

Podcast: The Quincecare duty - what does it mean for payment service providers?

Nikki Johnstone and Juliet de Pencier

Nikki Johnstone

Hello and welcome to this Allen & Overy podcast where today we'll be focusing our attention on the Quincecare duty, and what it means for payment service providers. My name is Nikki Johnstone and I'm a partner in the London Payments Regulatory team, and I'm joined today by Juliet de Pencier who is a senior associate in our Litigation and Investigations team, with a practice, which includes finance and civil fraud litigation. Juliet is therefore the best person to update us on what is now a 30 year old duty - what the duty is, why all payment service providers, and not just banks, should be thinking about it, and how the duty fits within the context of their existing regulatory and other legal obligations.

So, Juliet, starting with the basics, what is the Quincecare duty?

Juliet de Pencier

Hi Nikki, and thanks for that introduction. The Quincecare duty is part of a bank's duty to exercise reasonable care and skill in the services it provides. It relates to executing a customer's payment orders, and requires that a banker refrain from executing an order if and for so long as the banker is 'put on inquiry' - in the sense that he has reasonable grounds, although not necessarily proof, for believing - that the order is an attempt to misappropriate the funds of the customer.

The duty was established by the English court, as you say, about 30 years ago, and it gets its name from the court case that established it.

Nikki Johnstone

Right, so stopping you there for a second, you mentioned that this is part of a bank's duty, or at least the court talks about this being a bank's duty to exercise reasonable care and skill when executing customer payment instructions. Now, we know that the market for payments has changed pretty substantially, certainly over the last 30 years, and in the last 10 to 15, in quite a substantial way.

Does the fact that the court, only covering or citing the duty as applying in the context of a bank's duty of care mean that this duty in particular wouldn't apply to other types of payment service provider? I mean, would it apply to e-money or payment institutions?

Juliet de Pencier

The short, although not particularly helpful, answer to that, is it remains to be seen.

Although the majority of cases alleging a breach of the Quincecare duty have been brought against banks, the English court has held it to be arguable that a payment service provider owed that duty, and so future claims could well be brought against electronic money and payment institutions.

Nikki Johnstone

Okay, so it sounds like this is definitely something that PIs and EMIs need to be aware of and looking out for. Can you maybe explain why the duty was established in the first place and how it fits with a payment service provider's duty to comply promptly with authorised payment instructions when it receives them from the customer?

Juliet de Pencier

Of course. The duty exists for policy reasons, and it's designed to encourage institutions to assist in combating fraud, the idea being that if an institution has reasonable grounds to believe their customer is being defrauded, it shouldn't sit back and do nothing.

But you are completely right that the duty does seem to run counter, and does run counter, to a payment service provider's obligation to comply with its customer's payment instructions. It operates as an exception to that duty, and as a result it can throw up some pretty tricky issues.

While generally institutions have a duty to execute their customer's payment orders promptly, so as to meet execution requirements under the payment services regime and avoid loss to their customers, the Quincecare duty requires that institutions should not execute an order whilst "on inquiry" that there are reasonable grounds to believe that the order is an attempt to misappropriate the customer's funds. If there is no reason to believe that is the case, the institution should make the payment as instructed.

I appreciate that the concept of an institution being "put on inquiry" that their customer may be being defrauded is not the most clear one, so I'll break that down a little.

There are three points to keep in mind, which come from how the court has to date approached the question of whether an institution has been "put on inquiry", as part of its overall assessment of whether an institution has breached its Quincecare duty.

Firstly, when assessing whether an institution has been "put on inquiry", the court has considered the institution's actions against the likely perception of an ordinary, prudent banker - that is the standard against which an institution's conduct has been judged. Now, I appreciate that standard refers directly to a banker, and so it may be that the standard is expressed differently in a case involving a payment services provider.

Secondly, everything will depend on the facts, as you would imagine, surrounding the particular payment or payments. Factors such as the institution's knowledge of the individual giving the instruction, the amount involved, the need for a prompt transfer, the presence of unusual features, and the scope and means for making reasonable inquiries may well be relevant.

Finally, the courts recognise that trust, and not distrust, is the basis of an institution's dealings with its customer, and that full weight should be given to the nature of that relationship before it can be concluded that the institution had reasonable grounds for thinking that the order was part of a fraudulent scheme.

Nikki Johnstone

Great, there's so much in there. We've talked about that the fact that this duty's been around for more than 30 years, but some of those listening may be aware, and actually the reason why we're sitting down to talk about this today, is that the Quincecare duty does seem to have generated quite a significant volume of litigation in the last five years or so. Could you tell us a bit about how the courts approach the Quincecare duty, especially in some of its more recent cases?

Juliet de Pencier

Yes. In recent years, the court has indicated that the duty is narrow and it's confined. The focus of the duty is on the institution's belief about the specific payment instruction, as contrasted with that institution's knowledge of broader issues relating to the customer and its operations, such as money laundering or financial crime concerns. Unless the institution is on notice that the payment instruction in question itself is an attempt to misappropriate the customer's funds, the duty doesn't arise.

I think it's also worth noting that establishing that funds have been misappropriated is the first and critical step in a case that alleges an institution has breached its Quincecare duty, and the burden of proof sits with the customer alleging the breach of duty.

That may be reasonably straightforward in APP fraud cases, i.e., where the customer is deceived by a fraudster into authorising a payment. But it also could be a significant hurdle in more complex commercial cases where, for example, the instruction in question is given by an individual, authorised by that customer to give payment instructions on its behalf.

Nikki Johnstone

Yes, of course. Interesting. We've been talking about APP cases, but also complex commercial cases. Is the duty limited in any way to a particular category of customer?

Juliet de Pencier

No, it's not. The duty is owed to all of an institution's customers.

I think the reality is that only high value payments are likely to end up justifying the costs and risks of litigation, and so most court decisions relate to extremely high value payments and to claims brought by corporate customers where an agent has instructed the relevant payment.

However, it's worth emphasising that, at the moment, in principle, the Quincecare duty also applies to cases where the relevant payment instruction was not issued to the institution by an agent of the customer.

The Court of Appeal recently held that an individual customer can rely on the Quincecare duty and that the duty could apply where the customer themselves gives the payment instruction, for example, in cases of APP fraud. The Supreme Court heard the appeal of that decision in February of this year, and it's hoped that its decision will further clarify the law on this duty.

Nikki Johnstone

Oh, interesting - so watch this space. Let's see if we'll get this before the summer break.

Maybe we'll turn now to the practical implications of the Quincecare duty - how we bring it to life. Payment service providers of all types are already having to grapple with the multiple duties and requirements under UK law, which aim to strike a balance between on the one hand, ensuring there are speedy and transparent payments, particularly in the case of retail payments, but on the other hand, there's a need to ensure adequate protection from fraud or other losses that are arising outside the control of any payment service user.

This is obviously a really difficult balancing act, and it's perhaps why we're seeing the Government consult - most recently in its January 2023 Call for Evidence on the Payment Services Regulations - on potentially introducing a more "risk-based" approach to the execution requirements for payments, which essentially would allow, for more complex cases at least, payment service providers to delay payments if there is a suspicion of fraud. So perhaps take an extra day or two to investigate their suspicions of fraudulent activity, as an exception to their obligation to complete a payment transaction within T + 1 or within another timeframe set by law. For now, what do you think payment service providers should think about in order to address the duty?

Juliet de Pencier

I think there are two parts to this.

Firstly, what institutions can do to detect potential payment fraud, and secondly, how institutions should respond if they are put on inquiry that a payment order may be an attempt to misappropriate their customer's funds.

On the detection point, I think understanding your customers and refreshing your KYC is key if institutions are to be able to recognise unusual and uncharacteristic transactions, and that is especially the case for high value transfers, or payments going to overseas destinations, or to third parties where there's no obvious connection with your customer or the typical purpose for them making payment transactions using your service.

Having the systems in place which are capable of detecting and flagging such transactions is also essential. These should maintain clear and accurate records of all payment instructions and any customer communications, but also actions taken in response to a transaction flagged as suspicious.

As I'm sure listeners will be aware, when an institution is making these assessments, and particularly when dealing with retail customers, it's important to communicate with them if you can, and to do so in a timely manner, whilst also capturing information which aims to verify the authenticity and validity of the instruction coming from that customer.

If the customer is unresponsive, evasive, or inconsistent, or if there are other indicators of fraud, coercion, or undue influence, I think the payment service provider should exercise caution and discretion and consider delaying or refusing the payment and escalating it for further investigation.

Which leads me on to the second part of my answer, which was about how an institution responds when they are put on inquiry about a payment order. Once an institution has been put on inquiry that a payment instruction may be an attempt to defraud their customer, it needs to respond appropriately, to state the obvious probably.

Relevant employees should be trained and also have access to appropriate resources and support about how to investigate and escalate their concerns or red flags, and how to reach a reasonable and ethical decision as to how to proceed, which is then appropriately recorded. It's also very important that the decision taken by the institution to allow the payment, or not, is carefully reasoned and reached after consideration of the material circumstances. That rationale needs to be documented, and the record of that rationale, retained. I think there's a recognition that these can be very difficult calls to make, but having a record of a reasonable decision reached carefully and in good faith will be of benefit to the institution if its actions are ever questioned.

Finally, having those decisions regularly audited and reviewed, along with any related policies and procedures, will allow development and updating of decision making, and enable processes to evolve and improve over time, including by adding new corrective and preventative actions where necessary. I think having that feedback loop and being nimble in terms of how you respond to situations and update your policies and procedures to reflect your experience can be really helpful as well.

Nikki Johnstone

Yes, definitely. It certainly makes sense in the context of all of the policy discussions going on at the moment in the UK surrounding APP fraud, and future expectations that might be put on all types of payment service providers to take some additional responsibility for a real increase in fraud on the payer in particular, which interacts with this duty in quite a significant way.

Again, we are dealing with the here and now, but maybe taking all of this into account, is there anything that payment service providers can do, or maybe should consider from a contractual perspective that might help to mitigate or maybe balance the risk of claims from customers stemming from the duty?

Juliet de Pencier

Yes. From a contractual perspective, in principle, it is possible for institutions to exclude liability for breach of the Quincecare duty in commercial contracts.

The courts have held it is possible for a bank and its customer to agree expressly that the Quincecare duty will not arise, and that the bank is entitled to pay out on instructions of the authorised signatory, even if it suspected the payment was in furtherance of a fraud which that signatory was seeking to perpetrate on the bank's customer.

The courts have also accepted that it's possible to raise the standard of care for the Quincecare duty from ordinary negligence to the highest standard of gross negligence.

However, as with any exclusion clause, clear wording is required if the clause is to be construed as removing a protection that would otherwise exist, and the courts have recognised that a party is unlikely to have agreed to give up a valuable right, that it would otherwise have had, without very clear words being in the contract.

In addition to the clarity of any exclusion clause, other considerations will apply when an institution seeks to exclude liability for a breach of this duty. In particular, the provisions of the Unfair Contract Terms Act 1977, the Consumer Rights Act 2015, and the Payment Service Regulations.

In particular, I think institutions need to consider whether it's appropriate to agree an exclusion clause with certain categories of customer. For retail customers, for example, an exclusion clause for liability of this nature is likely to be challenged as unenforceable, and any narrowing of the duty in customer terms and conditions would need to be considered alongside a payment service provider's obligations under the Payment Services Regulations, their consumer protection, and also the FCA's new Consumer Duty.

To sum up on that point, in principle, there are things that can be done from a contractual perspective, but I think a payment service provider needs to think very carefully about whether, realistically, they can put those sorts of terms into their standard terms and conditions.

Nikki Johnstone

Yes, it will certainly be a difficult set of considerations to balance with, particularly as you say, the new Consumer Duty on the horizon in a retail context, just making it very difficult to, in some way, contract out of protections like this.

It sounds to me like the Quincecare duty is certainly here to stay for a while, and we should be looking out for the Supreme Court decision, which is due any day now. We'll be marking our calendars when we find out what date it will be handed down.

As a quick shout out, Juliet has very kindly, with a colleague, put together **an FAQ on the Quincecare duty**, which sets out what we've discussed today, in writing on our website.

It leaves to me to say thank you, Juliet, for taking the time to walk us through the Quincecare duty so clearly. And of course, thanks to everyone for listening.

Juliet de Pencier

Thanks, Nikki.