Shearn Delamore &co.

Dispute Resolution Update

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Banking Fraud — Bank's duty of care

Whether Banks may be held liable for third-party fraud in transferring or receiving fund depends in the first instance on the existence of the bank's duty of care to the victim.

In light of the fraudsters' sophisticated social engineering capabilities and the rapid, often irreversible nature of instant payment systems, banking fraud incidents such as Authorized Push Payment ("APP") fraud, has become prevalent globally. Victims of banking fraud often seek to pursue recovery of funds from the sender bank or receiving bank. In this article, we examine the approach of courts in Malaysia and other Commonwealth jurisdictions in response to such claims.

Bank's duty to its own Customer — Commonwealth Position

When the victim of fraud (who is also the customer of the Bank) had himself instructed the Bank to execute a payment instruction, a Quincecare duty does not apply; instead, the Bank is under a strict duty to make payments from the account in compliance with the customer's instructions. This was held in the recent case of **Philipp v Barclays Bank UK PLC** [2024] AC 346.

In that case, the claimant ("Mrs. Philipp"), was a victim of an APP fraud. Mrs Philip was deceived by fraudsters, posing as representatives of the National Crime Agency and the Financial Conduct Authority, into making a payment in the sum of £700,000 to an account in the UAE.

Plaintiff's claim

Despite Mrs. Philipp having personally attended at the Bank to give instructions for the international transfers, she sued the bank for breaching its Quincecare duty, alleging the Bank's failure to prevent and detect APP Fraud when she discovered the fraud.

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Supreme Court Decision

Overturning the Court of Appeal decision regarding the applicability of the Quincecare duty, the Supreme Court clarified that a bank's duty does not extend to cases where a customer authorises a transfer under APP fraud; where the victim is deceived into authorising their bank to transfer funds to a fraudulent account. The Supreme Court held, amongst others, that: -

a) a bank's basic duty under its contract with a customer is to execute payments in accordance with the customers' instructions. The Supreme Court stressed that this duty is strict and where the customer has authorised the bank to make a payment, it must carry out that instruction promptly without concerning itself with the "*wisdom or risks of its customer's payment decisions*";

b) the true basis of the Quincecare duty was to protect a customer in circumstances where a bank "*put on inquiry*" that the instructions may not be genuine, for example, if the bank has reasonable grounds to believe that the instructions from an agent of a customer is fraudulent or the customer lacks mental capacity. In such cases, the bank owes a duty to verify the instructions before carrying out such instruction only;

c) The Quincecare duty has no application when the bank receives a payment instruction from the customer himself;

d) as long as the instruction is clear and is given by the customer personally or by an agent acting with apparent authority, no inquiries are needed to clarify or verify what the bank must do. The bank's duty is to execute the instruction and any refusal or failure to do so will prima facie be a breach of duty by the bank.

Bank's duty to Non-Customer — Commonwealth Position

Royal Bank of Scotland International Ltd (Respondent) v JP SPC 4 and another (Appellants) *[2022] UKPC 18*

In **Royal Bank of Scotland International Ltd (Respondent) v JP SPC 4 and another (Appellants)** [2022] UKPC 18, the Privy Council rejected a motion to extend a bank's Quincecare duty to a non-customer of the bank, albeit that third party having beneficial ownership of the monies concerned.

Plaintiff's Claim

The claimant investment fund (the "Fund") set up a scheme allowing investors to earn profits by lending money to solicitors for litigation funding. These loans were managed through bank accounts maintained by Synergy (Isle of Man) Ltd (Synergy). The Fund

claimed that two individuals in control of Synergy had fraudulently diverted funds from these accounts.

The Fund contended that the bank had a duty of care in tort to them, as the beneficial owners of the money in the Synergy accounts, to exercise reasonable care and skill, citing the precedent set in **Barclays Bank plc v Quincecare**.

Privy Council Decision

The Privy Council ruled that there was no basis, either in principle or in the original Quincecare case and its subsequent applications, to support the argument that the Quincecare duty could extend to a third party with whom the bank has no contractual relationship, even if the bank knew or should have known that the third party was the beneficial owner of the funds in the customer's account.

Bank's duty to Non-Customer — Malaysian Position

Koperasi Sahabat Amanah Ikhtiar Bhd v RHB Investment Bank Bhd *[2022] 6 MLJ 722*

The Federal Court had held in **Koperasi Sahabat Amanah Ikhtiar Bhd v RHB Investment Bank Bhd** [2022] 6 MLJ 722 that financial institutions do not owe a duty of care to non-customers.

In this case, Koperasi Sahabat Amanah Ikhtiar Bhd (**"**Koperasi") fell victim to fraud perpetrated by an individual posing as an officer of RHB Investment Bank ("RHBIB"). The fraudster convinced Koperasi to invest RM10 million in a three-year scheme promising annual dividends.

Koperasi then passed a cheque worth RM10 million to the fraudster for the purported investment. The fraudster deposited the cheque into RHB Investment Bank's pool account. Based on usual practice, RHBIB acted in reliance on the bank in slip presented by the fraudster to transfer such funds into the share trading account held by a company associated with the fraudster. Subsequently, fraudster siphoned off the RM10 million from the said share trading account. Koperasi sued RHBIB for, *inter alia*, negligence.

Federal Court Decision

Overturning the decision in the Court of Appeal, the Federal Court ruled that financial institutions owe no duty of care to non-customers, applying the following three-fold test of reasonable foreseeability, legal proximity and policy consideration:

(i) Reasonable foreseeability

The Federal Court held that based on the totality of evidence, there was no factual basis to make any inference that RHBIB had knowledge or any reasonable grounds to believe that (i) the instruction to allocate the RM10 million into the fraudster's company's account was against mandate or authorization, or that (ii) Koperasi would lose the RM10 million. In the words of the Federal Court: "*There were no red flags and even if there were, that is still insufficient*".

(ii) Legal proximity

Further, the Federal Court noted that there was no special relationship or sufficient proximity on the facts to give rise to a duty of care for pure economic loss considering that Koperasi (i) was not a customer, (ii) did not have an account with RHBIB and (iii) had no prior dealings or relationship with RHB Investment Bank. The only nexus between RHBIB and Koperasi was that the RM10 million was deposited by a fraudster into RHBIB pool account.

(iii) Policy consideration

The Federal Court considereded it would be unjust, unfair and unreasonable to impose a duty of care on the RHBIB to Koperasi as a non-customer. According to the Federal Court, policy considerations would militate against the extension and imposition of such duty on banks as this would put RHBIB and all investment banks, in a position of commercial inertia and indeterminate liability.

Federal Court's Refusal of Leave to Appeal in **Sphere Management (Mauritius) Limited & Ors v CIMB Bank Berhad & Ors**

This legal stance was reinforced in the context of electronic banking transactions where on 14 May 2024, Shearn Delamore acting for CIMB Bank Berhad ("CIMB Bank") had successfully opposed an application for leave to appeal to the Federal Court seeking to extend a bank's duty of care to non-customer.

The facts here involved fund transfers made by Sphere Management, on the advice of impostors, to a customer's account maintained at CIMB Bank. By the time the fraud was discovered, the funds were withdrawn by the customer. Similar to the Koperasi case, Sphere Management in this case claimed that CIMB Bank, being the receiving bank, was negligent in allowing funds to be credited into the customer's account and to be withdrawn, alleging that there were red flags which ought to have put the bank on inquiry (amount of funds and speed of the transactions).

The Federal Court reiterated that the legal position on this is clear: common law precedent, exemplified by the Supreme Court's ruling **in Philipp v Barclays Bank UK plc**

[2024] AC 346, as well as the prevailing legal position in Malaysian in the Koperasi case, is that financial institutions bear no duty of care to non-customers.

Consequently, the Federal Court dismissed Sphere Management's application for leave to appeal, affirming the Court of Appeal's decision that financial institutions are not liable in tort to non-customers.

This Update is prepared by Koo Jia You and Teo Tze Jie.

For more information about this article or dispute resolution matters in general, please contact our Dispute Resolution Practice Group.