the bank is to freeze and to provide full transparency at the authorities' discretion. By reversing transactions the possibilities for a legal claim in case of wrongful suspicions are increasing. The bank still owes the customer under suspicion a duty of care in respect of the underlying obligation. One conclusion can be drawn from case law. When the level for suspicion has reached the level when the bank must act, the contract still remains, although the execution of this obligation is postponed for an indefinite period. The bank may not disengage from the general duty of care for the customer and the underlying contract.

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