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Commentary:

Private Rights of Action Under the Annunzio-Wylie Act: Can Banks Be Held Liable for Failing To File Suspicious Activity Reports?

By Roger E. Barton, Esq.

In the wake of the tragic events of Sept. 11, financial institutions should be cognizant, more than ever, of the potentially diabolic behavior of customers. One preventative measure already in place as part of the Annunzio-Wylie Anti-Money Laundering Act[1] (the "Act") is the requirement that financial institutions confronting "suspicious transactions" that might lead to a violation of law file a "Suspicious Activity Report" with "the appropriate Federal law enforcement agencies…."[2]

A financial institution that files a SAR enjoys the benefit of a "safe harbor" provision, providing it with complete immunity from suit.[3] What happens, however, when a financial institution fails to file a SAR? Does such a failure provide an independent basis of liability to individuals or entities harmed by the financial institution's failure to file the SAR, even though the Annunzio-Wylie Act does not explicitly provide for a private right of action? The statute is not clear on this point, and the courts have yet to resolve the issue. As shown below, there are strong arguments on both sides of this case.

Out of today's headlines, we have the following example. Swindled Inc. suffered a company's worst nightmare. It was defrauded by its chief financial officer, who diverted more than $10 million from its bank account into the hands of a terrorist organization. Although he was not an authorized signatory on Swindled's principal account, the CFO was able to siphon the money out of this account and into another account that he established personally under the name Swindled *Co.* The CFO would, without authorization, endorse checks payable to "Swindled Inc." and deposit such checks into the Swindled Co. account by endorsing such checks with a Swindled Co. stamp, then handwriting the words "Swindled Inc." over the stamp and depositing the checks into the "Co." account. Moreover, the CFO would immediately wire-transfer each deposit into an offshore account as soon as the funds cleared in the United States. Because the bank employees knew and trusted the CFO, they never thought twice about filing a SAR pursuant to the requirements of Annunzio-Wylie. As a result, the authorities were never informed of the CFO's wrongdoing, which was allowed to continue for five years.

After an unsuccessful attempt to recover from the CFO, Swindled Inc. now looks to the bank for recovery. Under the Uniform Commercial Code, Swindled may be limited in its claim for losses occurring within a three-year period for improperly endorsed checks, and to only one year for other defalcations. Moreover, case law suggests that Swindled may have no direct claim at all against a bank with which it has no privity or contractual connection. The question arises, however, whether the bank should be, at least partially, responsible to Swindled for its losses as a result of the bank's failure to file a SAR.

The Statute

In 1992 Congress passed the Annunzio-Wylie Act, the relevant section of which gives the Secretary of the Treasury the power to require banks and other financial institutions to report suspicious transactions to the

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This symbol indicates that case documents are included in this issue.

appropriate authorities, and it contains other provisions with respect to the mandatory or voluntary disclosure of suspicious activities.[4] In order to encourage financial institutions to report possible criminal activity, the Act gave financial institutions and their officers, employees and agents complete immunity from liability arising out of such disclosure:

> *Liability for disclosure.* Any financial institution that makes a disclosure of any possible violation of law or regulation or a disclosure pursuant to this subsection or any other authority, and any director, officer, employee, or agent of such institution, who makes or requires another to make any such disclosure, shall not be liable to any person under any law or regulation of the United States, any constitution, law or regulation of any State or political subdivision of any State or under any contract or other legally enforceable agreement (including arbitration agreements), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure.[5]

The regulations promulgated by the Secretary of the Treasury under the statute specifically require SARs to be filed whenever a financial institution detects "a known or suspected violation of federal law, a suspected transaction related to money laundering activity, or a violation of the Bank Secrecy Act."[6] While this section creates an affirmative duty on the part of banks to file SARs when they find possible violations of law, Annunzio-Wylie is silent as to a civil remedy for those persons or entities who may be affected by a bank's failure to file a SAR. The only section that addresses such inaction provides that banks "may" be subject to "supervisory action" in the event they fail to file a SAR in appropriate circumstances.[7]

While the Annunzio-Wylie Act was designed to uncover and stifle money laundering, particularly in connection with drug trafficking, "Congress, in its wisdom, chose to pass a statute that covered considerably more territory."[8] For instance, the wording chosen by Congress encompasses the complete ambit of criminal behavior, whether money laundering (a federal crime) or credit card fraud (a class A misdemeanor under New York state law).[9]

The Act and its legislative history are, however, bereft of any mention of the particular class of persons or entities who were intended to benefit from the coverage of the statute. Therefore, the question remains open as to whether a private individual or entity may use Annunzio-Wylie as a basis for liability against a financial institution that fails to file a SAR, or whether such an action is only available to the government.

The Arguments Against Private Rights of Action

Because Annunzio-Wylie is silent on this issue, plaintiffs seeking redress for violations of the law must first prove that "the Congressional intent [behind the Act] evinces a desire to provide individuals with a private right of action such that it is appropriate to imply a cause of action into the statute."[10] In *Cort v. Ash*,[11] the Supreme Court established a four-part test to determine whether or not a private right of action is implied in a statute. It asks:

- whether the plaintiff is part of the class for whose special benefit the statute was enacted;
- whether there is the indicia of legislative intent, explicit or implicit, to create or deny a private cause of action;
- whether implying a private cause of action is consistent with the underlying purpose of the legislative scheme; and
- whether the cause of action is traditionally relegated to state law.

Under the facts of Swindled's case, strong arguments can be made that the *Cort* factors weigh against its ability to maintain a private right of action under Annunzio-Wylie.

As to the first factor, it does not appear that Swindled is among the entities for whose benefit the statute was enacted. For instance, the relevant section of the Act states that the Secretary of the Treasury "may require financial institutions … to report any suspicious transaction relevant to a possible violation of law."[12] Indeed, nowhere are private litigants mentioned in the statute.

As to the second factor, a fair reading of the statute shows that Congress' intent in passing this section of the Act (and the safe harbor provision) was to encourage financial institutions to report suspicious transactions without fear of civil liability. Beyond that, there exist no indicia, explicit or implicit, to create or deny a private right of action.

As for the third element, the creation of a private right of action for Swindled would actually be inconsistent with the legislative scheme. Section 5318(g)(2) of the Act prohibits a financial institution that files a SAR from notifying any person involved with the suspicious transaction of the SAR filing. Thus, in order to defend itself against Swindled's claim of violating Section 5318(g) by failing to file a SAR, the bank would, assuming it filed a SAR, have to violate Section 5318(g)(2) when disclosing the existence of the SAR.[13]

Finally, as to the fourth prong, such a broadly worded statute, designed to cover federal and state law, and reaching multistate, and perhaps multinational, institutions, would arguably not be one relegated to state law.

The Arguments for Private Rights of Action

Strong arguments, however, can also be made in support of Swindled's claim against the bank. Again, because Annunzio-Wylie does not explicitly provide a private right of action, it is Swindled's burden to prove that one should be implied.[14]

One such argument flows from the Act's safe harbor provision, which provides complete immunity for financial institutions that file SARs. Conversely, banks that fail to file SARs should not receive such immunity; they should be susceptible to claims by those injured by their failure. In fact, arguments can be made to support this logic based on a close reading of the language of the safe harbor provision: financial institutions "shall not be liable to any *person … for* such disclosure or *for any failure to notify the person involved* in the transaction or any other person of such disclosure."[15]

By specifically addressing immunity to any "person," it can be argued that the same "person" should have a right of action for a violation of the statute. Moreover, the statute's specific wording contemplates liability "for such disclosure" or "for failure to notify the person[s] involved," indicating the potential liability for the underlying act if indeed the bank fails to file a SAR and processes a transaction in violation of law.

One can imagine the subject of a SAR filing, who was truly not involved, wanting to sue a financial institution for a wrongful filing. In this instance, the safe harbor provision works for financial institutions. To deny a private right of action against a bank where a violation of law could have been prevented by a SAR filing, however, would be to provide banks with the ability to insure against their own wrongdoing.

This line of reasoning supports the third prong of the *Cort* test: whether implying a private cause of action is consistent with the underlying purpose of the legislative scheme. If Congress' purpose in providing a safe harbor for financial institutions was to encourage them to file SARs to prevent financial harm to individuals or entities, then, as a deterrent, those institutions failing to file SARs should be susceptible to claims by individuals or entities harmed by their failure to do so.

Indeed, at least one case has followed this reasoning. In *Sonders v. PNC Bank N.A.*,[16] the plaintiff, the beneficiary of an attorney trust account in defendant PNC's bank, sued PNC for violating the Uniform Fiduciaries Act after the plaintiff's money was wrongfully converted by his attorney. In response to a claim that PNC's failure to file a SAR was evidence of its wrongdoing, the bank asserted, on a motion to dismiss, that it was immune from liability under 31 U.S.C. § 5318(g)(3), the safe harbor provision of Annunzio-Wylie.

In rejecting that argument and denying the motion to dismiss, the court noted that Section 5318(g)(3) only protects banks for filing proper reports and in this case, no such report was filed, leaving open the possibility of civil liability.[17] Inherent in the *Sonders* holding is the idea that the only way to give the SAR filing requirement any weight is to imply a private right of action, particularly when the regulations provide for the vague, non-punitive sanction of "supervisory action" for non-compliance.[18]

In addition, although the safe harbor provision read literally grants absolute immunity from any cause of action if financial institutions file a SAR, at least one court has held that in order to receive such immunity, a financial institution must have a "good-faith suspicion" that a law was violated.[19] Thus, banks that file SARs in bad faith will not be immune from suit. Therefore, it is reasonable to argue that an individual harmed by a failure to file a SAR should have the same right to sue as one who suffers as a result of a bad-faith filing.

Conclusion

While we wait for courts to consider the issues addressed in the above arguments, recent legislation indicates that there is still more work to be done to prevent sinister financial behavior. On Oct. 26, 2001, Congress passed the USA Patriot Act, which imposes many of the requirements of the Annunzio-Wylie Act, including the filing of SARs, on firms in the securities industry, such as hedge funds, insurance companies and money transferring institutions. While it is unclear if private rights of action exist under the USA Patriot Act, if so, there will be stronger incentives for compliance.

As this article illustrates, there is a high level of uncertainty as to whether or not Swindled can maintain an action against its bank for the losses it incurred by the CFO's wrongdoing. Until courts confront this issue head on, banks and other financial institutions should be all the more careful and file SARs when confronting suspicious activity even if it involves highly regarded customers.

The National Law Journal recently reported that SAR filings are up considerably this year from years past. Projections for 2001 estimate 179,598 SAR filings, up from 81,161 in 1997.[20] Although this data may suggest that financial institutions are becoming more cognizant of suspicious banking activity, the possibility of civil liability should instill even more compliance.

Notes

[1] *See* 31 U.S.C. §§ 5318(g); Pub. L. No. 102-550.

[2] 12 C.F.R. § 208.62.

[3] While the statute, on it face, appears to grant financial institutions complete immunity for filing SARs, at least one court has held that banks must file SARs only if they have a "good-faith" belief of a violation of law. *See Lopez v. First Union Nat'l Bank*, 129 F.3d 1186, 1191 (11th Cir., 1997); but *see Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2d Cir., 1999) (holding no "good-faith" requirement). For a more extensive discussion of this issue, *see infra*.

[4] 31 U.S.C. §§ 5318 *et seq.*

[5] 31 U.S.C. §§ 5318(g)(3)(A).

[6] 12 C.F.R. §§ 208.62(c).

[7] 12 C.F.R. §§ 208.62(i).

[8] *Nevin v. Citibank*, 107 F. Supp. 2d 333, 341 (S.D.N.Y., 2000).

[9] *Nevin*, 107 F. Supp. 2d at 341.

[10] *Rivera v. Golden Nat'l Mortgage Banking Corp.*, 2001 Lexis 8508 (S.D.N.Y., June 25, 2001); *see also Alaji Salahuddin v. Alaji*, 232 F.3d 305, 307-08 (2d Cir., 2000) (stating implied-right-of-action analysis "depends on whether it can be reasonably inferred that Congress intended to create such a private remedy").

[11] 422 U.S. 66, 78 (1975).

[12] 11 U.S.C. § 5318(g).

[13] Of course, it could be argued that an investigation touched off by a SAR filing would necessarily involve a step that would alert Swindled to the CFO's wrongdoings, and thus prevent any further harm.

[14] *See Suter v. Artist M.*, 503 U.S. 347, 363-64 (1992).

[15] *See* note 5, *supra* (emphasis added).

[16] 2001 Lexis 16696 (E.D. Pa., 2001).

[17] 2001 Lexis 16696, at *4.

[18] *See* note 7, *supra*.

[19] *Lopez v. First Union Nat'l Bank*, 129 F.3d 1186, 1192 (11th Cir., 1997); but *see Lee v. Bankers Trust Co.*, 166 F.3d 540, 542-44 (2d Cir., 1999) (holding no such "good-faith" requirement must be met, immunity is absolute).

[20] NAT'L L.J., Dec. 3, 2001, at B9.

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