THE LEGAL CONSEQUENCES OF FRAUDULENT ACCESS TO A BANK ACCOUNT IN SOUTH AFRICA

by

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I dedicate this work to my late mother, Thulile Alice Ngwenya who taught me to be self-reliant and wanted nothing but the best for me. Her memory lives on forever in my heart.

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THE LEGAL CONSEQUENCES OF FRAUDULENT ACCESS TO A BANK ACCOUNT IN SOUTH AFRICAN LAW

1. INTRODUCTION

The dissertation aims to determine the consequences of fraud on a bank account in South Africa and who the liable party for such fraud is. The case of *Hanley v ABSA Bank Limited*[1] which later went on appeal (*ABSA Bank Ltd v Hanley*[2]*) is* analysed critically in this context, as well as the recent case of *DA Ungaro & Sons (Pty) Limited v ABSA Bank Limited.* [3] These cases form the main focus of this dissertation.

Fraud is a worldwide issue which results in disastrous consequences for the individual who has been defrauded. Fraudsters conduct their operations through numerous channels. However, over the last 10 years banks often seem to be the targets where fraudsters carry out their fraudulent activity. Banking fraud is often coupled with money laundering.[4] Fraud has doubled if not tripled over the last decade. As pointed out by Goldsprink and Cole "banking and financial systems are undermined as they hide fraud and transfer the proceeds."[5] Several factors have made it easier for people to conduct fraud in banking.[6] Subramanian explains as follows:

> "In the good old days, when there were fewer customers and banks were for the most part local, they had the luxury of having 'face to face' relationships with customers. In the last 40 to 50 years this has been changing. Too many customers meant less available 'face to face' interactions. As more and more interactions became impersonal, the resulting anonymity also helped fraudsters to exploit the system."[7]

The dissertation aims to prove the importance of banking procedures and controls and the importance of bank officials applying these processes when conducting business with clients in order to prevent and/or detect fraud. Banks need to be able to identify and verify the clients that they are dealing with before concluding business relationships with them to avoid the disastrous consequences of dealing with sanctioned individuals and criminals. The Financial Intelligence Centre Act[8] (FICA) was established to combat financial crimes, fraud and money laundering.

[1] Hanley v ABSA Bank Limited 2012 4 All SA 318 GNP.
[2] *ABSA Bank Limited v Hanley* 2014 (4) 1 All SA 249 (SCA).
[3] *D A Ungaro & Sons v ABSA Bank Limited* 2015 ZAGPJHC 207 (7 September 2015).
[4] Goldsprink & Cole *International Commercial Fraud* Volume 2(2002) xv.
[5] (n 4).
[6] Subramanian *Wiley And SAS Business Series: Bank fraud using technology to combat losses* (2014) 3.
[7] (n 6).
[8] Financial Intelligence Centre Act 38 of 2001.

Accordingly, the impact of FICA on the question investigated in this dissertation is also considered.

The customer, of course, also has a responsibility to maintain his/her account in such a manner as to avoid fraud from being conducted from the account. This much emerges, inter alia, from the common law bank-customer agreement as well as from the South African Code of Banking Practice (the Code).

For the *Hanley* and *Ungaro* cases to be understood properly, knowledge of the bank-customer agreement and the impacts of FICA and the Code on it, is necessary. They are accordingly considered immediately below.

2. THE BANK – CUSTOMER AGREEMENT

When an individual decides to open an account with a specific bank, the individual has to enter into a contract with the bank. "The contract between the bank and customer", as Malan points out, "obliges the bank to render certain services, the so – called services de caisse, to the customer on his instructions and for this reason it can be classified as a contract of mandate."[9] The contract entered into will establish what is commonly known as the "bank and customer relationship".

The law regarding the bank–customer relationship has long been established to give clarity and certainty to the parties in the performance of their reciprocal duties and obligations. In *Standard Bank of South Africa Limited v Oneanate Investments Pty*[10] Selikowitz J stated:

> "The law treats the relationship between banker and customer as a contractual one. The reciprocal rights and duties included in the contract are to a great extent based on custom and usage....It is now accepted that the basic, albeit not sole, relationship between banker and customer of a current account is one of debtor and creditor."

In *Big Dutchman (South Africa) v Barclays National Bank*[11]it was stated that*:*

> "A customer's duty to his banker is a limited one. Save in respect of drawing documents to be presented to the bank and in warning of known or suspected forgeries he has no duty to the bank to supervise his employees, to run his business carefully, or to detect frauds... A customer of a bank has no duty to the bank to check his bank statements."

[9] Malan, Pretorius, Du Toit *Malan On Bills Of Exchange, Cheques And Promissory Notes* (2011) 296.
[10] 1995(4) SA 510 (C) 530 G-H.
[11] 1979 (3) SA 267 (W) 283 A - B.

The above-mentioned cases refer to a time when cheques were prevalent as a form of payment. In the 21st century the cheque is no longer the most common form of payment. Furthermore, the duties imposed on both banks and customers have expanded in scope and the rights of the customer are at the forefront in banking activities. Modern banking law has also brought about a shift in the duties of customers towards their banks; today it is abundantly clear that customers have a duty to inform their banks of unauthorised transactions on their accounts, where they suspect that there has been fraudulent access to their internet banking profile, of the loss of bank cards, and when they know or suspect that someone else knows their PIN.[12] Over and above these duties, customers are expected to be cautious in all transactions conducted with the bank and third parties.

In modern day banking, payments are made mainly by means of card, electronic fund transfers, debit or credit orders and letters of credit (apart from the receding use of cheques). The duties that were and are still imposed on customers who draw cheques should be amended to apply also to other methods of payment.

From the above it appears that a bank–customer relationship will only be established when the parties have entered into a contract that will bind them to perform in terms of the agreement. Furthermore, it is not only the bank (banker) that is expected to carry out its instructions with proper care; the customer also has duties to transact with care and protect his account from theft or fraud.

"The types of contract which may emerge from the bank–customer relationship are the contract of mandate, the contract of loan for use and the contract of deposit–taking."[13] For the purposes of this research, however, the focus falls on the contract of mandate. This contract has been defined as follows:

> "A contract of mandate is a consensual contract between one party, the mandator, and another, the mandatary, in terms of which the mandatary undertakes to perform a mandate or commission for the mandator."[14]

Therefore the mandatary conducts a specific performance or carries out a certain act at the behest of the mandatory.

[12] Moorcroft *Banking Law and Practice (looseleaf last updated November* 2015) 29.
[13] Havenga P, Havenga M, Hurter, Schulze, Kelbrick, Manamela, Stoop *General Principles of Commercial Law* (2010) 355.
[14] Van Zyl "Mandate and Negotiorum Gestio" in Joubert Vol 17 (1) *LAWSA* 2009 par 3.

Furthermore, the mandate must be within the confines of the law and must be binding and enforceable.[15]

Of particular importance is that the mandate must be clearly defined and should not be open to wide interpretation.[16] The mandatary must be able to clearly understand what is requested and expected of him.

In *Gulio v First National Bank Limited* [17]it was stated that:

> "The true nature of the relationship between banker and client is, insofar as the client instructs the bank to render banking services when required, and the bank agrees to carry out these instructions, one of mandate."

The underlying agreement between bank and its client is one of mandate and it has been strongly approved in South African law as appears from the dictum of Grosskopf J in *Volkskas Bank Bpk v Johnson*:[18]

> "Die verhouding tussen bankier en klient behels dat die bankier sy kliënt se opdrag om te betaal, soos uitgedruk in 'n tjek, moet uitvoer. Indien hy dit doen is hy geregtig om die kliënt se rekening te debiteer met die bedrag van die tjek."

In terms of the nature of a mandate as described above, both parties to the contract of mandate must, in the first place, have clarity as to the instructions given by the mandator to the mandatary and, secondly, be aware of the consequences that will ensue upon the failure of the mandatary to carry out the instructions of the mandator. The common law duties of the mandatary are stated and explained briefly as follows:

- The duty to execute the mandate entails that the mandatary must first accept the mandate, and, secondly, the mandatary must do everything in his power to ensure that the mandate is indeed carried out.[19] The duty to carry out the mandator's mandate simply amounts to the mandatary adhering to the mandator's request and instructions by carefully seeing that the instructions are carried out to completion.
- The duty not to exceed the terms and conditions of the mandate entails that the mandatary is to ensure that in the execution on his mandate, he is restricted to act within the scope of the

[15] Van Zyl (n 14) 4.
[16] Van Zyl (n 14) 4.
[17] 2002 6 SA 281 (C) par 20 289D – F.
[18] 1979 4 SA 775 (C) 777H – 778.
[19] Van Zyl (n 14) 8.

mandate. [20] Therefore any act exceeding the mandate is ultra vires and the mandatary can be held liable for breaching the terms of the mandate. The same goes for a bank (in a bank–customer relationship) that has been mandated to carry out specific instructions. Should the bank carry out a transaction without the customer's strict instructions, the bank has acted in breach of his general contract of mandate established by the bank–customer contract. Malan[21] "refers to the bank and customer relationship as a comprehensive mandate in terms of which the customer lends money to the bank on current account, and in return the bank undertakes to repay it on demand."

- Thus, the general contract of mandate between the customer and the bank is above and beyond the specific instructions (mandates) that the customer requests or instructs the bank to execute.
- The duty to perform the mandate personally entails that the mandator assigned the mandatary as a result of his or her knowledge, experience and reputation and therefore only that specific mandatary can execute the mandate. [22] In a bank–customer agreement a mandate is not usually delegated to a specific banker in a bank but to a bank as an institution which will then delegate the mandate to any of its staff members. In Roman–Dutch law the contract of mandate was 'free of charge' [23] and was generally an agreement among companions who did a great deal for one another.[24]In modern day banking law, however, the customer chooses a bank to execute numerous transactions for reward based on the bank's reputation, competence and fees (although it may sometimes happen that a customer chooses a bank or banker due to a previous personal relationship). However the services of the mandatary (bank) are not gratuitous but for a reward.
- The duty to act with reasonable care entails that the mandate must be carried out in a manner that exercises proper care, caution and utmost diligence.[25] The standard of the reasonable banker plays a crucial role in determining whether the mandatary executed the mandate with the required degree of care and skill or whether the mandatary executed the mandate negligently. If the bank executed the mandate negligently, thereby causing loss to the customer, the customer will have a claim for breach of contract against the bank.

[20] Havenga et al (n 13) 297.
[21] Malan et al (n 9) 296.
[22] Van Zyl (n 14) 10.
[23] Du Bois (editor), Bradfield *Wille's Principles of South African Law* (2007) 985.
[24] http://digitalcommons.law.uga.edu/fac_artchop/496 (last accessed on 04/05/2016).
[25] Van Zyl (n 14) 11.

- The duty to act in good faith entails that the mandatary must conduct his dealings in an honest and transparent manner on behalf of the mandator and must place the interests of the mandatory at the forefront in the execution of his mandate.[26] Furthermore the mandatary must avoid any conduct that would result in any loss or harm to the mandatory.[27] It follows that if the mandatary fails to act in good faith and with the required care and skill expected of a person in the profession of the mandatary, the mandatary would be held liable for breach of his or her mandate.
- The duty to render accounts relates to the mandatary furnishing the mandatory with an update report of the manner in which the mandate is being executed.[28] This duty includes the rendering of a statement of account. The banker in a bank–customer relationship is therefore liable to furnish the customer with updated reports on progress in the execution of the mandate. This duty also entails that the banker is to furnish the customer with monthly statements of account reflecting the transactions authorised on the account.

The common law duties of the mandator deal mainly with remuneration.

> "The duty to refund or compensate the mandatary for expenses or losses entails that if the mandatary should, in the performance of the mandate, incur expenses or suffer losses, the mandator would have the duty to refund or compensate him or her".[29]

Should the mandatary, in the execution of the mandate, incur unreasonable expenses due to his or her fault, such expenses would not be catered for by the mandator.[30] This is due to the fact that these costs were purely caused by the reckless conduct of the mandatary and the mandator cannot be liable for them.[31] Unreasonable expenses would include expenses incurred without the mandator's mandate or expenses incurred as a result of the mandatary acting *ultra vires*. The duty to pay the agreed remuneration entails that the mandator is to pay the mandatary the remuneration that has been agreed upon in terms of the contract of mandate.[32] If the remuneration is for the completion of the mandate, the mandator will pay the mandatary upon completion of the mandate.[33] Accordingly, a dissatisfied customer should have the right not to be

[26] Van Zyl (n 14) 13.
[27] Van Zyl (n 14) 13.
[28] Van Zyl (n 14) 14.
[29] Van Zyl (n 14) 16.
[30] Van Zyl (n 14) 16.
[31] Van Zyl (n 14) 16.
[32] Van Zyl (n 14) 16.
[33] Havenga et al (n 13) 296.

charged for fees and services if the bank fails in carrying out the mandate properly or in accordance with the customer's instructions.

It is submitted that these principles, transposed specifically to the bank-customer relationship, imply the following:

- The bank has a duty to act carefully.[34]
- The bank is obliged to honour its customer's cheques (and, it is submitted, other payment orders) on demand if funds are available and as long as the orders concerned are in all respects genuine and complete. In the event of any uncertainty, the bank is not entitled to delay payment in order to make enquiries.[35]
- The bank is obliged to collect cheques (and other payment orders) on behalf of the customer, and must credit the amounts due to his or her account.[36]
- The bank must adhere to the instructions of the customer.[37]
- The bank is obliged to render statements of account to the customer.[38]
- "A bank has no authority to execute a transfer of an order where the drawer's (customer's) signature is forged or the payment is unauthorized."[39]
- The bank is obliged to ensure that the customer's account is managed and maintained with the utmost care, skill, good faith and without negligence.[40]

In this regard attention can further be drawn to the following comments and dicta: Malan[41] states that "the bank must adhere strictly to the customer's instructions, and must perform its duties with care and good faith." In *Selangor United Rubber Estates Ltd v Cradock*[42] the court held:

> "a bank has a duty under its contract with its customer to exercise reasonable care and skill in carrying out its part with regards to operations within its contract with its customer. The standard of reasonable care and skill is an objective standard applicable to bankers."

In *McCarthy Limited v ABSA Bank Limited*[43] it was held that:

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[34] Moorcroft (n 12) 2.
[35] Jones *An Introduction To South African Banking And Credit Law (*2013) 5.
[36] Jones (n 35) 5.
[37] Jones (n 35) 5.
[38] Jones (n 35) 5.
[39] Joubert "*Banking, financial institutions and currency"* in Joubert WA Vol (1) LAWSA 1976 par 44.
[40] Jones (n 35) 5.
[41] Jones (n 35) 5.
[42] 1968 (2) All ER 1073 (Ch) 1118.
[43] 2010 (2) SA 321 par 18 – 34.

> "Absa was contractually obliged to exercise the care expected of a reasonable banker when disbursing amounts on the authority of its customer. ...Absa ought to have made further enquiry before it paid the cheques, and that its failure to do so was negligent."

In *Marfani & Co Ltd v Midland Bank Ltd*[44] it was concluded that:

> "It did not constitute lack of reasonable care to refrain from making inquiries unlikely to lead to detection of a dishonest purpose and which are calculated to offend him and may drive away his customer if he is honest."

The *Marfani*[45] judgment was decided years ago before the banking industry evolved and underwent stringent procedures to prevent financial crimes.

This duty owed by a bank towards its customer is obligatory and where banks fail to exercise their duties with reasonable care and their actions result in loss or damage, banks will be liable for breach of their duties towards their customers and penalised accordingly.

It is important that the bank strictly complies with a customer's mandate. Therefore a bank cannot execute a transfer of a transaction that has not been authorized by the customer. In *Kunneke v Eerste Nasionale Bank van Suidelike Afrika Bpk*[46]it was stated that:

> "The bank had a written mandate from the CC to pay only cheques signed by both surety and the member of the CC....R had no authority to sign cheques without the signature of the CC. Accordingly the bank paid cheques irregularly".

The most important duties owed by the customers are as follows:

- The customer must take reasonable care when operating his or her current account; the duty entails the following: "the customer must discuss his or her financial commitments and difficulties with the bank and keep the bank informed of any changes in his or her financial situation;[47] the customer must inform the bank if he knows or suspects that there may be unauthorised transactions on his or her account;[48] the customer must inform the bank of any loss of items such as cheque books and credit and debit cards;[49] and the customer must inform the bank when he or she suspects that someone else knows their PIN and other personal details."[50]

[44] 1968 2 All ER 573 (CA) 581G 0 - I.
[45] (n 44).
[46] 1997 3 SA 300 (T) 305E.
[47] Moorcroft (n 12) 29.
[48] Moorcroft (n 12) 29.
[49] Moorcroft (n 12) 29.
[50] Moorcroft (n 12) 29.

- The customer must ensure that all obligations arising from the agreement with the bank are adhered to.[51]

The above mentioned duties owed by customers to their banks are modern day banking law duties which were not all prevalent in ancient times when cheques were the preferred method of payment. The development in banking has shifted more duties towards banks and the customer has been given more protection.

A breach of contract occurs when a party to a contract without lawful excuse, fails to honour the obligations under the contract. The liability for breach of contract is distinct from liability in delict, as in contract, fault is not required. "However, a contract may create an obligation to exercise a mandate without negligence and any breach that occurs thereof will result in a contractual claim."[52]

In the contract of mandate, both the mandator and the mandatary have duties that must be executed to fulfil the contract and accordingly either party to the agreement may be held liable for breach. The same accordingly applies to a bank and a customer in a bank–customer agreement; both parties are obliged to adhere to their respective duties and the failure thereof will result in a breach.

In *Great Karoo Eco Investments v ABSA Bank*[53] the facts of the case were as follows: The plaintiff sold cattle to a buyer. The buyer furnished the plaintiff's representative with a document that would guarantee payment of the purchase price. The document was presented for payment at the bank. The bank teller who accepted the document then sent the document for processing in the bank's administration department. It was during the processing that the bank discovered that the document was not a bank cheque but a clearance voucher. The plaintiff was then notified and instituted action against the bank for misrepresentation and negligence. The bank was said to have breached its contract with the plaintiff by reversing the amount of the document that had been credited to the plaintiff's account. Two questions had to be determined to hold the bank liable. The first question to be determined related to whether the bank teller's negligence by accepting the clearance certificate, was a representation to the plaintiff that the document was indeed a bank cheque and therefore an acceptable method of payment. The second question to be determined related to whether the defendant's negligent misrepresentation, was the cause of the plaintiff's damages. In response to the first question, the bank's teller should have noticed that

[51] Jones n (35) 7.
[52] Du Bois, Bradfield (n 23) 858 – 859.
[53] 2003 (1) SA 222 (WPA) 226 – 238.

the document was not a cheque immediately upon her examination of the document.[54] Therefore the failure to examine the document was negligent.[55] Furthermore, her acceptance of the document gave the impression that the document was a bank cheque[56]. Accordingly, a reasonable banker in the position of the teller would have noticed that the document was not a bank cheque.[57] In response to the second question it was held that the plaintiff's representative also contributed to the plaintiff's damages by failing to notice that the document had the word's "clearance certificate" written on the document[58]. The plaintiff's representative would have noticed that the document is not a bank cheque and would have followed it up quickly with the buyer before accepting payment. Accordingly damages were apportioned.[59]

The above case relates to a bank's breach of contract in not exercising the care of a diligent and prudent person. Had the teller noticed, at the time the document was presented for payment that it was not a cheque, the plaintiff would have no claim against the bank, but only a claim against the buyer.

Before a bank – customer relationship can be established it is important that the bank ascertain the identity of the individual that it will be conducting business with. The bank has to ensure that it has identified and verified the client that it will be conducting business transactions for. Therefore a reasonable banker is expected to assure himself of the identity of a new customer and to obtain enough information in order to ascertain that it is who the individual or entity purports to be.[60] This entails that the bank needs to adhere to the Financial Intelligence Centre Act.[61]

3. IMPACT OF FICA ON THE BANK – CUSTOMER RELATIONSHIP

In terms of Chapter 3 of the Financial Intelligence Centre Act[62], institutions need to utilize money laundering control measures to combat money laundering and the financing of terrorist and related activities. The objectives of the Act[63] are the following:

[54] (n 53) par 28.
[55] (n 53) par 28.
[56] (n 53) par 31.
[57] (n 53) par 33.
[58] (n 53) par 44.
[59] (n 53) par 44.
[60] Van Jaarsveld "*Mimicking Sisyphus? An evaluation of the know your customer policy obiter"* 2006 *TSAR* 242.
[61] (n 8).
[62] chapter 3 of Financial Intelligence Centre Act 38 of 2001.
[63] (n 8).

- The principal objective of the Centre is to assist in the identification of the proceeds of unlawful activities and the combating of money laundering activities and the financing of terrorist and related activities.[64]

The obligations imposed by the Act[65] entail the following:

- An accountable institution may not establish a business relationship or conclude a single transaction with a client unless the accountable institution has taken the prescribed steps—
    - To establish and verify the identity of the client;[66]
- If the client is acting on behalf of another person, to establish and verify—[67]
    - The identity of that other person; and[68]
    - The client's authority to establish the business relationship or to conclude the single transaction on behalf of that other person.[69]
- If an accountable institution had established a business relationship with a client before this Act took effect, the accountable institution may not conclude a transaction in the course of that business relationship, unless the accountable institution has taken the prescribed steps—[70]
    - To establish and verify the identity of the client.[71]

Furthermore the Financial Intelligence Centre Act[72] requires that banks obtain the following information:

- In respect of a natural person, the bank must obtain and verify the following information before it may conclude a bank – customer relationship: (1) An accountable institution must obtain from, or in respect of, a natural person who is a citizen of, or resident in, the Republic, that person's–[73]
    - full names;
    - date of birth;
    - identity number;
    - income tax registration number, if such a number has been issued to that person; and
    - residential address.

[64] s 3(1) of of Financial Intelligence Centre Act 38 of 2001.
[65](n 8).
[66]s 21(1)(a) of the Financial Intelligence Centre Act 38 of 2001.
[67]s 21(1)(b) of the Financial Intelligence Centre Act 38 of 2001.
[68]s 21(1)(b)(i) of the Financial Intelligence Centre Act 38 of 2001
[69]s 21(1)(b)(ii) of the Financial Intelligence Centre Act 38 of 2001.
[70]s 21(2) of the Financial Intelligence Centre Act 38 of 2001.
[71]s 21(2)(a) of the Financial Intelligence Centre Act 38 of 2001.
[72] (n 8).
[73]Regulation 3 of the Financial Intelligence Centre Act 38 of 2001.

Furthermore the information obtained for the natural person must be verified and this entails the following: in terms of regulation 4(1)[74] an accountable institution must verify the full names, date of birth and identity number of a natural person by comparing these particulars with an identification document of that person; or another document issued to that person.

The Know - Your -Client (KYC) policy has been incorporated into the Financial Intelligence Centre Act.[75] "The KYC policy consists of four internationally recognised elements namely customer identification, record keeping, recognition and reporting of suspicious transactions, and training, which are also fully incorporated in FICA."[76] Once an institution has obtained and verified information of a particular client, a profile of the client is created and risk rated according to certain factors. This is known as client risk profiling.[77] Client risk profiling enables the institution to match the client's behaviour against that of clients with a similar profile.[78] It also enables the institution to anticipate certain transactions by the client. Therefore if an 'out of the ordinary' transaction is made by the client, the bank can easily be alerted. [79]

KYC Policy enables banks to establish a good business relationship with their customers in that they know the type of customers that they are conducting services for and they know the type of behaviour that they can expect from their clients. This also enables banks to efficiently detect any unlikely behaviour in their client's business transactions.[80]

The Financial Intelligence Centre notes that the South African Reserve Bank had sanctioned four banks for non-compliance with FICA. The sanctions include financial penalties ranging from R10 million to R60 million as well as instructions to implement remedial actions.[81]

The South African Reserve Bank conducted inspections on banking institutions over a period of time to assess whether each of the banks had the appropriate measures in place to ensure compliance with the relevant provisions of FICA.[82] As a result of the findings of the inspections, the South African Reserve Bank imposed financial penalties and has instructed the sanctioned banks to take steps for remedial action.[83]

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[74]Regulation 4 of the Financial Intelligence Centre Act 38 of 2001.
[75] (n 8).
[76]Van Jaarsveld (n 43) 229.
[77] De Koker "*Client identification and money laundering control: perspectives on the financial intelligence centre act 38 of 2001" 2004 TSAR* 722.
[78] De Koker (n 71).
[79] De Koker (n 71).
[80] Experience obtained in Corporate Banking as a Compliance Officer at Nedbank Ltd in 2014 – 2015.
[81] SARB release for FICA :**Issued by the Financial Intelligence Centre: www.fic.gov.za** (last accessed on 24/11/2015).
[82] (n 81).
[83] (n 81).

It is unlikely that banks will continue to ignore the duties imposed on them by the Act.[84]

4. THE IMPACT OF THE CODE OF BANKING PRACTICE ON THE BANK – CUSTOMER RELATIONSHIP

The Code of Banking Practice (the Code) is a voluntary code that sets out the minimum standards for service and conduct which customers can expect from their bank with regard to the services and products banks offer.[85] The Code serves as a guide for customers when transacting with their banks and it will help customers understand their rights and responsibilities better as well as the bank's responsibilities in serving customers.[86] Cas Coovadia, the managing director of the Banking Association of South Africa states:

> "Furthermore the code supplements the regulatory and contractual requirements that govern relationships between banks and these customers, committing the banks to do that little bit more in providing good service."[87]

The code is relevant in the bank – customer relationship as it plays a role in the manner in which a bank is to service its customers. The terms and conditions in the standard agreements between banks and customers are governed by the code of banking practice.

"Although the code is not law and neither can it be referenced as binding in a court of law, the code may, to a certain extent, influence the manner in which bank – customer agreements are drafted."[88] If an agreement is not in accordance with the minimum standards required by the code, such agreement can be regarded as null and void as it does not take into account the standards which are important to establish a bank – customer relationship.

Moorcroft[89] refers to the code of banking practice in his reference to the duties of clients towards their bank;

> "The Code of Banking practice requires clients to discuss their financial commitments and difficulties with their bank and keep the bank informed of changes in their personal details or financial situation."[90]

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[84] (n 8).
[85] The Code of Banking Practice 2012.
[86](n 85).
[87]http://www.bizcommunity.com/Article/196/513/68880.html (last accessed on 05/05/2016).
[88] Du Toit "*Reflections on the South African code of banking practice"* 2014 *TSAR* 570.
[89] Moorcraft (n 12) 29.
[90] Moorcraft (n 12).

Malan refers to the Code of Banking practice in his publication and states that the code sets out the standards of disclosure and conduct for banks and their customers.[91]

Clause 3.1 relates to the customers entitlements and responsibilities and gives an overview of what a customer should expect from their bank in the establishment of the bank – customer relationship.[92]

Clause 3.2 relates to the customer's responsibilities that the bank expects the customer to fulfil such as the responsibility to inform the bank as soon as possible when the customer discovers any unauthorized activities conducted on the account.[93] This responsibility placed upon the customer, is in actual fact a duty to inform or warn the bank on becoming aware of unauthorized activities being conducted on the account.

Clause 4 refers to the bank's key commitments in its relationship with customers.[94] The bank gives assurance that staff is trained to provide efficient service so that transactions and enquiries are attended to promptly.[95]

There is no doubt that the code plays a role in the bank – customer relationship. However different views have led authors to question the relevance of the code in banking law.[96] Malan referred to Schulze's view that:

> "the mere fact that a particular banking practice or usage has been acknowledged and explained in the Code in the first place, is already a strong indication that it qualified or that it existed as a banking practice or trade usage in its own right even before its inclusion in the Code."[97]

Du Toit's publication on the Code provides support for the influence of the code to be more meaningful.[98]

[91] Malan et al (n 9) 298.
[92] (n 87) (cl 3.1) 4 – 5.
[93] (n 87) (cl 3.2) 6 – 7.
[94] (n 87) (cl 4) 7 – 8.
[95] (n 94).
[96] (n 85).
[97] Malan et al (n 9) 299.
[98] (n 88) 579.

5. CASE LAW: HANLEY v ABSA

The *Hanley v ABSA*[99] case is in fact a reflection of poor internal banking controls, the lack of exercising existing processes or the ignorance of bank officials in discharging their duties towards their customers. The judgments of both the court a quo and the supreme court of appeal are of the same view that the bank employees were negligent, and that their negligence was the direct cause of the fraudulent transfer of funds from the customer's account.[100]

Had the bankers in the *Hanley*[101] case acted in terms of their mandate and as reasonable prudent bankers, they would have been able to detect that the instruction letter was fraudulent and prevent their client (Hanley) from losing funds from his account.

Introduction

The nature of banking is such that a customer entrusts his hard earned funds with the bank for safekeeping and expects the bank to conduct activities on his account upon instruction. This is a relationship of trust and confidence in which the customer believes that the bank will safe – keep his funds from any harm or unforeseen circumstances that may arise. When the very bank that the customer has trusted, breaks the customer's confidence, it acts to its detriment and affects the bank's reputation.

Facts

The plaintiff, Daniel Hanley opened a bank account with ABSA Bank Limited (Absa) through the assistance of a bank employee, Fourie.[102] The bank – customer agreement was concluded in Johannesburg. When the account was opened, Hanley gave Fourie his contact details and requested Fourie to advise him when transactions were being conducted on the account.[103] Hanley had opened the account for the purpose of assisting his brother, Noel Hanley, to obtain finance for the purchase of aeroplanes.[104] La Cote was an international fraudster who had found an opportunity to defraud the plaintiff by posing as an aircraft financier.

[99] (n 1).
[100] (n 1) 338 par 83.
[101] (n 1).
[102] (n 1) par 3 320.
[103] (n 1) par 16 321.
[104] (n 1) par 9 326.

La Cote had opened a bank account with (Absa) prior to Hanley through the assistance of a private banker, Hewan.[105] La Cote fraudulently used the name of Noel Hanley's company to open the bank account.[106] The bank officials did not at any stage request any documents from La Cote to identify and verify his identity and or that of his supposed company.

Shortly after opening the bank account, Hanley deposited an amount of US$1 750 000 into his bank account.[107] With the intention of stealing this money La Cote sent a faxed, forged instruction letter authorizing Absa to transfer the funds out of Hanley's account.[108] The bank rejected the mandate since the instruction letter was sent to the bank by fax, which was not an acceptable method for authorizing such a payment.[109] The bank official, Hewan, then telephoned the number on the fax and advised a person whom he thought was the plaintiff, to furnish the bank with the original document.[110] It was then arranged with Hewan and the person he assumed to be the plaintiff, that the original letter would be collected by Hewan's nephew.[111] This was La Cote's second attempt to defraud the plaintiff. La Cote was unsuccessful as the bank found that the signature on the form differed from the specimen provided to the bank by Hanley when the account was opened.[112]

Instead of conducting investigations on the forged signature, Fourie telephoned the number on the fax and forwarded to La Cote an original bank transfer form.[113] La Cote then arranged for Hanley to sign the transfer form.[114] Hanley was unaware of the attempts by La Cote and neither was he aware that the documents that he was called upon to sign were in fact transfer forms.[115] La Cote had falsely stated that the documents that Hanley were to sign were required for reserve bank approval.[116] La Cote further requested Hanley to write two letters of instruction that were said to be required for submission to the reserve bank.[117] Hanley refused to sign the documents and on his brother's insistence travelled to Johannesburg to complete the transfer.[118] On Hanley's arrival in Johannesburg, he did not consult with Fourie or Hewan, but concluded the transfer of funds from his account in his hotel room.[119] However Hanley falsely stipulated that he was in London on the transfer form.[120] La Cote had furnished Hanley with a blank two page

[105] (n 1) par 13 321.
[106] (n 1) par 13 321.
[107] (n 1) par 17 322.
[108] (n 1) par 18 322.
[109] (n 1) par 18 322.
[110] (n1) par 18 322.
[111] (n 1) par 19 322.
[112] (n 1) par 20 322.
[113] (n 1) par 20 322.
[114] (n1) par 21 322.
[115] (n 1) par 21 322.
[116] (n 1) par 21 322.
[117] (n 1) par 21 322.
[118] (n 1) par 22 323.
[119] (n 1) par 22 323.
[120] (n 1) par 27 324.

transfer document which Hanley thought was poorly devised but proceeded to complete the document, regardless.[121] The transfer document was rejected by La Cote and Hanley was given another transfer document to complete, which Hanley completed 'correctly' this time and La Cote confirmed that the document would be accepted for approval.[122] The transfer amount on the transfer document was for US$100 000. However La Cote changed the amount to US$1 600 000 by adding an additional number and changing the "1" to "6". This time La Cote succeeded in his attempt. It appeared that the transfer document was executed in a manner in which a third party could make alterations, as it was easy for La Cote to add an additional number to the amount. On receipt of the payment instruction the bank official, Fourie, proceeded to execute the transfer without firstly, noticing the alteration, and, secondly, without communicating with Hanley to confirm the payment instruction and the transfer amount to be made. Nevertheless, the amount of US $1 600 000 was transferred from Hanley's account into that of Store-A-Car and La Cote obtained access to the funds.[123] Hanley's case was that he did not authorise the transfer and that Absa was negligent in effecting the transfer. Therefore, Absa's negligence caused Hanley's loss.

Judgment

In his judgment Mothle's J discussed three critical points to arrive at his decision:

- Firstly the duty of care owed by a customer to the bank was analysed in determining whether Hanley owed any duty of care to the bank for the manner in which he managed his account.[124] Although Hanley was negligent in the manner in which the payment instruction was written, the learned Judge stated that Hanley only had to confirm that he did not authorise the transfer of the funds from his bank account.[125]
- Secondly the bank was tasked with the onus of proving that the plaintiff was negligent in the manner in which the payment instruction was written.[126] The bank failed in this regard as it was the negligence of the bank that caused Hanley's loss and not Hanley's written instructions which caused his own loss.[127] Accordingly it was stated that Hanley's negligence did not cause his loss.[128]

[121] (n 1) par 22 323.
[122] (n 1) par 22 323.
[123] (n 1) par 33 326.
[124](n 1) par 48 330.
[125] (n 1) par 62 333.
[126] (n 1) par 75 337.
[127] (n 1) par 75 337.
[128] (n 1) par 75 337.

- Thirdly the issue of the negligence of the bank employees and that of Hanley was put to question.[129] The bank representatives who testified as the bank's witnesses, failed to defend the bank employees who defaulted in their duties to act in the best interests of their customer. The bank employees failed to act as expected of prudent bankers.[130]
- Motlhe J held in favour of Hanley for the following reasons:

The bank officials, Hewan and Fourie authorised the transfer of funds out of Hanley's bank account without authority. Their conduct was negligent and this was the direct cause of Hanley's loss and subsequent claim against the bank.[131]

SCA Judgement

Absa appealed to the supreme court of appeal. The judgment was handed down by Malan JA. In his judgment he dealt mainly with two critical issues:

- The first related to Hanley's conduct in the manner in which the payment instruction was executed by stipulating that he was in London and by the manner in which the transfer form was signed. The question which was asked was whether Hanley drew the payment instruction with care.[132] Malan JA confirmed that irrespective of the manner in which the payment instruction was written, Hanley would not have foreseen that the payment instruction would be altered.[133]
- The second critical issue relates to the bank's negligence in failing to firstly notice the alteration made on the payment instruction, and, secondly, the bank's failure to communicate with Hanley to confirm the payment instruction[134] and all transfer attempts supposedly executed by Hanley,[135] and, thirdly, the failure to conduct checks and inquiries on La Cote before accepting him as a client of the bank. [136] The court

[129] (n 1) par 76 337.
[130] (n 1) par 82 338.
[131] (n 1) par 86 339: "Fourie and Hewan as employees of the bank allowed themselves to be duped by La Cote, became gullible and servile to his subterfuge and thereby exposed the bank to fraud; the bank employees were negligent, which negligence was the direct cause of the fraudulent transfer of funds from the account without authority to do so".
[132] (n 2) par 28 259.
[133] (n 2) par 29 259.
[134] (n 2) par 32 260.
[135] (n 2) par 33 260.
[136] (n 2) par 34 261.

stated that it was neither here nor there as the essential issue is how the bank employees failed in their exercise of their duty towards Hanley.[137]

Malan JA held that:

> "Hanley should have, and probably did, realise that in signing the second page of the 702 form the first page could be substituted with a different one reflecting a different amount and a different beneficiary. He could not, however, reasonably have foreseen the possibility that the amount stated on the second page would be altered as well. He did not facilitate the alteration, and wrote the figures and words with care. In these circumstances Fourie's negligence is the real, immediate or proximate cause of the loss. The appellant, therefore, did not show that it was entitled to debit Hanley's account in the absence of his authority."[138]

Hence the decision of the court a quo that the proximate cause of Hanley's loss was as a result of the bank employees' negligent conduct was confirmed.[139]

Discussion of the case

The case deals with three legal issues which the court of first instance sought to determine: firstly the question of whether the plaintiff had any legal duty of care towards the bank; secondly the defence of estoppel; and lastly the issue of whether the duty of care is a matter of fact.[140]

In terms of the issue relating to the plaintiff's duty of care towards the bank, the bank - customer agreement comes into play. The bank and customer bind themselves to the terms and conditions of their agreement by entering into such agreement. Should either party fail to fulfil his duties in terms of the contract, the one party will be liable towards the other to make good the harm caused to the other. The leading case which deals with the banker – customer relationship is that of *Big Dutchman (South Africa) (Pty) Ltd v Barclays National Bank Ltd*[141] in which Philips AJ said as follows:

> "A customer's duty to his banker is a limited one. Save in respect of drawing documents to be presented to the bank and in warning of known or suspected forgeries he has no duty to the bank to supervise his employees, to run his business carefully, or to detect frauds."

[137] (n 2) par 37 262.
[138] (n 2) par 37 262.
[139] (n 2) par 37 262.
[140] (n 1) par 47 330.
[141] (n 11).

In terms of the bank and customer agreement, the customer has a duty of care in the management, maintenance and execution of transactions on his account. Mothle J puts it thus:[142]

> "The bank contends that the plaintiff or any customer, owes a duty of care in regard to how it operates its account." This view is supported by *Malan on Bills of Exchange, Cheques and Promissory Notes*[143] where the learned authors state the principle as follows:
>
> 'The duties of a customer in drawing a cheque are to some extent generalised, and he may in certain circumstances be precluded from raising the forgery or lack of authority. It has been held that a customer owes a contractual duty to the bank to draw his cheques with reasonable care in order to prevent forgery or alteration that could mislead the bank. If he draws a cheque in breach of this duty and the bank suffers a loss as a result, the bank may debit his account with the amount of the forged or altered cheque. However, the negligence or carelessness of the customer must have been the real, direct or immediate cause of the bank having been misled. The negligence must have been in the transaction itself, *viz* in the manner in which the cheque was drawn.'

Hence it is clear that if the customer fails to execute his instructions with care or if he is careless in the drawing of a cheque, he will have no recourse and will be liable to the bank for the breach of his duty. This is the case irrespective of the fact that the customer may be under the impression that he has executed his written instructions with reasonable care and did not foresee that his payment document may end up in the wrong hands or that alterations could be made before the bank receives the instruction. It may also be that the customer has done everything in his control to ensure that no person can try to forge his mandate, but his instruction ends up in another person's possession.

Mothle J went on to deal with all the terms of the bank and customer agreement which the plaintiff had to adhere to in terms of the agreement.[144]

> "The bank in this case pleads the additional express, alternatively implied, further alternatively tacit terms of the agreement as follows:
> "3.2.1 the bank would be entitled to debit the plaintiff's account with the amounts of withdrawals or transfers that were authorised by the plaintiff;
> 3.2.2 the plaintiff would execute all documents that contained written instructions to withdraw or transfer funds with due diligence and in a manner that did not facilitate fraud or forgery;……"

These terms and conditions are of importance in determining whether the plaintiff managed his account with care and in determining whether there was any negligence on the part of the

[142] (n 1) par 48 330.
[143] (n 9).
[144] (n 1) par 49 331.

plaintiff in the exercise of his duties. Furthermore these terms form part of the code of banking practice.[145] Should the plaintiff breach any of the terms of the agreement, his negligence must have been the proximate cause of the bank's loss or of his loss in order to hold him liable.

The plaintiff bears the onus of proving that the bank was negligent in making the payment of an unauthorized amount.[146] Hanley disputed that he was negligent and alleged that it was the bank that was negligent in proceeding with payment which was unauthorized. [147] It is a fact that Mr Hanley executed written instructions to the bank to make payment to La Cote. However the bank exceeded its mandate by making payment for an amount that was unauthorized by Mr Hanley.[148]

Moorcroft,[149] with reference to *Barclays Bank DCO v Straw*[150] sets out the issue of onus, as follows:

> "The client bears the onus of proving that the bank has exceeded its mandate. The defendant bank bears the onus that of proving that it was not negligent in making a disbursement on behalf of its client in an amount it had no authority to pay out."

It is suggested with respect that Hanley succeeded to prove that the bank was negligent in carrying out *ultra vires* instructions. The witnesses who testified for the bank failed to prove that the bank was not negligent, in fact the bank's witnesses strengthened Hanley's case.

The bank sought to rely on estoppel in their case to prove that that Hanley made a representation that caused the bank to act in a manner that resulted in the perpetration of fraud.[151] It is submitted that Hanley did not execute his instructions with the care expected of a person in his position. Hanley, being a solicitor in Ireland by profession, was expected to act with caution and to equip himself with insight before executing transactions.[152] When Hanley decided to fly to Johannesburg, he had already been informed by La Cote that the loan agreement documents produced to him were required for the Reserve Bank approval.[153] A reasonable solicitor in the position of Hanley, therefore being able to apply his mind legally, should have enquired as to the banking laws in South Africa and in particular the Reserve Bank policies and Exchange Control Regulations. It should have crossed Hanley's mind that when conducting business in different

[145] (n 85).
[146] (n 1) par 54 332.
[147] (n 1) par 35 326.
[148] (n 1) par 22 323.
[149] Moorcraft (n 12) 15.
[150] *Barclays Bank DCO v Straw 1965 (2) SA* 93 (O) 95C – D.
[151] (n 1) par 63 334.
[152] (n 1) par 72 336.
[153] (n 1) par 16 321.

jurisdictions, one has to be knowledgeable with the laws, policies and business practices in that particular jurisdiction.

Secondly, the fact that Mr Hanley had refused to sign the loan agreement document which La Cote's "secretary" delivered to him, is evident that Mr Hanley had doubts and might have also been suspicious of how the transaction was being carried out, which then led him to travel to Johannesburg.[154]

Thirdly although Mr Hanley had flown to Johannesburg (on the insistence of his brother Noel), he did not insist that La Cote meet him at the Parktown branch office in order for the transfer documents to be signed with the assistance and in the presence of Fourie and/or Hewan as they were assigned to their accounts.[155] Instead Mr Hanley decided to wait in his hotel room "upon La Cote's instructions" without questioning La Cote or even contacting the branch officials for clarity.[156] Mr Hanley being a foreigner in South Africa should have contacted the bank officials and enquired of them the details of the transfer documents and how the document should be completed between himself and La Cote.

According to the background facts of the case Hanley recalled that the transfer forms that were sent to his Hotel room by Chris Peters were poorly devised in that "the transfer details were on the first page and the second page bore the signature".[157] However, Hanley proceeded to complete and sign the form regardless of his suspicions and without making the necessary enquiries. Once again, Mr Hanley did not exercise the care that a reasonable person in his position would have exercised. When La Cote rejected the 702 transfer documents, Mr Hanley did not request any assistance from the bank officials as to how the forms were to be completed. Mr Hanley's conduct made it easier for the fraud to be perpetrated on his account as he signed the letter of instruction, accompanying the transfer form, as if he was in London.[158] This made it easy for Fourie to think that the person that she had telephoned for a prior transaction in London was indeed Mr Hanley.[159] Mr Hanley acted to his detriment by not contacting Fourie and/or Hewan to enquire whether the transfer documents were received and whether the transaction was successfully processed.

[154] (n 1) par 21 – 22 322 – 323.
[155] (n 1) par 22 323.
[156] (n 1) par 22 323.
[157] (n 1) par 22 323,
[158] (n 1) par 27 324.
[159] (n 1) par 26 324.

It is submitted that the nature of the contract between the bank and private banking clients is of a personalized nature and therefore there was nothing preventing Mr Hanley from keeping in constant contact with Fourie and/or Hewan throughout the execution process. La Cote was also a foreign national conducting "business" in South Africa and that did not mean that Hanley had to believe his every word. Being a solicitor Hanley could have built relations or made contacts with legal experts in South Africa to inform him of the processes that were followed in business transactions of this nature. For the above reasons, I echo Mothle J where he stated " [i]n spite of cautionary measures he took to protect the funds entrusted to him by AIB Bank, Mr Hanley was incredibly naive as a solicitor."[160]

I am in agreement with the judge's finding in that in writing the letters purporting to be in London, Mr Hanley was negligent.[161] The judge proceeded to state that "the test for negligence in this particular case is that of a reasonable customer of the bank and not a solicitor."[162] It is suggested that the test for negligence should be different from the reasonable standard, in that Mothle J put it that:

> "When Noel Hanley approached AIB Bank in Ireland to assist him with the amount of US$1 150 000 against a mortgage on his house, the bank agreed to advance the said amount subject to certain conditions. One of the conditions was that in making available this amount, it must be deposited in a solicitor's account to hold the funds until the whole amount of US$3 000 000 is received. Noel then approached his brother the plaintiff, who was at that time practising as Hanley and Lange solicitors in Ireland."[163]

It was a condition of the bank agreement that the amount to be financed was to be deposited into the bank account of a solicitor. Therefore Mr Hanley was brought into the equation in his capacity as a professional person, and therefore the test for negligence should have been that of a reasonable solicitor.[164] Mr Hanley did not apply the caution and care that a solicitor in his position would have applied in the management of his account.

It is therefore submitted that the bank cannot rely on estoppel to hold Mr Hanley liable for his own loss. This is due to the reason that, in as much as Mr Hanley was negligent, his negligence did not cause the bank to perform *ultra vires* transactions.[165] Neither did Hanley's negligence prevent the bank officials from following bank procedure and practices in managing and transacting on their client's accounts.

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[160] (n 1) par 72 323.
[161] (n 1) par 83.1 338.
[162] (n 1) par 72 336.
[163] (n 1) par 11 320.
[164] (n 1) par 11 320.
[165] (n 1) par 75 337.

The issue of the bank's negligence is now referred to. The bank officials were negligent and their conduct resulted in Mr Hanley's loss.[166] The bank failed in its duty in terms of the bank and customer relationship, to inter alia, maintain and execute transactions on client's accounts with proper care, skill and diligence.

Hewan bypassed the identification and verification procedure when opening an account with La Cote. He did not follow the operational and compliance requirements for concluding bank and customer relations with private banking clients. Hewan disregarded the requirements which would qualify one to become a private banking account holder by failing to verify that La Cote has assets that are worth four to five million rand. Apart from the bank's negligent conduct in the opening of La Cote's account, the bank was reckless and for the reasons set out below.

Fourie was negligent in failing to communicate with Mr Hanley when transactions were being processed on the account as he had requested.[167] Mr Hanley gave specific instructions to Fourie that he should be contacted on his mobile number in regards to transactions on his account.[168] Fourie failed to follow proper instructions by failing to telephone Mr Hanley on his mobile number "as he had requested".[169] The bank officials breached their duty of care by managing Hanley's account recklessly. On the receipt of the faxed forged letter instructing Hewan to pay an amount of US$1 740 000 out of Hanley's account, Hewan telephoned the number on the fax form and formed the impression that he was communicating with Hanley, without even verifying that he was indeed communicating with the correct person.[170] Taking into account the amount of money which was to be processed and the failure to follow FICA and Anti Money Laundering procedures, the bank officials acted with negligence. In terms of the Financial Intelligence Centre Act, all transactions processed on client's accounts are subject to a R24 999.00 threshold. Should a transaction exceed the threshold the client's account is to undergo vigilant anti money laundering checks.[171]

Fourie and Hewan were prepared to circumvent the KYC and FICA procedures [172] by disregarding the forged signature on the faxed instruction letter addressed to Hewan, despite the fact that another bank official (Adele) refused to process the document as it was evident *prima facie* that the signature on the forged instruction letter was different from the signature of the

[166] (n 1) par 76 337.
[167] (n 1) par 16 321.
[168] (n 1) par 79 338.
[169] (n 1) par 16 321.
[170] (n 1) par 18 322.
[171] Guidance Note 5 on s 28 of the Financial Intelligence Centre Act 38 of 2001.
[172] Guidance Note 3A of the Financial Intelligence Centre Act 38 of 2001.

plaintiff as per the documents processed when the account was opened.[173] The moment it came to Hewan's attention that the signature was forged, Hewan should have conducted investigations to prevent any fraud from being perpetrated on Hanley's bank account, but he did not and proceeded to communicate with a stranger.[174] Hewan had a fiduciary duty to manage and maintain Hanley's account with the care of a prudent banker.

The manner in which Hewan proceeded to entertain the forged instruction letter was reckless. Furthermore there is no banking procedure which would allow for Hewan's nephew to fetch the instruction letter from a person he believed to be Mr Hanley and then furnish it to a bank official whom the nephew met at the airport and thereafter furnish the document to Hewan.[175] This procedure is contrary to the bank and client privilege in that numerous individuals had access to the forged instruction letter. The very nature of private banking is that private account holders have a one on one relationship with their private banker and this was not done in this particular case. Therefore, even if the instruction was not forged Hewan would have breached his duty of care under the bank and customer agreement by exposing his client's instructions to third parties.

Upon Fourie's receipt of the 702 transfer form it was evident *prima facie* that the form which was initially a one – page document that had to be completed on both sides, page 1 and page 2, now comprised of two separate pages being copies, of page 1 and page 2 of the single original 702 form.[176] Fourie not only proceeded to process a copy of the transfer form but also failed to enquire as to the format in which the 702 transfer form was completed.[177] The submission of the transfer forms in this manner, was suspect and should have put Fourie on enquiry. The manner in which the forms were returned could easily pave the way for forgery and fraud to be perpetrated as indeed it was. The failure of Fourie in enquiring from Hanley of the manner in which the form was completed and copied made it easy for La Cote to proceed with his plan to defraud Hanley.

Witnesses for the bank testified that the alteration of the US $100 000 to that of US $1 600 000 appearing on the 702 transfer form was visible to the naked eye.[178] Even a forensic investigator from ABSA testified that a careful banker would have required an initial next to the

[173] (n 1) par 20 322.
[174] (n 1) par 19 322.
[175] (n 1) par 19 322.
[176] (n 1) par 30.1 325.
[177] (n 1) par 29 325.
[178] (n 1) par 38 – 39 327 – 328.

alteration.[179] Even Fourie admitted in examination in chief that she thought the alteration was clearly visible.[180] Clearly Fourie was prepared to proceed to execute the transaction despite alarm bells that were evident of "possible forgery". Everything in the 702 transfer form indicated to any reasonable person that something was not right. Oblivious to the possibility that the form was forged, Fourie caused an account which was under his control to be defrauded. As an employee of the bank Fourie had an important role to play in the safe guarding of client's funds. Within the first three months of a bank employee's employment, a bank official is subject to complete and numerous training courses and is bound to banking policies, mostly which are based on anti -money laundering, compliance, risk and fraud.[181]

It is submitted that Fourie and Hewan had an even greater responsibility in their roles as private bankers in that they were dealing with accounts and the funds of clients on a daily basis. They knew the implications of not following bank procedures when executing transactions for their clients. They knew that any negligence on their part in the managing of client's accounts would cost the bank dearly.

The most unfortunate part was that the fraud could have been prevented, even after Fourie had failed to scrutinize the transfer form. Fourie still had a chance to do right and protect Hanley's funds and redeem the bank. When Hanley came to know of the US $1 600 000 he wrote a letter clearly disputing that he had authorized the transfer and cautioned that he would hold the bank liable should they proceed with the unauthorized transaction.[182] After Fourie realized that Hanley did not authorize the transfer, she notified Hewan and other senior officials of the bank, who did nothing to prevent the fraud on Hanley's account.[183] They still had a chance to reverse the transfer but they failed dismally to do so. Even after the bank officials discovered that the authorization was forged, they still proceeded to process payment. Fourie and Hewan ought to have known that their actions would result in disastrous consequences which could ruin the reputation of the bank. Bank officials in particular client - facing staff, undergo stringent training which bank officials have to adhere to when dealing with clients.[184]

This was a clear case of recklessness by the bank officials. Both judges in the court *a quo* and court of appeal were correct in stating that the bank employees were negligent.[185]

[179] (n 1) par 38 327.
[180] (n 1) par 41 328.
[181] (n 80).
[182] (n 1) par 31 326.
[183] (n 1) par 32 326.
[184] (n 80).
[185] (n 2) par 37 262.

6. DA UNGARO & SONS v ABSA BANK LIMITED

Introduction

A similar case in which judgment was recently handed down is that of *D A Ungaro & Sons v ABSA Bank Limited*.[186] In this case it was held that the bank acted negligently and breached the bank and customer agreement with regards to the opening and operation of the plaintiff's account. The dissertation will discuss the similar conduct that the bank officials executed which resulted in the fraud on the customer's bank account.

Facts

Mr Ungaro had instructed Huang to open an investment account for D A Ungaro & Sons (Pty) Ltd at the defendant bank.[187] Huang had been the company's financial manager for a considerable number of years and was entrusted with this task of opening the investment account.[188] The account opening forms were completed by the directors of the plaintiff, namely, Mr Ungaro and Temasso Ungaro.[189] The defendant bank was offering reasonable investment returns to prospective customers who open investment accounts and Mr Ungaro took up this offer by opening the investment account with the defendant bank.[190]

The application form was completed and signed by Huang as per the plaintiff's instructions.[191] During the account opening process the bank official, Ms Judy Lourens, enquired whether Huang had any existing account with the bank.[192] Huang confirmed that he had an account with the bank and quoted his personal bank account number.[193] Huang furnished the bank official with his residential address as the plaintiff's registered address.[194] Huang furnished the plaintiff's certificate of incorporation and change of name certificate when the account was opened.[195]It must be noted that the defendant bank did not request signatories to be loaded onto the account

[186] (n 3) .
[187] (n 3) par 13.
[188] (n 3) par 13.
[189] (n 3) par 13.
[190] (n 3) par 13.
[191] (n 3) par 5.
[192] (n 3 par 5.
[193] (n 3) par 5.
[194] (n 3) par 5.
[195] (n 3) par 28.

and therefore there were no specimens of signatures on the account.[196] Furthermore, the bank did not furnish Huang with a business bank card for cash to be withdrawn on the account.[197]

After the account was in operation, Ungaro conducted numerous transfers into the entity's new account[198]. Transfers totalling R15 million were deposited into the account.[199] Upon Ungaro's discovery that payments were being executed without his knowledge or authorisation, Ungaro closed the account.[200] It was found that some of the transactions were conducted telephonically and they included cash withdrawals.[201] Although Huang had authority to open the account, he had no authority to make withdrawals or transfers in respect of the account.[202]

Judgment

The plaintiff's claim was that the bank was negligent in allowing Huang to execute transactions on the account without having obtained authority to do so. Huang had no mandate to conduct any transfers from or into the account. The court found in favour of the plaintiff as the bank employees acted negligently with regards to the opening and the managing of the plaintiff's bank account and that the negligence was the direct cause of the plaintiff's loss.[203] The bank employees failed to act as reasonable bankers would have by failing to identify and verify the details submitted by Huang and in not verifying with the plaintiff certain authorisations on the account.[204]

Discussion of the case

The case is analysed based on the three issues determined by the court.[205]

> "The issues were firstly, whether the opening of the account on behalf of the plaintiff resulted in the conclusion of a bank and customer agreement between the plaintiff and ABSA; secondly, whether it was a term of the agreement, that ABSA would conduct transfers and make payments out of the plaintiff's account only on the instructions

[196] (n 3) par 22.
[197] (n 3) par 33.
[198] (n 3) par 14.
[199] (n 3) par 5.
[200] (n 3) par 5.
[201] (n 3) par 5.
[202] (n 3) par 5.
[203] (n 3) par 43.
[204] (n 3) par 35.
[205] (n 3) par 24.

authorised by the plaintiff company; and thirdly, whether ABSA and its officials acted negligently in managing the account."[206]

In terms of the first issue the bank and customer relationship comes into play. Indeed an agreement was created between the plaintiff company and the defendant bank in that both parties had the intention that an investment account be opened for the plaintiff company. Huang brought the forms that the company directors signed and completed.[207] Huang's role was to open the account on behalf of the plaintiff company by submitting the forms that were completed and signed by Mr Ungaro and his brother.[208]

In terms of the second issue, it was an implied term of the agreement that the plaintiff company had to authorise all transactions on the account.[209] Furthermore, in the absence of a company resolution or written mandate issued by the plaintiff to this effect, Huang had no authority to make transfers or withdrawals from the account. Hence the bank had breached its obligations under the bank – customer agreement[210] by allowing Huang to conduct transfers and withdrawals from the account without the consent of the directors of the company.[211] Since the plaintiff did not request the bank to make any payments or withdrawals, the bank acted negligently.

In terms of the last issue to be determined, there is no dispute that the bank was negligent in all respects, from the opening of the account, in not requesting all documents relating to the account opening procedure, not following internal processes to ensure that KYC standards were adhered to and in finally authorizing transactions without a company resolution granting Huang authority to transfer on the account. [212]

It is suggested that when Huang signed and completed the application on behalf of the plaintiff and on the plaintiff's instructions, Huang did not have any intentions to defraud the company. After all he was the plaintiff's financial manager and had access to the plaintiff's financial documents since 1992.[213] However, as Ungaro had testified that Huang had never opened any bank accounts before, it may be that Huang never had the opportunity to defraud the plaintiff company.[214] It is further suggested that Huang had a "change of mind" when the bank's official,

[206] (n 3) par 24.1 – 24.3.
[207] (n 3) par 14.
[208] (n 3) par 14.
[209] (n 3) par 30.
[210] (n 3) par 30.
[211] (n 3) par 21 – 22.
[212] (n 3) par 21.
[213] (n 3) par 5.
[214] (n 3) par 13.

Ms Judy Lourens, enquired as to whether he has any existing accounts with the bank in the same name and when she requested that he state the account number.[215] Huang then saw this as an opportunity to defraud the plaintiff by presenting himself as the owner of the company which led him to furnish his residential address as the plaintiff's address.[216]

As soon as the application was signed and information provided by Huang, the bank official had the duty to conduct checks on the account number that Huang furnished as well as to conduct KYC procedure in ensuring that Huang is indeed the owner of the plaintiff company. Had the bank official checked on its system, it would have come to her attention that Mr Huang is an employee of the plaintiff and that the address furnished is in fact Huang's residential address.[217]

Company checks on the Companies and Intellectual Property Commission (CIPC) and on the internet would have revealed Huang's capacity in the plaintiff's company. However, as client-facing staff operate on the basis to reach and exceed targets, they tend to take short cuts and bypass the bank's controls to open accounts expediently.[218]

Furthermore, something that was found peculiar by a witness of the plaintiff (Mr Wills) is that the bank official opened an active savings account which is an account opened for natural persons and not for companies.[219] Maybe the reason why the bank did not regard it as necessary to obtain a company resolution stipulating the authorized persons on the account was that they believed that the account was opened by Huang in his personal capacity as owner of the company. This is probably the reason why all the bank officials authorized the transactions from the new account to his existing account without any hesitation or suspicion. It makes sense in the context of the question why the bank officials did not question Huang's authority and of the use of his residential address as the plaintiff's place of business.[220]

Regardless of the fact that the account was styled as an active saving account instead of an investment account for the plaintiff company, the bank official did not furnish Huang with a bank card to enable him to withdraw from the account. [221]

[215] (n 3) par 5.
[216] (n 3) par 5.
[217] (n 14) par 21.
[218] (n 80).
[219] (n 3) par 11.
[220] (n 3) par 5.
[221] (n 3) par 20.

Even if the submission is that the bank official opening the account knew that it was an account for a company, no check list for the opening of bank accounts with juristic persons was followed.[222] No resolution was requested for signatories on the account; nor was there any signature specimen for Huang.[223] No proof of place of business was requested from the plaintiff,[224] nor did the bank follow up on the certificate of incorporation and certificate of name change, to inspect who the directors of the company are. The bank also did not conduct its own Company and Intellectual Properties Commission (CIPC) search on the plaintiff.

In *Energy Measurements v First National Bank of South Africa Ltd*[225] it was stated:

> "When opening a new bank account, the very least that is required of a bank is to properly consider all the documentation that is placed before it and apply their minds thereto."

It is submitted that the bank officials were reckless and negligent by failing to conduct themselves as reasonable bankers would have. By failing to follow internal procedures in the opening of accounts and in allowing transfers to go through from the plaintiff's account to that of Huang without making enquiries or informing the plaintiff of the transactions, the bank officials exposed the bank to loss and ruined the bank's reputation.

In *A L Underwood v Bank of Liverpool*[226] it was stated:

> "If banks for fear of offending their customers will not make inquiries into unusual circumstances, they must take with the benefit of not annoying their customer the risk of liability because they do not inquire."

It is accordingly suggested that in holding the bank liable in these circumstances the judgment is to be commended.

7. CONCLUSION

From the above case law and authorities, the legal consequences of fraud on a customer's bank account have been discussed. What has been the central point in this research is the bank and customer relationship and the customer's mandate to the bank in carrying out the mandate properly, without negligence and in good faith.

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[222] (n 80).
[223] (n 3) par 22.
[224] (n 3) par 5 10.
[225] 2001 (3) SA 132 (W).
[226] 1924 1 KB 775 (CA) 793.

English law also provides supports for the view that the mandate is to be carried out in accordance with the customer's instructions and without negligence.

In the exercise of the bank's duty towards its customer to execute the customer's mandate properly, the bank is to carry out the mandate strictly.[227] Tyree puts it thus:[228]

> "This means paying the right amount to the right person and if the bank fails in this obligation, then there is a prima facie breach of the contract by the bank."

English law saw "the birth" of the Macmillan duty. This duty entails that a customer must express his or her mandate carefully and clearly.[229] In *London Joint Stock Bank v Macmillan & Arthur*[230] it was stated:

> "The banker, as mandatary has a right to insist on having his mandate in a form which does not leave room for misgiving as to what he is called to do. Thus if the mandate is ambiguous, then the bank may refuse to pay."

It is clear that the bank must carry out the customer's mandate in accordance with the customer's instructions. If, however, the instruction is not given by the customer but by an unauthorised other person, the bank should not carry it out.

The customer also has a duty towards its bank not to facilitate fraud in the manner in which payment instructions are drawn. In *Burnett v Westminster Bank Ltd*[231] it was held that:

> "A customer undertakes to exercise reasonable care in executing written orders so as not to facilitate forgery and so as not to mislead the bank by ambiguities."

The ruling in *Patel v Standard Chartered Bank*[232] grants the customer more protection in that even if the customer furnishes ambiguous instructions to the bank, the bank will still be held liable for executing unauthorized instructions. It was held that:

> "Where the payer's instructions are ambiguous the paying bank may be under a duty to seek clarification of such instructions."

After all the bank as mandatary has to adhere to the mandator's instructions and if there is uncertainty, the bank should enquire to ensure that the customer's mandate is fulfilled without negligence.

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[227] Tyree *Australian Law of Cheques and Payment Orders* (1988) 29.
[228] Tyree (n 227).
[229] Tyree (n 227).
[230] AC 777.
[231] 1966 1 742 QB 760.
[232] 2001 ALL ER (D) 66.

Foreign law provides extensive protection to the customer to ensure that the customer's mandate is complied with. Section 204 of Article 4A of the American Uniform Commercial Code (UCC), for example provides as follows:

> "If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under section 4A – 202 , or (ii) not enforceable, in whole or in part, against the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund."[233]

According to a paper written on litigation liabilities of financial institutions in English law the claim that a customer can make against a bank may be the following:[234]

> "A bank which wrongly pays money away when it has no authority to do so will usually be treated as if it had paid using its own funds, not those of its customer. The customer's claim will be for a declaration that the debits made to its account should be reversed out, and for damages to compensate the customer for any reasonably foreseeable losses incurred by the customer as a result of the bank's failure to state the balance of the account accurately."

What measures can be taken by both customers and banks to prevent fraud on client's bank account?

Firstly, banks need to ensure that they adhere to the obligations imposed by FICA[235] by ensuring that potential customers are identified and verified before bank accounts are opened. Banks need to ensure that all information and documentation pertaining to the customer is obtained and verified.

Secondly, if the reciprocal duties owed between a bank and customer in terms of the bank – customer agreement (of ensuring that a customer's account is properly maintained and managed and that the customer's mandate is carried out without negligence), were complied with, fraud would be minimized if not completely prevented.

The South African Banking Risk Information Centre (SABRIC) encourages customers to take care of their bank accounts and to be cautious of sharing too much personal information on

[233] Uniform Commercial Code (published in 2012).
[234] www.guidehallchambers.co.uk (last accessed on 15/05/2016).
[235] (n 8).

social media.[236] Furthermore SABRIC advises that customers should not allow their accounts to be used by another person for deposits or other transactions.[237]

Furthermore customers need to be vigilant in familiarising themselves with the information provided by their banks pertaining to fraud prevention. For instance, the Standard Bank website has laid down tips and measures that consumers need to familiarize themselves with to protect themselves from fraud.[238]

Therefore every bank in South Africa is compelled to establish and maintain a risk management policy and framework to protect the bank from being exposed to risk which it cannot provide measures for.[239] Such a risk framework should preferably form part of the accountable institution's internal policies and procedures to address money laundering and other financial crimes.[240]

It is highly unlikely that there is any bank in South Africa that does not operate with a risk management framework in place. New legislation that has been introduced over the years has given lending institutions more guidance and protection for banks. The mere existence of a risk framework will not protect a bank from risk but the application of the policy in the bank's policies and procedures may well do so. Of particular importance in relation to the topic, is the bank's ability to apply a risk-based approach when new accounts are opened.[241]

The legal consequences of fraud on a customer's account is that the customer loses the amount of funds in his bank account, which results in a claim against the bank for payment of the monies lost or stolen, which eventually results in the banks reputation being affected. According to Walter Volker, the CEO of the Payments Association of South Africa (PASA)[242]:

> "Banks collectively process about 56 million debit orders a month, about 800 000 of those debits are disputed every month at an interbank level. Disputes can be based on the bank having no authority to debit (which might be as a result of fraud), the amount is incorrect etc."

[236] www.sabric.co.za (last accessed on 15/05/2016).
[237] (n 236).
[238] www.standardbank.co.za (last accessed on 15/05/2016).
[239] (n 80).
[240] (n 80).
[241] (n 80).
[242] www.bdlive.co.za (last accessed on 7/05/2016).

Mr Volker further stated that should consumers suspect that the debits were as a result of fraud, this information should be reported to the South African Police Service.[243]

The consequences of fraud on a customer's account allow fraudsters to launder money easily. Once fraudsters have access to a customer's bank accounts, money laundering and other financial criminal activity can easily be conducted without a customer even becoming aware.

The question as to who is liable for the perpetration of fraud on the customer's account depends on who breached the duty that was expected at the time when the breach was conducted. If it is the customer who made out his written instructions on a transfer form in a manner that would facilitate fraud or forgery, then it is the customer who failed to exercise the duty of a reasonable customer and he must therefore bear the loss. If the bank was negligent in conducting transfers which were not authorised by the customer, then it is the bank that is liable for the fraud perpetrated on the customer's account.

In both the *Hanley*[244] and the *DA Ungaro*[245] cases, the bank facilitated the fraud by being negligent in the execution of the customer's mandate. At a time when money laundering is so rife worldwide, the bank officials operated in a negligent manner, thus leading the bank into disrepute. The bank officials caused the loss of the bank by failing to adhere to internal procedures and controls.

The dissertation points out the importance of carrying out a customer's mandate properly so as to prevent liability caused by failure to adhere to instructions. Perhaps stringent measures and penalties need to be enforced against banks and financial institutions to ensure that the client's mandate is adhered to in the best possible manner at all times.

It is high time that banks take better steps to protect their customers' accounts from fraud and other financial crimes. If the fines imposed by FICA did not cause banks to "pull up their socks" then the customers' bank accounts and the monies entrusted to the bank are not in safe custody.

[243] (n 242).
[244] (n 1).
[245] (n 3).

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