

Refusal of consent under Guernsey's AML reporting regime

Insights - 19/06/2018

The Royal Court weighs in on balancing the rights of asset custodians and asset owners

The Financial Intelligence Service's refusal to consent to a proposed transaction under Guernsey's anti-money laundering reporting regime has resulted in the Royal Court deciding its first private law action between the person claiming the asset and the financial institution holding it.

In 2012, the Guernsey Court of Appeal indicated in *Garnet*^[1] that the appropriate remedy for an asset owner being denied access to their funds following a Suspicious Activity Report (SAR) was to bring proceedings against the entity holding the funds. The Court considered that this route was preferable to judicial review proceedings against the Financial Intelligence Service (FIS), as it would allow the Court to fully explore the evidence with the assistance of the fund owner and fund holder and thereby enable the status of the funds to be determined. It was therefore only a matter of time before such a private law action was brought before the Royal Court.

The Deputy Bailiff's recently released decision in *Liang v RBC Trustees (Guernsey) Limited* ^[2] provides clarification of the legal framework for determining the source of funds which will be highly relevant to all regulated entities in Guernsey.

The Facts

Hazel Liang (**Ms Liang**) is the beneficiary of the Lavender (2009) Trust of which RBC Trustees (Guernsey) Limited (**RBC**) is the trustee. It is Ms Liang's desire to have the trust terminated, however due to the effect of the legislative regime against money laundering in Guernsey, RBC's position is that it is unable to comply with her request:

- RBC made a SAR to the FIS in 2011 as a result of open-source information relating to Ms Liang's

husband, Songxiao Li. Mr Li is a wanted person in Hong Kong suspected of conspiring to make various fraudulent property transactions to the benefit of Neo-China Land Group (Holdings) Limited (NCG). RBC suspected that the funds from which the trust was settled derived from the sale of Mr Li's shares in NCG

- Ms Liang requested that the trust be terminated in April 2013
- The FIS have refused to provide RBC with consent to terminate the trust
- Despite its requests for Ms Liang to fully explain the source of funds and provide independent reports on the provenance of the funds, RBC's suspicions have not been allayed by the extra information provided

Ms Liang's position was that RBC's suspicion was not reasonable or justified and she brought a private law action in the Royal Court against RBC seeking a declaration that the assets in the trust belong to her (and not her husband from whom she is now formally separated). RBC maintained a neutral position in relation to the provenance of the funds.

Decision and clarification of the law

As a result of the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999, Guernsey has wide-ranging all-crime prohibitions on laundering the proceeds of crime. In particular, section 39 contains the offence of assisting another person to retain the proceeds of crime. A defence to this offence is available if suspicion is reported to the police and consent obtained for the act concerned.

As intended by the legislature, this regime provides a strong incentive for any suspicions to be reported to the FIS and means that financial institutions are understandably extremely reluctant to go ahead with proposed transactions in the absence of police consent. However, unlike the UK, Guernsey's legislation does not provide a statutory moratorium where deemed consent to the transaction is provided in the event that the relevant authorities do not respond within seven working days. This lack of a moratorium can often lead to assets being left in limbo for years with the asset owner unable to satisfy the financial institution that the funds are not tainted.

The Royal Court has previously acknowledged in *Jakob International Inc v HSBC Private Bank (CI) Ltd*^[3] that a person seeking access to funds without the consent of the FIS can obtain relief from the Royal Court in the following manner:

- By questioning whether the person or institution reporting the suspicion can establish that it has the requisite suspicion that the funds were proceeds of crime
- By proving the provenance of the funds, that is to say that the funds are not tainted by proceeds of crime in the manner suspected

Suspicion

The Royal Court made it clear that the custodian of the funds, in this case RBC, has the burden of establishing on the balance of probabilities that as at the time of the hearing, there are still relevant facts on which to base the suspicion about the source of funds in the trust. A valid suspicion requires more than general mistrust, that is the custodian must think that there are relevant facts which lead to a more than fanciful possibility that the asset holder was or had been engaged in or had benefitted from criminal conduct. Notably, the suspicion does not have to be clear or even based on reasonable grounds.

In the present case, the Deputy Bailiff held that RBC was entirely justified in its suspicions that Mr Li had been the originator of the funds in the trust and insufficient explanation had been given to dispel that belief. It was found that Ms Liang had been unwilling to supply information demonstrating a suitable audit trail which would fully address RBC's enquiries and did not provide the level of co-operation required to sufficiently allay RBC's suspicions.

Source of funds

The court held that it would be inappropriate to require a financial institution to prove that the funds were tainted in a situation where it does not have all the details of the sources and is unable to compel the required explanations. Once a custodian has established that it has the necessary suspicion, it is the asset owner who must establish that on the balance of probabilities the suspicion is unfounded.

Ms Liang would have been able to discharge the burden on her if she could show that she independently owned the property that was used to fund the trust's assets and it was in fact her property that had been used for this purpose. However the court found that there had been insufficient clarity as to Ms Liang's personal wealth generation. Whilst the court allowed amounts introduced to the trust that Ms Liang was able to show traced back to her own personal wealth, the court found the nature of the documents produced by Ms Liang to be selective and that she had provided an incomplete picture leaving more questions than it answered. It was for this reason that the Court was not persuaded that it should treat the assets of the trust as belonging to Ms Liang and therefore denied her the declaration she sought.

Ogier Comment

In reaching its decision, the Royal Court has tried to create a workable balance between the conflicting interests of the custodian and the beneficiary. From the custodian's point of view, it needs to establish that it is justified in its suspicions that the funds are tainted by proceeds of crime and it still has those suspicions at the date of the hearing. However the court has helpfully clarified that it can maintain a neutral position in relation to the question of the source of the funds whilst the asset owner attempts to show on the balance of probabilities that the funds are

not so tainted.

The decision also highlighted the rights of the asset owner. The court must have the ability to make an order for payment if the asset owner can show that the funds are not proceeds of crime. It would be unacceptable to have an indefinite informal freeze of the funds without any judicial supervision. The court would have been willing to make the declaration that Ms Liang sought if it had not found her reluctant to divulge information in circumstances where the court considered the paperwork capable of being produced.

Whilst the court has attempted to strike the right balance, the position still remains somewhat unsatisfactory from the perspective of both custodian and beneficiary. Ms Liang has not been accused of any criminal conduct; she remains caught by association with a husband from whom she is formally separated. The Deputy Bailiff was concerned that there may be future cases involving an innocent victim by association forced to prove source of funds without having access to all the material available to a law enforcement agency. Indeed, at Ogier we are aware of such instances happening, although they have been resolved without the need for recourse to the court.

Further, the present balance does not provide complete protection for the custodian. It is only a police officer who may give consent under the Proceeds of Crime Law. The Law Officers have not clarified whether a bank complying with a civil court order to pay out monies, may still be prosecuted if the monies later turn out to be proceeds of crime. The Deputy Bailiff's judgment stressed the need for the prosecuting authorities to use common sense and reality (which, again in our experience, is evident in the right cases), but it is clear that until the Law Officers and States of Guernsey consider the difficulties arising from the present reporting regime further, there are likely to be many more cases brought before the Royal Court.

[1] *The Chief Officer of Customs & Excise, Immigration & Nationality Service v Garnet Investments Limited* [2011-12] GLR 250

[2] Guernsey judgment 20/2018

[3] [2016] GLR N-6

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