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BANKS' DUTIES WHEN EXECUTING CLIENT INSTRUCTIONS: THE QUINCECARE DUTY

This note provides an overview of the *Quincecare* duty and explains how banks can mitigate the risks of acting in breach of the duty when executing client instructions. It is one of a suite of notes on banks' duties aimed at in-house legal counsel working at a bank.

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SCOPE OF THIS NOTE

The *Quincecare* duty is increasingly in the limelight. In 2019, the first successful claim for breach of the *Quincecare* duty was upheld by the Supreme Court (*Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe Ltd [2019] UKSC 50*). In the same year, the Court of Appeal handed down a decision which expanded the scope of the duty (*JP Morgan Chase Bank NA v Federal Republic of Nigeria [2019] EWCA Civ 1641*). The *Quincecare* duty has gained particular importance in anti-money laundering and fraud cases where banks are increasingly expected by the regulator and the courts to play a role in preventing financial crime. This note examines when a *Quincecare* duty may arise, how to avoid a breach of the duty and the practical implications on the daily interactions of banks with their clients.

The note is part of a suite of notes on banks' duties. The other notes are listed below:

- *Practice note, Banks' duties when providing bank references and other information to third parties.*
- *Practice note, Banks' duties: fiduciary duties owed by banks.*
- *Practice note, Banks' duties: equitable duties owed by mortgagees when exercising a power of sale.*
- *Banks' duties when providing advice and information .*

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OVERVIEW OF THE *QUINCECARE* DUTY

Scope of the duty

The *Quincecare* duty (established in *Barclays Bank v Quincecare [1992] 4 All ER 363*) prevents a bank from executing a payment instruction where it has reasonable grounds to believe that the instruction is an attempt to misappropriate the account holder's funds. For example, the fact that the payment is for a significant sum of money and is outside the customer's usual course of business might constitute reasonable grounds. The duty is an aspect of the bank's duty of reasonable care and skill in executing the customer's instructions. It arises by virtue of an implied term of the contract between the bank and the customer or as a co-extensive duty in tort.

It was originally thought that the *Quincecare* duty was (exclusively) a negative duty not to execute the payment instruction, rather than a duty requiring the bank to take positive steps to verify its legitimacy. However, the Court of Appeal's decision in *JP Morgan* has left this in doubt. That decision suggests that the court's assessment of what a defendant bank should have done will turn on the facts of each case and that a bank may, in an appropriate case, be required to investigate whether the payment instruction is an attempt to defraud the account holder (see paragraph 22; although also see the recent decision in *Philipp v Barclays Bank UK Plc [2021] EWHC 10 (Comm)*, at paragraph 117).

Authorised push payment frauds

The *Quincecare* duty does not apply in circumstances where a customer makes a payment instruction as a result of fraud (as opposed to where an agent of the customer makes a fraudulent payment instruction). In *Philipp*, HHJ Russen QC (sitting as a High Court judge) struck out a claim brought against a bank by a customer who had been duped by a fraudster into paying £700,000 to "safe accounts" in the UAE (see, in particular, paragraphs 130, 156 to 165, and 171 to 174).

Financial institutions other than banks

The *Quincecare* duty is not just relevant to banks. Payment services providers and other financial institutions which provide facilities similar to bank accounts may be subject to the *Quincecare* duty. This is because these entities ordinarily will have an obligation to comply with their customer's mandate and, by implication, a duty to exercise reasonable care and skill in doing so. In *Hamblin v World First Ltd [2020] EWHC 2383 (Comm)*, it was assumed that the *Quincecare* duty applied to a payment services provider which in effect provided current banking account facilities.

Role of banks in preventing financial crime

In the earlier cases, the courts accorded a high degree of weight to the professional judgement of banks in assessing whether there had been a breach of the *Quincecare* duty. In *Barclays Bank v Quincecare*, Steyn J said:

> "… it is right to say that trust, not distrust, is also the basis of a bank's dealings with its customers. And full weight must be given to this consideration before one is entitled, in a given case, to conclude that the banker had reasonable grounds for thinking that the order was part of a fraudulent scheme to defraud the company."
>
> In the modern cases, there is a discernible shift. The courts have increasingly recognised the role of banks in preventing financial crime. The likely consequence of this is that the courts will be more exacting in assessing whether a bank has breached the *Quincecare* duty.

The high-water mark is the recent decision at first instance in *JP Morgan Chase Bank NA v Federal Republic of Nigeria [2019] EWHC 347 (Comm)*. In that decision, Andrew Burrows J stated that the duty constitutes not just a negative duty to refrain from executing a payment instruction where there are reasonable grounds to suspect fraud, but also a positive duty to investigate the bank's suspicions. He went on to say:

> "To recognise such a duty of enquiry would be in line with sound policy. In the fight to combat fraud, banks with the relevant reasonable grounds for belief should not sit back and do nothing."

IMPLICATIONS AND RISKS FOR BANKS

There are several ways for banks to mitigate the risks of breaching the *Quincecare* duty.

Contracting out of the duty

It is possible to contract out of the *Quincecare* duty. However, very clear wording must be used. For example, the *Quincecare* duty is generally not negated by:

- An entire agreement clause. This is a clause providing that the written contract constitutes the entire agreement between the two parties. A contract including an entire agreement clause generally will not prevent the *Quincecare* duty from being implied into the contract. For more information, see *Contracts: entire agreement clauses.*

- A clause which merely narrows down the bank's obligations to the basic obligations of holding money and executing instructions received. That is because the duty to perform those functions with reasonable care and skill (the essence of the *Quincecare* duty), is part and parcel of those obligations.

(See the Court of Appeal's decision in *JP Morgan*, at paragraphs 32 to 48.)

In other words, only a clause specifically excluding the *Quincecare* duty may enable a bank or other financial institution to contract out. However, this clause likely would have to provide that the bank is entitled to pay out on instruction of the authorised signatory even if it has reasonable grounds for believing that the payment is in furtherance of a fraud. Such a clause is likely to be commercially unattractive.

Further, given that most bank-customer contracts will be on the bank's standard terms, a clause purporting to exclude the *Quincecare* duty is likely to be subject to challenge as an unfair term under section 11 of the Unfair Contract Terms Act 1977 (on the basis that it is unreasonable) or section 62 of the Consumer Rights Act 2015 (on the basis that, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer). For more information, see *Practice note, Unfair terms in financial services contracts under CRA 2015*.

Avoiding a breach of the duty

There have been only a handful of decisions relating to the *Quincecare* duty and fewer still where the bank has been held to be liable. *Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd [2017] EWHC 257 (Ch)* is one such case. It usefully illustrates a number of important practical considerations for banks.

In *Singularis Holdings*, the defendant, a London subsidiary of a Japanese investment bank and brokerage firm, held around $204 million for the claimant, a Cayman Islands company, in a segregated client account. The money was paid out on the instructions of Mr Al Sanea, a Saudi national who was the sole shareholder and a director of the claimant. The payments were made to the bank accounts of companies in a group owned by Mr Al Sanea and were thereby misappropriated. The liquidators of the claimant brought a claim against the defendant (the bank) for breach of the *Quincecare* duty.

In holding that the defendant was liable for breach of the *Quincecare* duty, Rose J made the following findings:

- At a general level, the defendant (the bank) had a dysfunctional structure where "everyone assumes that someone else is dealing with investigating the disputed payments but no one troubles to check whether that is right or not".

- The defendant (the bank) was aware that Mr Al Sanea and the group of companies he owned were in dire financial straits around the time of the payments. Mr Al Sanea's assets had been frozen by the Saudi authorities. There had been reports in the press about the need for the group to restructure its (substantial) debts. Moody's and S&P had downgraded and then withdrawn their credit rating of the group.

- The defendant was aware that the claimant might have other substantial creditors with an interest in the money. For example, it knew that other banks were selling off collateral they held for the claimant.
- There was a large amount of evidence to put the defendant on notice that there was something wrong with the way Mr Al Sanea was operating the claimant's account. This included the appearance of $80 million in the claimant's bank account shortly after Mr Al Sanea's and the group's other bank accounts had been frozen.
- There was a stark contrast between the way in which some payment requests were processed and how the disputed payments were handled. In contrast to other payments, the disputed payments were signed off without any consultation or discussion between management and in-house legal and compliance functions.

To mitigate the risks of being found liable for breach of the *Quincecare* duty, banks should take the following steps:

- Surveillance and monitoring: have in place robust systems for monitoring accounts and detecting transactions and instructions which are unusual in the light of the customer's usual course of activity, including in relation to:
  - the identity of the person giving the instruction;
  - the form of the instruction;
  - the size of the payment;
  - the identity of the payee;
  - the fact that the account holder might be insolvent; and
  - the fact that the account holder is a one-man-band company, controlled by a sole director and shareholder.
- Know your customer: to the extent possible, make use of relevant information available from other sources, such as information in the public domain. Know your customer policies and procedures should hold the sales department accountable for passing this information onto the compliance department. Internal systems should also track this kind of information from external sources.
- Escalation processes: have in place clear, step-by-step protocols for escalating concerns to compliance personnel.
- Red flags: red flag key events in the system so that the information flows through the various functions involved.
- Investigation: have in place a clear procedure for enhanced due diligences and the documenting of investigations.
- Training: train sales teams not to accept at face value, and to interrogate thoroughly, explanations and documents proffered by the account holder.
- Clear allocation of responsibilities: ensure that the responsibility for making decisions in respect of the matter investigated is allocated, by way of written policies and procedures, to a specific person or group of people.
- Retaining evidence and documenting decisions:
  - if the conclusion is reached that there are reasonable grounds to believe that the instruction is an attempt to defraud the account holder, document that conclusion carefully and the reasons for it, and decline to execute the instruction until sufficient evidence is produced to demonstrate that the instruction is legitimate. If at any point a bank considers itself to be "on inquiry" for the purposes of its *Quincecare* duty, it should also consider whether it needs to file a suspicious activity report (SAR) under the Proceeds of Crime

Act 2002 (POCA). Banks should be careful to avoid committing the tipping-off offence under POCA if they have filed a SAR. For more information, see *Article, Quincecare duty: the role of banks in fighting financial crime*; or

- if the conclusion is reached that sufficient evidence has been produced to demonstrate that the instruction is legitimate, document that conclusion carefully and the reasons for it, before executing the instruction.

- Industry standards: ensure that the bank's internal policies are in line with, or go further than, industry standards (compliance with industry standards, rather than the bank's internal policies per se, will be relevant to whether the *Quincecare* duty is breached: see *Philipp*, at paragraph 149 and *Morley v Royal Bank of Scotland Plc [2020] EWHC 88 (Ch)*, at paragraphs 157 to 158).