Duty of stockbrokers and financial services providers

The analysis and the recent decision of Excel Courage Holdings Limited v Seto Ming Wai & CLC Securities Limited [2024] HKCFI 984 (the "**Case**") further explains and elucidates the concept of Quincecare duty of care. In this case, while the Court acknowledges that financial institutions owe their clients a duty of care when executing orders, the Court considers what objectively a "reasonable and honest banker" would have done to discharge such duty of care. In short, the Quincecare duty of care obligates financial institutions not to follow their customer's instructions when they are "put on enquiry" that complying with the customer's request might facilitate a fraud against the customer. This is difficult to reconcile with a bank's or financial institution's duty to follow its customers' instructions, no wonder it was not until 2019 that a bank is liable for such a breach despite the duty was established in 1992 in the case of Barclays Bank plc v Quincecare Limited [1992] 4 All ER 363.

In the present case, the plaintiff, a corporation incorporated in the British Virgin Islands, owned shares in two publicly listed companies (the "**Shares**"). On 24 September 2013, Mr. Wong, the sole shareholder and director of the plaintiff at the relevant time, established a securities account with CLC Securities Limited ("**CLC**"). Subsequently, on 25 September 2013, Mr. Wong initiated the transfer of the Shares to the newly created account at CLC (hereinafter referred to as "the Account"). Mr. Wong proceeded to instruct the transfer of the Shares from the Account to the accounts of four unrelated individuals (the "**Recipients**"), each holding accounts with CLC (the "**Transfers**"). The plaintiff did not receive any consideration for the Transfers, and the Recipients eventually disposed of the Shares. Under these circumstances, the plaintiff initiated legal proceedings against CLC and Ms. Seto, the relationship manager responsible for handling Mr. Wong's transactions. The plaintiff alleged, among other claims, that CLC had breached its Quincecare duty of care towards the plaintiff by executing the Transfers.

The litigation underscores the importance of financial institutions adhering to their fiduciary responsibilities, particularly under the Quincecare duty of care, to prevent unauthorized or fraudulent transactions that may harm account holders.

The Case reconfirms that a provider of financial services, such as CLC, owes duties to its client to act with reasonable skill and care in providing those services. Financial advisers owe a duty to take reasonable steps to prevent an account from being misused to the client's detriment. This involves extensive "know your client" and due diligence processes to comply with international anti-money laundering and anti-terrorism financing regulations. In Hong Kong, relevant codes include the Code of Conduct for Persons Licensed by or Registered with the SFC, the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, and the SFC's AML guidelines. According to the AML guidelines, an account should not be opened, nor a transaction processed, until customer due diligence has been completed.

Baroness Hale in Singularis Holdings Ltd v Daiwa Capital Markets Ltd [2020] AC 1189, [1] explains the duty as follows: "…there would be liability if the bank executed the order knowing it to be dishonestly given… or acted recklessly in failing to make such inquiries as an honest and reasonable man would make; and the bank should refrain from executing an order if and for so long as it was put on inquiry by having reasonable grounds for believing that the order was an attempt to misappropriate funds."

To determine what objectively a "reasonable and honest banker" would have done, Lord Sumption NPJ in the recent CFA decision in PT Asuransi Tugu Pratama Indonesia TBK v Citibank N.A. [2023] HKCFA 3, [17], pointed out that the banker's Quincecare duty is breached if the following occurs: "… if there are features of the transaction apparent to a bank that indicate wrongdoing unless there is some special explanation, then an explanation must be sought before it can be assumed that all is well. In other words, if a bank actually knows of facts which to their face indicate a want of actual authority, it is not entitled to proceed regardless without inquiry."

However, for the Quincecare duty of care to be engaged, the plaintiff needed to demonstrate that there were features of the Transfers suggesting "impropriety of some sort, which might involve a wrong done to the company and requires explanation." Harris J further emphasized that this necessitates something materially more than non-compliance with regulatory best practice, or "a general irregularity in the structuring or documenting of a transaction."

It is important to note that the Quincecare duty of care only applies to situation where payment instructions are not properly authorised i.e., they are made by a customer's agent to misappropriate funds and not situation where the payment instructions are made by the customers (see Philipp v Barclays Bank UK plc [2023] UKSC 25). In this case, it is held that the general duty of skill and care of a bank "applies to interpreting, ascertaining, and acting in accordance with the instructions" of the customer. The Quincecare duty of care, in line with the general law of agency, requires the bank to make inquiries to verify that the instruction has been properly authorized and to refrain from executing the payment until verification is complete.

In Stanford International Bank Ltd v HSBC Bank plc [2022] UKSC 34 it was held that there was no loss incurred, as the act of paying a valid debt did not diminish the payer's wealth, particularly when the payment instrument favoured early customers, who withdrew their funds entirely without loss, over late customers, who faced significant risk of losing nearly all their funds as creditors in the liquidation, receiving only a minimal dividend (approximately 5 percent). It also confirms that the Quincecare duty of care is not owed to creditors even if the company is insolvent.

The action of the Case was dismissed mainly because the beneficial owner of the plaintiff made a conscious decision to hide the fact that Mr. Wong was a nominee, giving the impression that he had complete control over its affair and assets. The beneficial owner, Mr. Lau, wanted to hide his identity because its shareholding would have triggered a mandatory offer under Rule 26 of the Takeovers and Mergers Code.

It was also held that even if there was a breach of duty, which caused loss, the loss was too remote because it does not fall within the scope of the risk created by the negligence and is, therefore, too remote and legally irrelevant. It has been argued by the plaintiff that CLC should ask for an updated Certificate of Incumbency when it was clearly outdated. The loss which the plaintiff has suffered was caused by the alleged breach of fiduciary duty owed by Mr Wong to the plaintiff, which is not a harm falling within the type of risk which a duty to require an updated certificate is meant to prevent (as Mr. Wong was in fact the sole shareholder and director), and is therefore too remote.

The Quincecare duty of care undoubtedly serves to protect customers from the risks of fraudulent or improper transactions. However, the Hong Kong Court remains firm in ensuring that this duty does not become an unjustifiably onerous burden on banks, financial institutions, and their employees. Despite that, the financial institutions should always fulfil all its customer's due diligence obligations and make enquiries whenever a red flag is raised in relation to a customer's instruction.

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