Ponzi Banking: The Law and Psychology of Banks that Service Financial Misconduct

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Banker-customer relationship; Bankers' duties; Banks; Canada; Comparative law; Duty of care; Fraud; Psychology and law; Pyramid selling; State of mind; United States

Abstract

Banks rarely incur civil liability for providing routine banking services that enable Ponzi schemes and other financial misconduct. Victims of fraud face substantial barriers in stating a claim against banks in such cases. This article, co-authored by a practising asset recovery lawyer and an expert in the psychodynamics of fraud, provides an integrated, two-fold interdisciplinary and multijurisdictional analysis of this issue. We examine the legal frameworks applicable to liability for banks that service major financial misconduct in the context of six leading judgments from three jurisdictions—the US, Canada, and England and Wales, scrutinising cases where victims of fraud enabled by a bank were successful in seeking compensation for their loss as well as where they were not. But courts are not only making determinations of fact and law. In determining civil liability for wrongdoing, jurists are also assessing the workings of the mind and aspects of character to explain why one party deceived or disadvantaged another, or why a banker may have recklessly lent assistance to a primary wrongdoer. These mental elements—for instance, actual knowledge, wilful blindness, reckless disregard and awareness of risk of fraud—are well-established in legal theory and practice. Yet courts face persistent challenges in uniformly defining their meanings, interpreting applicable standards, and determining which elements must meet these standards. Even where courts agree in principle on the paramount importance of establishing civil liability for what is an intentional tort for facilitating fraud based on knowledge of financial wrongdoing, approaches to and understandings of concepts of the mind can be confused, vague or inconsistent across frontiers. Thus, in addition to analysing the legal reasoning in support of each judgment, we provide brief explanations of the key mental states connected to each case together with a concise overview of corresponding (and not infrequently conflicting) psychological features. Through this, we discuss the quality of each court's conclusions regarding the mind states of relevant employees of the financial institution who may have knowingly participated in or wilfully enabled harm. Our conjoined legal and psychological analyses underscore that courts need to improve their approach to determining the mind states of bankers who have facilitated financial misconduct. We offer recommendations for how courts can more reliably determine the requisite mind state elements of causes of action pled to hold a bank to account for the harm caused by servicing financial misconduct intentionally. Separately, we consider how courts are responding to fraud victims' claims against banks for damages sounded in the unintentional tort of negligence. This is where claims are pled in response to careless conduct which falls below the standard of care expected of a reasonable bank. We argue that harmonising settled jurisprudence with more sophisticated psychiatric and psychological understandings of mental states—the theories of the mind in law and their real-world implications in courts—represents a vital step towards redressing inequities of power and advantage and, ultimately, to helping victims of fraud recover against institutional enablers when the law permits it.

"You can't run a Ponzi scheme without a bank."

Introduction

Banks rarely incur civil liability for providing routine banking services that enable Ponzi schemes and other financial misconduct.[1] Victims of fraud face substantial barriers in stating a claim against banks in such cases.[2] This article provides an interdisciplinary and multijurisdictional analysis of the legal framework applicable to liability for banks that service major financial misconduct,[3] particularly Ponzi schemes, in three jurisdictions:[4] the US, Canada, and England and Wales.

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[1] This article was inspired by a workshop named "David & Goliath Unbound: A new paradigm for holding banks accountable to victims for enabling fraud", held at the 41st Annual Cambridge International Symposium on Economic Crime, Jesus College Cambridge, 1–8 September 2024. This workshop was presented by the co-authors together with Michele Caratsch, Baldi & Caratsch (Zurich); Matthew Bradley KC, 4 New Square Chambers (London); and Paul Austin, LLM, Highgate (London).

[2] This phrase was coined by co-author Martin Kenney during a panel discussion named "You Can't Run a Ponzi Scheme Without a Bank: Victims Strike Back", held at the 14th Annual Offshore Alert Conference in Miami, May 2016. The panel was made up of four other asset recovery lawyers: Yves Klein of Monfrini Bitton Klein (Geneva, Switzerland); Lincoln Caylor of Bennett Jones (Toronto, Canada); Charles H. Lichtman of Berger Singerman (Fort Lauderdale, US); and Gonzalo Zeballos of BakerHostetler (New York, US).

[3] The authors wish to extend their gratitude to Nathan Shaheen of Bennett Jones (Toronto) for his contribution in completing a peer-review and edit of the Canadian law section of this article.

[4] The authors wish to extend their gratitude to Charles Bott KC, head of advocacy at MKS Law, for his contribution in completing a peer-review and edit of the section on the law of England and Wales.

The authors provide commentary on these frameworks from the perspectives of a practising lawyer and an expert in the psychodynamics of fraud.[5]

For each jurisdiction, this article is organised as follows: (1) an overview of the legal framework applicable to civil liability of banks that provide financial services to perpetrators of fraud; (2) a case study of one case in which a defendant bank was found liable and one where it was not; (3) a legal commentary on the cases; and (4) a psychology commentary on the cases.

Ponzi schemes

Ponzi schemes are a type of investment fraud. Investors are promised high returns with limited risk. Operators of the scheme use funds collected from new investors to pay existing investors, rather than investing the funds as promised. To maintain the illusion of sustainability, Ponzi schemes require constant capital injections. When capital demands from investors exiting the scheme exceed capital injection by new investors the schemes collapse. Investors who did not withdraw funds prior to the onset of insolvency, risk incurring substantial loss.

Banks are often involved in Ponzi schemes. The role of banks in Ponzi schemes varies. Banks can be active participants. Banks can also be unwitting facilitators of fraud. Depending on the nature of a bank's involvement in a Ponzi scheme, a bank may be liable to pay damages to compensate victims. Claims may be pursued by investors in the Ponzi scheme, by liquidators of the insolvent entity that perpetrated the Ponzi scheme, or by other interested parties.

Where Ponzi schemes collapse, banks may be a litigation target. Ponzi scheme investors often have difficulty recovering from the operators of Ponzi schemes. These operators will typically have dissipated the investors' assets, leaving the scheme's funds insufficiently capitalised to satisfy judgments against the scheme operators. By contrast, banks are typically sufficiently capitalised to satisfy judgments. However, the process of recovering from banks in such circumstances is complex and often fruitless.

As a multi-disciplinary article, we start by concisely tracing the historical application of psychological theories and understandings of mental states and character into legal determinations of a defendant's state of mind. For instance, each concept of the mind such as intent, knowledge, awareness, truthfulness, recklessness and disregard for consequences may form part of the mental element assessed by a court in determining civil liability for wrongdoing.

In criminal law, the establishment of a mental element—*actus non facit reum nisi mens sit rea* (the act does not render one guilty unless the thought is also guilty)—has come to permeate legal theory and practice as a settled and straightforward principle. It is, however, exceedingly complex psychologically. Consequently, courts face persistent challenges in uniformly defining terms and meanings relating to mental states, interpreting applicable standards, and determining which elements must meet these standards in particular crimes. In civil litigation against banks for servicing financial misconduct, the relevant mental states are typically actual knowledge, wilful blindness and reckless disregard for apparent risk of fraud. Colourfully, English courts have referred to a person who suspects something is wrong—but who chooses not to act on it—as someone who is guilty of "wilful blind-eye knowledge of the obvious".[6] Under this principle, deliberate ignorance of facts is the equivalent to actual knowledge where a party suspects the truth (e.g. where a bank has reason to believe a customer is using their account at the bank to operate a Ponzi scheme), but refrains from inquiry in order to avoid confirming it. In *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd*,[7] Lord Scott held that:

> "A person who deliberately shuts his eyes to the obvious is in precisely the same position, so far as knowledge is concerned, as if he had had actual knowledge."

Even where courts and legal systems agree in principle on the paramount importance of establishing liability for what is an intentional tort based on knowledge of or participation in financial wrongdoing, approaches to and understandings of mental states can be confused, vague or inconsistent across national frontiers.

The article also provides brief explanations, definitions and legal implications of the key mental states connected to civil actions involving banking misconduct and other white-collar cases together with a concise overview of corresponding (and not infrequently conflicting) psychological features. The objective is to clarify how mental state concepts used by courts, such as actual or constructive knowledge, recklessness and wilful blindness, intersect with and differ from psychological constructs.

These perspectives are offered to argue that harmonising settled jurisprudence with more sophisticated psychiatric and psychological understandings of mental states will enable a redress of entrenched inequities of power and advantage in cases of financial institution misconduct which can help victims of fraud obtain compensation from institutional enablers to the extent that the law permits. One way civil courts can improve the precision of their conclusions about a party's knowledge (or mind state) is by relying on opinion testimony from experts in the psychodynamics of fraud—just as criminal courts have relied upon the

[5] Notably, the US has 50 separate legal systems; while Canada has 13 (10 Provinces and 3 Territories). For the purposes of this article, we have sought to summarise the law of civil liability of banks for enabling fraud in these multi-jurisdictional countries.
[6] See *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 A.C. 164 where the English House of Lords considered "blind-eye knowledge" in the context of dishonest assistance.
[7] *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 A.C. 469 (HL).

testimony of forensic psychiatrists and other experts when considering the defence of insanity since at least 1843 in *R. v M'Naghten*.[8]

Expert testimony continues to inform English criminal courts' decisions on questions of diminished responsibility, fitness to plead and whether a defendant has a treatable psychiatric illness. However, many judges remain sceptical of expert opinion on the workings of the human mind. In many cases, particularly where the consensus in the field of psychology is inconsistent with hallowed legal concepts, some judges may instruct juries to disregard expert psychological or psychiatric opinion even where research supports its relevance to the matter at hand.

How jurisprudence misunderstands the mind and the consequent challenges to holding banks accountable for enabling misconduct

Codes of acceptable conduct and sanctions for violating them are as old as recorded history. In early medieval times, criminal laws reflected a primitive view of punishing individuals who committed crimes. Early trials were dealt with by ordeal or combat, rooted in religious precepts that assumed God would see to it that justice prevailed for the deserving party.

By the thirteenth century many felonies had been defined but states of mind continued to be overlooked as an element in explaining or judicially addressing them. Over time, mitigating circumstances such as the absence of intent or premeditation, and the defendant being *non compos mentis* (meaning "of unsound mind", a concept used in early English law to describe people afflicted by madness, loss of memory or apparent inability to reason), were introduced and sentences could be lowered accordingly. Over the next several centuries, more formal definitions of states of mind in criminal behaviour began to emerge.

As more sophisticated jurisprudence developed and became more influential, early British and American common law began, albeit rudimentarily, to consider not just bad acts but perpetrators' mind-state. Mind-state (or "*mens rea*") refers to formal psychological theories and evidence-based understandings about the workings of the mind and aspects of character intended to enable triers of fact and law to determine motive, intent, knowledge, truthfulness, culpability and other ostensibly definable elements of wrongdoing to codify how individuals ought to be dealt with by the law.

While these inquiries developed in the criminal context, courts in civil fraud litigation now undertake related mental state assessments. In the US, claims against financial institutions for damages based on a bank aiding and abetting fraud or breach of fiduciary duty on the part of a director of a company used in a fraud, require proof that the defendant had actual knowledge of the primary wrong and substantially assisted in its commission. In Canada and England, claims for dishonest assistance in the breach of a fiduciary duty require evidence that the defendant had actual knowledge, or was wilfully blind or reckless to obvious risk, of the fiduciary's dishonest conduct and provided assistance in furtherance of that breach.

The law—the grand body of jurisprudence—is in its essence a constellation of principles foundationally rooted in and structured to regulate human behaviour. In sum, the mind is central to the law.

When we talk about wrongdoing, dishonesty, negligence, recklessness and the like, we are referring to people injuring other people to such a degree of involvement that they need to make good a loss. These are not just abstract concepts. They draw a line in defining actionable conduct and a right to a remedy. Understanding why, their motivation, intent or knowledge of wrongfulness are all relevant when assigning blame to facilitators of fraud. Whether explicitly acknowledged or not, courts are not only making determinations of fact and law, but also explicating upon why one party harmed, deceived or disadvantaged another; or why a banker may have recklessly lent assistance to a primary wrongdoer. Accordingly, if, how, and to what extent third parties, for instance a bank—which is actually to say relevant executives and employees in that financial institution—knowingly participated in or wilfully enabled that harm can become weighty questions for courts to resolve.

Understanding how the law has historically understood mental states–and the implications of that history for courts today—is a vital step towards correcting power imbalances and enabling fraud victims to recover against institutional enablers in cases where it is legally rational to do so.

Comprehensively tracing the history of the evolution of *mens rea* and of affiliated conceptualisations of human impulsivity and other drivers of wrongdoing is beyond the scope of this brief overview. Suffice it to say, however, there exists significant ambiguity and variation in what courts and the law understand about the state of a culpable person's mind and, as a result, how the concept is applied in practice. Additional doctrinal tests connected but adjacent to the mental state of an intentional wrongdoer include, for instance, the "wild beast" test, the "policeman at the elbow" test, the "irresistible impulse" test, McNaughton's rule, and the Durham rule, among others. All were attempts to provide jurists and juries with a more precise definition of mental states or conditions suggested to be causal to criminal acts. While grounded in criminal law, these efforts reflect a broader legal ambition: to identify when internal psychological conditions meaningfully affect culpability. This ambition persists in modern civil jurisprudence, particularly where

[8] *R. v M'Naghten* 10 Cl. & Fin. 200; 8 E.R. 718 (HL).

courts must assess whether a defendant's conduct meets mental thresholds such as actual knowledge, recklessness or wilful blindness.

The history of inaccurate, incomplete and error-riddled models of mind and theories of human psychology in jurisprudence and legal practice has given rise to unacknowledged confusion, misunderstanding and contradictions in purpose.

Time and again courts return to age-old questions and uncertainties around how to define mind-state. This challenge is particularly acute in civil litigation against banks and other financial institutions for facilitating financial misconduct, where institutional structure and diffusion of responsibility often obscure whether key actors had the requisite knowledge or intent required to make a bank liable to pay damages to a victim of fraud. Or to hold responsible, and certainly not passively reward, not just the dutiful lieutenants but the architects and leaders directing policies and practices which derogate or ignore duties of care and exploit legal and regulatory loopholes with impunity. And to create and uphold laws that balance society's calls for security, trust and deterrence, with accountability and, where financial harms have been inflicted, the imposition of meaningful penalties and economically appropriate repatriation of victims' losses. In cases involving fraud or other forms of economic misconduct, the law must parse whether individual facilitators knowingly enabled wrongdoing, turned a blind eye or merely followed institutional routines without awareness of the harm being facilitated.

Fraud and other economic misconduct is predicated in deception, manipulation, betrayals of trust and abuses of power. Such misconduct can be considered intrinsically and dominantly relational, emotional and psychological, and only notionally or subordinately explained by the pursuit of financial gain.[9]

The human condition is in many ways defined by entrenched fears and fantasies about the doings of the mind, the limits of our knowledge and control of what goes on inside us, and our challenges to restraining ourselves from enacting various thoughts and impulses. Those are very real factors in the maintenance and ongoing creation of a corpus of inaccurate, psychologically unsophisticated, and retrograde legal theory and practice.

Any number of flawed and fossilised misconceptions relating to human psychology and mind-states have over centuries been deeply and seamlessly incorporated into law.

Equally significant to matters involving the level of precision (or imprecision) of descriptions and understandings of mental states, is the effect of how judges interpret (and misinterpret) their meaning. Justice Oliver Wendell Holmes famously made the point that the law is only that which a judge will sustain in his opinion.

Through inadvertent oversight or strategic exploitation of judicial, regulatory and procedural ambiguities by bad actors and their consiglieri, both banks and courts alike can effectively abet and enable insulation from accountability for dishonest or knowing assistance, negligence, or operationally permissible but ethically reprehensible facilitation of harm to accountholders or third parties who have been defrauded or swindled.

The implications of this are that the law is, regrettably, not always or necessarily an ally in the pursuit of justice for fraud victims. Often, over-reliance on legal knowledge and judicial mechanisms can be a hindrance, not a boon.

So where does this leave us? And, more importantly, how can it help?

Aldous Huxley observed: "that men do not learn very much from the lessons of history is the most important of all the lessons that history has to teach".

We must be the exception to that, not evidence of it. We must confront and expertly examine the many misconceptions and misunderstandings of human psychology in the law so as to be prepared to effectively navigate and overcome the ways laws and institutions, edifices of probity and providence, sometimes conspire to defer or obstruct justice rather than deliver it. Fraud weaponises human psychology. Psychology can be used as a countermeasure.

We must adroitly capitalise on knowledge of human decision-making and behaviour, not be hog-tied by conservative thinking or sandbagged by ignorance or cynicism. This is important to address shortcomings in the law and in courts. It is also critical to understanding and addressing the role leaders, employees and cultures of financial institutions play in causing or enabling victims' injuries.

No matter the size of their balance sheets or apparent invincibility, institutions are not impregnable monoliths but complex human ecosystems. Every organisation, even the most successful and powerful, operates with myriad human challenges of its own making: frustrated and disaffected employees; interpersonal and interdepartmental squabbling; complaints about compensation, title and advancement; communication quagmires and failures; cultural rot; toxic managers; soul-crushing bureaucratic nonsense; left hands and right hands that never meet; truthtellers who are silenced and those who keep silent. Every CEO and board has blind spots. No compliance programme is bulletproof. Not all internal controls work as designed.

Sometimes by ethically repugnant design, and sometimes without recognition, any or all of these phenomena can aggregate to the derogation of duties of care, complicity in harm, or outright actionable misconduct.

Under expert analysis, the human dimensions and underpinning dysfunction of even the most imposing corporate adversary will reveal exploitable vulnerabilities.

[9] Alexander Stein, "Innovations and Strategic Applications in the Psychology of Fraud" in *ICC FraudNet Global Report 2023: Fraud and Asset Recovery in an Unstable World*, pp.233–254.

Finally, we must leverage the unparalleled potency of multidisciplinary collaboration. Joining forces of different relevant professional disciplines is a force-multiplier that can exponentially amplify capability and effectiveness in complex cases, enabling more institutional wrongdoers to be brought to book and more victims to enjoy justice.

The underpinning psychology of mens rea and affiliated mental state elements

Law and psychology intertwine in numerous, complex ways. In simplest essence, law focuses on establishing and enforcing rules and regulations to govern society and protect individuals' rights and freedoms. The law's interest in human psychology is primarily, though not exclusively, a formal attempt to govern human behaviour and resolve conflicts. Psychology is a branch of science dedicated to understanding and explaining the underlying causes and mechanisms of human behaviour, thoughts and emotions.

Each discipline has overlapping interests in human behaviour and the states of mind and motivations that influence and drive it. But each also has differing objectives, methods and approaches, and areas of focus, application and practice which can create tension or discrepancy between legal and psychological understandings of important terms, concepts and outcomes.

As a counterpart to the foregoing, the following is a precis of psychological perspectives on *mens rea* and other affiliated mental states deemed essential for determinations of culpability under law.

The underpinning states of mind giving rise to certain decisions and actions, may, as an entirely separate matter from their legality (or cognisance thereof), be vastly more complex than the law recognises.

Many wrongful acts, whether criminal or civil, are intrinsically psychological events. Misconduct is understandable as a behavioural expression of the actor's internal world inflicted outward onto others. A signal attribute of many wrongdoers is an inability to appropriately self-regulate, manage or contain—reconsider or walk back—primitive urges in harmless fantasies or other nondisruptive outlets, or harness and transpose adversity or other difficult personal experiences into socially appropriate and law-abiding actions.[10]

Early trauma of various sorts can generate cognitive and emotional disorganisation, debilitatingly low self-esteem, insecurity and psychological impotence (powerlessness). The persistent dread of disempowerment (and the shame that typically accompanies it) impels a callous disregard for people and social norms and, in certain situations, can trigger aggression, cruelty or callous disregard.

Impulsivity, whether a formally diagnosed disorder or associated with other more quotidian psychological issues that impinge or disrupt self-regulation, will cause difficulty in considering the consequences of and, therefore, inhibiting or adjusting actions.

Deficiencies in empathy or other blockages to exercising moral conscience which normally promote pro-social behaviour will, instead, foster an active disregard or disdain for—even a sadistic or nihilistic delight in—the potential harms their actions could cause.

There are many factors potentially driving reckless behaviour, poor judgment and ill-considered decision-making. These include unresolved psycho-emotional issues, addictions and substance abuse (which can be both stand-alone psychopathologies as well as symptomatic of or comorbid with other issues). These factors can impair reasoned assessments and judgment and lead to reckless behaviour.

Some individuals engage in reckless behaviour to bolster a fantasy of omnipotence or are recapitulating a dynamic cycle from earlier life involving taunting or toying with some severe risk which is linked to an attempt to master and overcome or defeat it.

For others, recklessness can serve to deny or compensate against anxiety (whether as a diagnosed disorder or an inability to modulate or evacuate such internal states).

Legal and psychological convergence and divergence in cases of banks facilitating financial misconduct

As noted above, the law has traditionally understood criminal liability to require the concurrence of both a proscribed act (the *actus reus*) and a guilty mind (*mens rea*). Holding a financial institution to account in civil damages for harm done to the victims of fraud facilitated by an institution can also require an examination into a banker's mind-state or their level of lawlessness of risk to loss to victims if, on their watch, a bank facilitates misconduct. Establishment of a mental element—a state of mind, knowledge, awareness, recklessness, disregard, intent—has therefore long been deemed necessary to justify culpability in both criminal cases and intentional civil torts. Despite the rise of offences imposing strict liability or reversing the burden of proof, the law continues to presume that culpability requires a mental element unless a statute provides otherwise.

Despite the seeming straightforwardness of the principle that civil liability for an intentional wrong (such as aiding and abetting a fraud or dishonest assistance in the breach of a fiduciary duty) requires a culpable mental state, it is, as already noted, exceedingly complex psychologically. Consequently, courts the world over face persistent challenges in uniformly defining terms and meanings relating to *mens rea*, interpreting applicable standards (such as knowledge, wilfulness and intent) and

[10] Stein, "Innovations and Strategic Applications in the Psychology of Fraud" in *ICC FraudNet Global Report 2023: Fraud and Asset Recovery in an Unstable World*, pp.206–207.

determining which elements must meet these standards in particular cases. This difficulty is magnified in civil litigation involving complex financial institutions, where mental states must often be inferred from patterns of conduct, structural oversight failures or policy decisions.

Thus, while many courts and legal systems agree in principle on the paramount importance of proving mental culpability as a requisite to imposing civil liability or sanction for intentional forms of wrongdoing, approaches to and understandings of mental states can be confused, vague or inconsistent across jurisdictions.

The tort of negligence is said to be an objective "conduct based" civil wrong of carelessness which leads to accountability for reasonably foreseeable loss when there is proximity between the careless and the injured party. And yet in some civil claims against banks sounded in negligence, we can see courts importing a subjective mind-state element into what is otherwise supposed to be a wrong based on conduct falling below an accepted standard of care. We refer to our discussion below of the 2021 judgment in *McDonald v TD Bank*[11] where the trial judge in Ontario, Canada found that: (a) $4.288 billion of loss had been caused, in fact and in law, by TD Bank's conduct; but (b) the claim failed because the claimant liquidators of Stanford International Bank (Antigua) did not prove that TD Bank knew or had reason to suspect that Robert Alan Stanford was engaged in what was then the second largest Ponzi scheme in world financial history between 1992 and 2009—using the US dollar correspondent banking facilities of TD Bank in Toronto to receive, process and pay out approximately $10 billion of the proceeds of the fraud. This fraud visited harm on over 22,000 people in 141 countries.

Conclusion

Our intent here, to be clear, is not to argue that psychologically inaccurate interpretations of or misunderstandings regarding proof of actual knowledge of a fraud and affiliated mental states ought to constrain, undermine or neuter laws codified over centuries essential for determinations of civil liability for knowingly or negligently facilitating a fraud.

To the contrary, our suggestion is that harmonising settled jurisprudence with more sophisticated psychiatric and psychological understandings of a person's state of mind will enable a redress of entrenched inequities of power and advantage in cases of financial institution misconduct and can help victims of fraud recover against reckless or careless institutional enablers when it is legally reasonable and rational for this to occur.

United States

Plaintiffs in Ponzi scheme cases stating claims against banks in US courts face an uphill battle. Courts have limited the scope of liability in important ways. Liability is limited based on the nature of the banking services provided. US courts tend to be reluctant to find banks liable in Ponzi scheme cases as long as the bank merely provided routine banking services.[12]

Liability is also limited depending on the identity of the plaintiffs. Courts tend to be reluctant to expand the scope of plaintiffs to include non-customers and prefer claims to be brought directly by aggrieved investors.[13] This presents a major challenge for liquidators seeking to recover on behalf of investors.

Perhaps most significantly, courts have established a high threshold for a finding of "notice" or "knowledge". Failing to act on "red flags" will often not be enough. For instance, in the context of claims for aiding and abetting fraud, courts typically expect that plaintiffs establish actual knowledge, and are unlikely to impose liability where a defendant bank should have known of conduct.

Plaintiffs in the US seeking to recover damages from banks that enable or turn a blind eye to Ponzi schemes and other major fraudulent activities typically state the following claims: negligence, aiding and abetting fraud or aiding and abetting a breach of fiduciary duty.

To state a claim for negligence under New York law, the plaintiff must typically establish the following elements:

- the defendant owed the plaintiff a cognisable duty of care;
- the defendant breached that duty; and
- the plaintiff suffered resulting damages.[14]

To state a claim for aiding and abetting fraud under New York law, the plaintiff must typically establish the following elements:

- the existence of a violation by the primary wrongdoer;
- knowledge of this violation by the aider and abettor; and
- proof that the aider and abettor substantially assisted in the primary wrong.[15]

To state a claim for aiding and abetting a breach of fiduciary duty under New York law, the plaintiff must typically establish the following elements:

- there was a breach of fiduciary obligations to another;
- the defendant knowingly induced or participated in the breach; and

[11] It is noted that one of the co-authors of this article, Martin Kenney, acted as co-general counsel for the joint liquidators of SIB (Antigua estate) and acted as instructing counsel in the *McDonald v TD Bank* claim. Between 1985 and 1990, SIB was based in Montserrat and went by the name Guardian International Bank Ltd. In 1990, Stanford moved the bank to Antigua and, in 1994, changed the name to Stanford International Bank Ltd.
[12] See, e.g. *Isaiah v JPMorgan Chase Bank*, 960 F.3d 1296 (11th Cir. 2020).
[13] See, e.g. *In re Bernard L. Madoff Inv. Secs.* LLC, 2013 BL 163325, p3 (2d Cir. 20 June 2013).
[14] *MLSMK Inv. Co v JP Morgan Chase & Co*, 737 F.Supp.2d 137, 145–146 (SDNY, 2010).
[15] *Armstrong v McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983).

- the plaintiff suffered resulting damages.[16]

The following two cases, *TelexFree* and *Agape*, provide a useful case study. In both cases, plaintiff victims of Ponzi schemes brought an action for tortious aiding and abetting against the Bank of America (BOA). In *TelexFree*, a Massachusetts District Court denied the BOA's motion to dismiss. In *Agape*, a New York District Court granted BOA's motion to dismiss.

In re TelexFree Section Litigation

TelexFree was a Ponzi scheme that operated from February 2012 to April 2014. TelexFree[17] was disguised as an internet phone service company and promised investors high returns but paid out these returns with money from new investors. TelexFree used BOA's services in furtherance of the TelexFree scheme. The scheme collapsed into insolvency in 2014 and TelexFree filed for bankruptcy. TelexFree involved $1 billion in investments and approximately 2 million participants worldwide, with a substantial concentration in the state of Massachusetts.

Investors brought a claim against BOA for tortious aiding and abetting.

To state a claim for tortious aiding and abetting under Massachusetts law, a plaintiff must establish the following elements:

- a tortfeasor committed an underlying tort;
- the defendant knew that the tortfeasor was committing the underlying tort;
- the defendant actively participated in or substantially assisted the tortfeasor in committing the underlying tort; and
- the plaintiff suffered resulting damages.[18]

The key legal issues were whether the defendant had actual knowledge of the underlying tort, and whether the defendant actively participated or substantially assisted in the commission of the underlying tort.

To establish that a defendant had actual knowledge of an underlying tort, a plaintiff must allege facts that give rise to a "strong inference" that the defendant "actually knew" that the underlying tort was being committed.[19] Constructive knowledge is generally insufficient.[20]

The District Court found that the evidence submitted by the plaintiffs did support an inference that BOA knew that TelexFree was operating a fraudulent scheme. Evidence included the following: Brazilian regulators had publicly shut down TelexFree operations in Brazil, and BOA had closed certain TelexFree accounts due to suspicious activity.[21]

To establish that a defendant actively participated in or substantially assisted the tortfeasor, a plaintiff must allege facts that demonstrate that the defendant was a "substantial factor" in the ability of the tortfeasor to commit the tort.[22] This requirement will likely be satisfied where a bank is providing routine banking services to a client and the bank also has actual knowledge that its services are assisting the customer in committing a tort.[23]

Here, the plaintiffs alleged that, following the date at which there was sufficient evidence to support an inference that BOA was aware of the TelexFree scheme, BOA transferred $30 million to a Wells Fargo account controlled by the defendants. The District Court found that this evidence was sufficient to support a claim that the defendant actively participated in or substantially assisted the tortfeasor.

Accordingly, the District Court of Massachusetts denied BOA's motion to dismiss.

In re Agape Litigation

The *In re Agape Litigation*[24] concerned a Ponzi scheme (the Agape scheme) orchestrated by Mr Nicholas Cosmo through Agape Merchant Advance LLC, Agape World Bridges LLC, and Agape World Inc. (collectively "Agape"). Between 2005 and 2009, Mr Cosmo promised investors high returns with little risk by purportedly providing bridge loans to commercial borrowers. Instead, Mr Cosmo used investor money to pay off earlier investors. Agape used BOA banking services in furtherance of the Agape scheme. When the Ponzi scheme collapsed, investors were left with losses of approximately $415 million in value.

Investors in the Agape scheme filed a class action lawsuit against BOA. The suit alleged, inter alia, that BOA had aided and abetted Mr Cosmo's fraud.

Procedural history

The New York District Court granted BOA's motion to dismiss the class action complaint. The plaintiffs were given an opportunity to amend their complaint, but they did not do so. The case was subsequently settled.

Legal reasoning: aiding and abetting

To state a claim for aiding and abetting fraud under New York law, the plaintiff must typically establish the following elements:

- the existence of a violation by the primary wrongdoer;

[16] *Pension Comm. of Univ. of Montreal Pension Plan v Banc of Am. Sec., LLC*, 446 F.Supp.2d 163, 201 (SDNY, 2006).
[17] *In re TelexFree Sec. Litig., 626 F.Supp.3d 253*.
[18] *In re TelexFree Sec. Litig.*, 626 F.Supp.3d 253, 268 (D. Mass. 2022).
[19] *Vasquez v Hong Kong and Shanghai Banking Corp Ltd*, 2019 WL 2327810, p.17 (SDNY, 30 May 2019).
[20] *Lerner v Fleet Bank*, NA, 459 F.3d 273, 293 (2d Cir. 2006)
[21] *In re TelexFree Sec. Litig.*, 626 F.Supp.3d 253, 272 (D. Mass. 2022).
[22] *Massachusetts Port Auth. v Turo Inc.*, 487 Mass. 235, 243, 166 N.E.3d 972, 981 (2021).
[23] *Massachusetts Port Auth.*, 487 Mass. 235, 243, 166 N.E.3d 972, 981 (2021).
[24] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010).

- knowledge of this violation by the aider and abettor; and
- proof that the aider and abettor substantially assisted in the primary wrong.[25]

The first key legal issue was whether BOA had actual knowledge of the alleged wrongdoing.[26] The plaintiffs adduced the following evidence in support of the proposition that BOA could be inferred to have actual knowledge of the fraud. (1) BOA had established an unofficial branch within Agape headquarters to provide on-site banking services staffed by one employee dedicated to solely servicing Agape's needs. (2) This branch had full access to BOA's systems and business records and had personal access to Agape employees. (3) BOA and Agape had shared proprietary information, including account information about respective customers. (4) BOA employees had repeated interactions with Agape customers, including conversations in which one BOA employee failed to disabuse an Agape investor of a misrepresentation made by Agape in furtherance of the Agape scheme.[27]

The District Court held that, although the allegations reflected unfavourably on BOA's fraud monitoring regime, the allegations fell below the threshold necessary to demonstrate an inference of actual knowledge.[28] In supporting this position, the District Court provided examples of cases that would, or would not, satisfy the actual knowledge threshold:

> "*Nigerian Nat'l Petroleum Corp. v Citibank, N.A.*, No. 98-CV-4960, 1999 WL 558141, at *7 (S.D.N.Y. July 30, 1999) (allegations that a bank knowingly or recklessly disregarded several 'badges of fraud' in accounts involving millions of dollars did not give 'rise to an inference, let alone a 'strong inference', that the bank actually knew of, and participated in' the fraud); *cf.Mazzaro de Abreu v Bank of Am. Corp.*, 525 F.Supp.2d 381, 388 (S.D.N.Y.2007) (finding that a plaintiff sufficiently alleged that a bank had actual knowledge of the purported fraud where the bank knew certain recipients of transfers were black market currency traders and advised the perpetrator of the fraud how to conceal its activities)."[29]

The second key legal issue was whether BOA provided substantial assistance in the Agape scheme. Substantial assistance requires that "a defendant 'affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed'".[30] Here, the District Court found that opening accounts and approving transfers did not amount to substantial assistance, even if the bank had notice that the accounts were associated with fraudulent activity.

Accordingly, the District Court granted BOA's motion to dismiss the case.

United States case commentary: legal analysis

As a matter of law, the *TelexFree* case is notable. The trial judge adopted a novel approach to the issue of whether routine banking services could constitute substantial assistance for the purpose of tortious aiding and abetting. US jurisprudence in similar cases has tended not to recognise the provision of routine banking services as sufficient to constitute "substantial assistance". The trial judge in *TelexFree* departed from this approach, holding that the provision of routine banking services could constitute "substantial assistance" where the bank had "actual knowledge" that the services facilitated their customer's fraud. If this becomes orthodoxy, it will potentially substantially expand the scope of litigation risk for defendant banks.

By contrast, the *Agape* case demonstrates that plaintiffs need extensive evidence to substantiate an actionable claim that a bank had "actual knowledge" of fraud in a tortious aiding and abetting case. The trial judge in the *Agape* case helpfully provided examples of evidence that would satisfy this "actual knowledge" threshold, including a bank knowing certain recipients of transfers were black market currency traders and having advised the perpetrator of the fraud how to conceal its activities.[31] In the instant case, evidence of an exceptionally close relationship between the bank and the fraudster, including the bank establishing a branch within the fraudster's office, failed to provide sufficient evidence to substantiate a claim that the bank had "actual knowledge" of the Ponzi scheme. There is a meaningful difference between an actionable claim and a claim for which a court will merely disapprove of a bank's internal monitoring infrastructure.

United States case commentary: psychology analysis

In holding the Bank liable, the *TelexFree* case is additionally notable in weakening wilful blindness—the deliberate avoidance of knowledge of the facts as a means of avoiding culpability or self-incrimination—as a defence, as well as demonstrating the court's willingness to recognise that the wilful avoidance of red flags can meet the actual knowledge standard.

The essential contours and conceptual complexities of wilful blindness are captured in the following jury instructions:

[25] *Armstrong*, 699 F.2d 79, 91 (2d Cir. 1983).
[26] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010) at [9].
[27] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010) at [10].
[28] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010) at [11].
[29] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010) at [11].
[30] *Rosner v Bank of China*, No.06-CV-13562, 2008 WL 5416380, p.5 (SDNY, 18 December 2008).
[31] *In re Agape Litigation*, 681 F.Supp.2d 352 (2010) at [11], citing *Mazzaro de Abreu v Bank of Am. Corp*, 525 F.Supp.2d 381, 388 (SDNY, 2007).

> "In deciding whether [the defendant] acted knowingly, you may infer that [the defendant] had knowledge of a fact if you find that [he/she] deliberately closed [his/her] eyes to a fact that otherwise would have been obvious to [him/her]. In order to infer knowledge, you must find that two things have been established. First, that [the defendant] was aware of a high probability of [the fact in question]. Second, that [the defendant] consciously and deliberately avoided learning of that fact. That is to say, [the defendant] wilfully made [himself/herself] blind to that fact. It is entirely up to you to determine whether [he/she] deliberately closed [his/her] eyes to the fact and, if so, what inference, if any, should be drawn. However, it is important to bear in mind that mere negligence or mistake in failing to learn the fact is not sufficient. There must be a deliberate effort to remain ignorant of the fact [in *United States v Gabriele*, 63 F.3d 61, 66 n.6 (1st Cir. 1995), and *United States v Brandon*, 17 F.3d 409, 451-52 n.72 (1st Cir. 1994)]."

This jury instruction—though originating in the criminal context—has clear implications for civil cases where courts must determine whether an institution's decision-makers engaged in deliberate avoidance of obvious indicators of fraud. The psychology of wilful blindness supports this legal reasoning, emphasising the cognitive dissonance and motivated inattention that enable actors to sidestep uncomfortable truths while maintaining plausible deniability.

What is actually meant by "a deliberate effort to remain ignorant?" Researchers studying the phenomenology of wilful blindness point out that the concept, when taken literally, negates itself. "If truly 'willed' then the blindness is more artificial than real; if truly 'blind' then surely it cannot be wilful." [32]

Outside the law, wilful blindness involves an array of phenomena, behaviours and mental states. We turn a blind eye or bury our heads in the sand; deny reality, are selectively aware and consciously avoidant. All of these phrases and the attitudes they convey are borne of mechanisms in our minds—denial, negation, disavowal, suppression, repression, splitting, dissociation, among others—any of us might unconsciously use to protect ourselves from overwhelming feelings or memories.

We unthinkingly turn a blind eye to feel safe, avoid conflict or reduce anxiety or emotional distress, but also, knowingly, to protect our reputation or escape accountability.

In US criminal law, the wilful blindness doctrine (also referenced as wilful ignorance, deliberate indifference, conscious avoidance and the ostrich instruction) contains at least two elements: (1) defendant's suspicion that the incriminating fact exists; plus (2) defendant's deliberate avoidance of the truth of that fact. Civil courts applying analogous doctrines in fraud and aiding and abetting cases often borrow this structure, particularly when evaluating whether institutional actors turned a blind eye to red flags that would have revealed the wrongdoing had they made minimal inquiry.

As both a legal principle and a guideline for establishing mental states, there are important distinctions between, for example, actionable misconduct committed by an individual who knows a material circumstance of the crime is true, and another who is reckless.

It is at that juncture that the legal and psychological definitions converge. Where blindness serves multiple functions in numerous circumstances, wilfulness under law implies a deliberate decision, not an unconscious manoeuvre to maintain emotional homeostasis.

TelexFree also points to inroads in effectively blunting institutional avoidance of liability for knowing assistance of wrongdoing through claims of cognitive dissonance (also referred to as rationalisation).

While not a formal legal term, cognitive dissonance is frequently referenced in legal contexts to describe a psychological phenomenon where individuals, institutions or groups of decision-makers justify, explain away or suppress ethical discomfort for actions or beliefs to reduce internal conflict.

Even if cognitive dissonance is not a recognised element of law, it has relevance in legal proceedings. For example, defendants may rationalise or justify their actions or beliefs to appear more credible or avoid admitting to inconsistencies, or downplay involvement in or knowledge of a crime by claiming they were "just following orders" or "didn't know" the full extent of the situation or its likely consequences. Defendants often use rationalisation to explain (or explain away) their actions, even if those actions are actionable or immoral, for example, asserting duress, or that their decisions or actions were justified by a perceived threat, even if evidence contradicts such a claim.

The bank's liability in *TelexFree* also highlights groupthink as a plausible approach for holding an institution accountable. The phenomenon of groupthink was initially theorised by psychologist Irving Janis in 1972 and refers to the tendency of groups to make irrational or poor-quality decisions due to social pressure, conformity and the false illusion of unanimity. The theory describes the tendency of groups to try to minimise conflict and reach consensus without sufficiently testing, analysing and evaluating their ideas. Pressures for conformity restrict the thinking of the group, bias its analysis, promote simplistic and stereotyped thinking, and stifle individual creative and independent thought. In groupthink, the supposedly neutral process of decision-making in structured groups can be influenced by mental shortcuts, cognitive illusions and internal group dynamics. Those extraneous factors often lead to excessive concurrence-seeking, which in turn may result in self-censorship and faulty decision-making.

[32] J. Bovensiepen and M. Pelkmans, "Dynamics of wilful blindness: An introduction" (2020) 40(4) *Critique of Anthropology* 387–402, *https://doi.org/10.1177/0308275X20959432* (original work published, 2020).

There can be no psychoanalytic autopsy in the *Agape* case aimed at gaining speculative *ex post facto* insight into the trial judge's understandings and misunderstandings of the underpinning psychological factors involved in the claim that the bank had actual knowledge of the Ponzi scheme.

However, in consideration of the facts adduced and in the light of the trial judge's ruling, *Agape* presents an opportunity to consider potential novel pathways to satisfying the actual knowledge threshold and to mounting a prosecutorial strategy that more effectively mitigates, or circumvents, unconscious judicial bias.

One such approach leverages a deeper understanding of the phenomenology of selective attention. It is important as a precedent step, however, to first examine actual knowledge. The essential legal definition of knowledge is awareness or understanding of an act, a fact or the truth. It is grounded in the principle *ignorantia juris non excusat*, meaning ignorance of or mistake about the law cannot be used as a legal defence. It refers to the explicit awareness that meets the legal threshold for establishing liability for negligence and aiding and abetting fraud. There are different ways knowledge is defined and applied.

Actual knowledge is information based on facts or evidence, and that a person is consciously aware of and had to have known. Actual knowledge can be proven by direct or circumstantial evidence.

Constructive knowledge, by contrast, is commonly defined as knowledge a person would have after some reasonable level of diligence. It concerns a person legally presumed to know something because they should have known it. Courts may determine constructive knowledge even in the absence of actual knowledge.

From a psychological perspective, knowledge and awareness are multifaceted and nuanced. They involve subtypes of knowledge—for instance implicit, explicit and tacit, among others—which can be subject to bias, distortion and interpretation, generating tension or conflict between legal and psychological positions on what can be conclusively validated about knowledge and awareness.

In legal contexts, selective attention generally refers to focusing on specific information while ignoring others. This selectivity, or narrowing of focus, can be relevant when, for instance, evaluating witness testimony, evidence or arguments, as well as understanding how people perceive and process information. It can cause or lead to biased decision-making, where a judge or jury focuses on evidence that supports a particular outcome, ignoring evidence that contradicts it; a flawed understanding of a case, if important details or alternative perspectives are overlooked; and misinterpretations of evidence through highlighting certain facts while downplaying or excluding others.

It can also have distinct relevance in matters of corporate misconduct where individual predispositions coupled with corporate culture and policy drive focus on profits or efficiency over attention and response to red flags or other indicators of actual or potential wrongdoing.

The general capacity to concentrate, and for selective attention more specifically, is a mental process that allows us to focus on particular stimuli or information while ignoring others. This crucial cognitive function helps us to navigate a world of sensory input by concentrating on certain tasks without becoming distracted or overwhelmed. It involves various brain processes that filter, prioritise and manage sensory input, and enables efficiency and productivity. It is unquestionably crucial to and plays a significant role in both proper professional performance in organisations as well as in matters of misconduct.

Selective attention is shaped by a mix of internal and external factors. Internally, stress or anxiety can sharpen or weaken focus, while motivation and adequate rest play critical roles in maintaining attention. Externally, environmental conditions such as noise, task complexity and distractions can significantly impact the ability to concentrate.

Selectively attending to one set of tasks and ignoring others creates a narrowing of our perceptual and cognitive apparatus. Consequently, we often fail to notice unexpected events or other inputs. This gives rise to temporary states of inattentional blindness—the phenomenon of failing to notice something obvious due to a lack of focus—and to divided attention (also commonly referred to as "multi-tasking") which can be challenging to sustain due to the limited capacity of our attention.

In law, a justification is a type of defense showing that an otherwise unlawful act was lawful under the circumstances. By contrast, justification in non-legal contexts is understood as an argument offered to support (justify) a decision or action or as an acceptable reason for doing something.

Rationalisation is adjacent to but distinct from justification. Strictly defined, rationalisation is an attempt to explain or justify behaviour or an attitude with logical reasons, even if these are not appropriate, and describing, interpreting or explaining something (such as bad behaviour) to make it seem proper, better, acceptable or ethical.

Justification and rationalisation are often conflated, for instance when we mentally distort justification into a reason for doing something known to be wrong or try to transform an act understood as wrong to appear less bad or even righteous.

Canada

Claimants in Canada seeking to recover damages from banks that enable or turn a blind eye to Ponzi schemes and other major fraudulent activities,[33] typically state the following claims: negligence or knowing assistance in breach of fiduciary duty.

To state a claim for negligence under Canadian provincial law,[34] the claimant must typically establish the following elements:

- the defendant owed the plaintiff a duty of care;
- the defendant's behaviour fell below the standard of care (and thereby breached the duty of care owed);
- the plaintiff sustained a loss; and
- the loss was caused, in fact and in law, by the defendant's breach.[35]

To state a claim for knowing assistance in breach of fiduciary duty under Canadian provincial law, the claimant must typically establish the following elements:

- the existence of a fiduciary duty;
- the fiduciary breached that duty fraudulently and dishonestly;
- the stranger to the fiduciary relationship must have had actual knowledge, including recklessness or wilful blindness, of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and
- the stranger must have participated in or assisted the fiduciary's fraudulent and dishonest conduct.[36]

Two cases, *McDonald v TD* and *Oak Incentives v TD Bank*, are instructive. In both cases, victims of fraud brought claims against a bank that had provided banking services to the perpetrator of the fraud. In *McDonald v TD*, the Ontario Superior Court of Justice dismissed the claimant's negligence and knowing assistance claims. In *Oak Incentives v TD*, the Ontario Superior Court of Justice allowed the claimant's negligence claim. In both cases, the Court of Appeal for Ontario upheld the lower court's decision.

McDonald v The Toronto-Dominion Bank

McDonald v The Toronto-Dominion Bank[37] (*McDonald v TD*) concerned the Stanford Ponzi scheme—the same fraud that gave rise to the *SIB v HSBC*[38] case in the English courts, which will be examined below.

The Stanford Ponzi scheme was orchestrated by Robert Allen Stanford, a Texas financier, and a small cabal of his close associates. Beginning in 1985, Stanford caused his Antigua-based Stanford International Bank Limited (SIB)[39] to guarantee investors high rates of return on certificates of deposit (CDs). In reality, such returns were not being generated and, instead, Stanford was misappropriating SIB's assets to fund his lavish lifestyle and further his fraud. He also used a substantial portion ($5.5 billion) of the proceeds of what grew to be a $10 billion Ponzi scheme to fund CD redemption payments—or "Ponzi payments" to victims—to keep the fraud running for 24 years. The result was that SIB had insufficient assets to back its CD liabilities to its creditors. Stanford concealed his personal misappropriation of $2 billion through, among other things, false accounting and bribes of SIB's auditor and regulator; and by using new investor funds to pay off existing investors.

In February 2009, SIB collapsed. The US Securities and Exchange Commission alleged a massive ongoing fraud involving SIB CDs. Receivers were appointed in both the US and Antigua, and SIB was soon after placed into liquidation by the Eastern Caribbean Supreme Court in Antigua. The jointly appointed liquidators therefore came to control SIB's Antiguan estate, for the benefit of its thousands of creditors; while an SEC receiver was placed in charge of SIB's US estate. A competition between the Antiguan and US office holders broke out over assets of SIB in the UK ($100 million), Switzerland ($200 million); and elsewhere. Eventually, Stanford was convicted and sentenced to 110 years in prison.

SIB's joint liquidators brought two claims on behalf of SIB, as victim of Stanford's fraud, against the Toronto-Dominion Bank (TD) in Toronto. Operating from Canada, TD had provided the primary US dollar correspondent bank account to its customer, SIB, that Stanford required to perpetrate his fraud. TD did so uninterrupted from 1991 until SIB's collapse in February 2009. The provision of this correspondent bank account in US dollars proved to be crucial to the success of the fraud. $10 billion of victim money ran through this account. SIB had no other reliable access to the US dollar payment system absent its piggy-backing off of TD's US Federal Reserve master account.

SIB's liquidators pled two causes of action against TD in the Commercial List division of Ontario's Superior Court of Justice. The first claim was that TD was liable in negligence to its customer, SIB. The second claim was that TD was liable for dishonest assistance in Stanford's breaches of fiduciary duty.

[33] With thanks to Nathan Shaheen of Bennett Jones (Toronto) for his valuable assistance in carrying out a peer review of the Canada section of this article.
[34] Canada is made up of 10 provinces and three territories—each with its own system of law. However, in general, the legal principles discussed in this section of the article are followed across English-speaking Canada.
[35] *Mustapha v Culligan of Canada Ltd*, 2008 SCC 27; [2008] 2 S.C.R. 114 at [3].
[36] *DBDC Spadina Ltd v Walton*, 2018 ONCA 60, 419 D.L.R. (4th) 409 at [211].
[37] *McDonald v The Toronto-Dominion Bank*, 2021 ONSC 3872.
[38] To restate, a co-author of this article, Martin Kenney, acted as co-general counsel to the joint liquidators of SIB (Antiguan estate). He was also instructing counsel in the *SIB v HSBC* matter.
[39] Between 1985 and 1990, SIB was based in Montserrat and went by the name Guardian International Bank Ltd. In 1990, Stanford moved the bank to Antigua and, in 1994, changed the name to Stanford International Bank Ltd.

Procedural history

In the Superior Court of Justice, the trial judge dismissed both claims following a three-month trial. The joint liquidators appealed the dismissal of the claim. On appeal, the Court of Appeal for Ontario affirmed the lower court's decision to dismiss the negligence claim. The joint liquidators applied for leave to appeal to the Supreme Court of Canada. The application was dismissed.

Legal reasoning: negligence

In *McDonald v TD*, the trial judge of the Superior Court of Justice ultimately concluded that SIB had suffered losses (potentially in the magnitude of $4.288 billion) and that SIB's losses had been caused, in fact and in law, by TD's conduct.[40] However, the trial judge was also required to consider the remaining elements of negligence, namely whether TD owed SIB a duty of care, and whether TD had fallen below the applicable standard of care. The trial judge concluded that neither element was present, and therefore dismissed the joint liquidators' negligence claim on behalf of SIB.

Despite SIB having been TD's customer, the trial judge concluded that the relationship between SIB and TD lacked sufficient proximity to give rise to a relevant duty of care. On this basis alone, the trial judge dismissed the joint liquidators' negligence claim.

The trial judge did so having concluded that, on the facts of the case, TD's "undertaking to operate a correspondent account did not extend to monitoring the internal operations of SIB" or "protecting SIB from insider abuse", notably, "unless there were clear indicia to put the bank on notice that the account was being used for nefarious purposes or that fraudulent conduct might be in issue". The trial judge further reasoned that there was "no basis for SIB to reasonably rely on TD Bank to protect it from insider abuse". The trial judge did not accept the joint liquidators' argument that banks *prima facie* owe a duty of care to their customers, or that any duty of care needed to be articulated more generally, whether as "the duty to exercise reasonable care and skill in providing the U.S. dollar account to SIB", or "the duty to prevent the use of that account in the face of circumstances objectively indicating misuse of the account".

Despite having held there was no duty of care, the trial judge went on to consider whether, had there been such a duty, TD would have fallen below the applicable standard of care, which was to be determined based on how a reasonable bank in TD's circumstances would have acted. The trial judge found that TD acted reasonably and therefore did not fall below the applicable standard of care.

In doing so, the trial judge considered several potential liability dates put forward by the joint liquidators. The dates included when TD first opened SIB's correspondent bank account, which it did without determining SIB's regulatory history or Stanford's personal background, which included a bankruptcy. The dates also included when TD was the subject of a US Senate report that highlighted the prior use of TD's US dollar correspondent services to facilitate fraud specifically involving Antiguan banks, and when the TD personnel responsible for the SIB relationship obtained one of the many news articles (in the Philadelphia Inquirer) indicating that Stanford was the subject of an unprecedented US FinCEN Advisory issued due to Stanford's role in making Antigua a haven for money launderers. Those personnel then declined to share the article with TD's internal compliance (AML) team or otherwise respond to it.

The trial judge preferred the expert witness put forward by TD over the fact and expert witnesses relied on by the joint liquidators, and concluded that TD did not fall below the applicable standard of care at any of the potential liability dates. The trial judge did so without directly considering or applying any particular international or domestic banking standard, or even TD's internal policies, but rather by reference to what TD's expert witness testified was reasonable in the circumstances of the case. Having done so, the trial judge concluded that "TD Bank did not know or have any reason to suspect that [Stanford] was engaged in fraudulent behaviour at the time".

The Court of Appeal for Ontario accepted, without modification, the trial judge's reasoning on the issues of the duty and standard of care, and therefore dismissed the joint liquidators' appeal. Among other things, the Court of Appeal rejected the joint liquidators' argument that the trial judge improperly injected a subjective element akin to knowledge in the place of the objective fault standard applicable to negligence claims by concluding that a duty of care arose only if the bank was "on notice" of "clear indicia" of the underlying fraud.

Legal reasoning: knowing assistance in breach of fiduciary duty

In *McDonald v TD*, there was no dispute that Stanford owed SIB a fiduciary duty, Stanford breached that duty by perpetrating his fraudulent scheme, TD's US dollar correspondent banking services facilitated Stanford's perpetration of the scheme, and TD knew that Stanford owed SIB a fiduciary duty. In respect of the joint liquidators' knowing assistance claim, the only issue was therefore whether TD had knowledge of Stanford's breach of duty. The trial judge concluded that TD did not.

The joint liquidators accepted that TD did not have actual knowledge of Stanford's fraud or breach of fiduciary duty to SIB. They argued, however, that TD was reckless or wilfully blind to Stanford's breach, which under Canadian law is equivalent to knowledge.

Consistent with her analysis of the standard of care element of negligence, the trial judge concluded that TD was not reckless or wilfully blind. In this regard, the trial

[40] The trial judge concluded that, without the US dollar correspondent account that TD provided to SIB, Stanford "would not have been able to receive the continuous influx of new investor funds and maintain the Ponzi scheme", in which case "SIB would have collapsed".

judge held that there was no basis to conclude that TD suspected Stanford of breaching his fiduciary duty to SIB (recklessness). Furthermore, the judge found no basis to conclude that TD had become aware of the need to inquire into whether Stanford was defrauding SIB yet deliberately refrained from doing so. The liquidators for SIB did not appeal this ruling.[41]

Oak Incentives Group Inc. v Toronto Dominion Bank

Oak Incentives Group Inc. (Oak)[42] was a business customer of TD. It was in the business of distributing brand appliances. Oak received an unusually large order for Sony televisions from a new customer. It insisted on payment in full before the delivery of the televisions. Payment was to occur by wire transfer. Oak told TD about the transaction, including that the funds were to arrive by wire transfer and that the funds needed to be secured prior to Oak shipping the televisions. Instead, TD accepted a fraudulent cheque for the amounts owing (and at an out-of-province branch and drawn on the name of a company with a different name from the entity Oak thought it was dealing with). TD then advised Oak that the funds had been successfully deposited. On that basis, Oak caused the televisions to be shipped. Only later did Oak discover that, in fact, no funds had been deposited, and it was instead the victim of fraud. In turn, Oak brought an action in negligence against TD.

Procedural history

The Ontario Superior Court of Justice found that TD was liable for negligence. On appeal, the Court of Appeal affirmed the trial judge's decision with only minor corrections to factual errors made by the trial judge.

Legal reasoning: negligence

In *Oak Incentive v TD*, like in *McDonald v TD*, the key issues were whether TD owed Oak a duty of care, and whether TD fell below the applicable standard of care.

The trial judge readily concluded that TD owed a duty of care to Oak. With only minimal analysis, the trial judge stated concisely:

> "The relationship between the parties was close and it was reasonably contemplated by Oak that carelessness on the Bank's part might cause damage to it. I see nothing that would limit that scope of duty in the circumstances of this case."[43]

Having done so, the trial judge concluded that TD fell below the applicable standard of care. Under the circumstances, which included TD's actual knowledge of the specifics of the transaction in which Oak was intending to engage, TD should have warned Oak that no wire transfer had been made and that a hold should be placed on the cheque received. Had TD acted as a reasonable bank would have in the same circumstances, Oak would have had sufficient time to stop the delivery of the televisions and would not have been defrauded. Notably, the trial judge reached these conclusions in the absence of expert evidence, concluding instead (over TD's objections) that the judge's "common sense" was sufficient in this case.

The Court of Appeal for Ontario accepted the trial judge's reasoning on the issues of the duty and standard of care, and therefore dismissed the appeal. While there were certain factual errors made by the trial judge, the facts nonetheless supported the trial judge's conclusions, including in the absence of expert evidence.

Canada case commentary: legal analysis

It could be argued that *McDonald* and *Oak* reflect Canadian courts injecting subjective knowledge into negligence claims. In *McDonald*, TD did not have actual knowledge of wrongdoing (or, in the judge's words, was not "on notice" of "clear indicia"). In turn, no duty of care was found to be owed and the bank was found not to have fallen below the applicable standard of care. In contrast, in *Oak*, TD's actual knowledge of the specifics of the transaction in question appears to have driven the judge's conclusion that a duty of care was owed and that TD fell below the standard. This actual knowledge-driven approach is contrary to the objective standard of negligence and often has the effect of conflating the elements required to establish liability in negligence and dishonest assistance claims.

As a matter of law, the decision in *McDonald* has important implications for the banking industry in Canada. Claimants in like cases bear a dual burden. They will need to clearly establish that the bank's duty of care sounded in negligence extended to the present matter, and they will also need to demonstrate that the bank's conduct reached the high threshold set for breach of duty.

In *McDonald*, the Court of Appeal clarified that courts look beyond the "mere identity" of the parties to determine whether a relationship is sufficiently proximate to ground negligence liability. In the instant case, the court found that the bank was not negligent on the grounds that the bank did not owe its customer a duty to prevent SIB insider abuse, or to monitor the internal operations of the customer. This position contrasts with English jurisprudence, where the *Quincecare* duty of care automatically imposes a duty of care on a banker in like cases. The Court of Appeal also set a very high bar for conduct that might be indicia of liability. For instance, negative news treatment in a major broadsheet which raised concerns about the perpetrator of the Ponzi scheme was not considered a sufficient "red flag" to ground liability.

[41] *McDonald v The Toronto-Dominion Bank*, 2021 ONSC 3872.
[42] *Oak Incentives Group Inc. v Toronto Dominion Bank*, 2011 ONSC 3245.
[43] *Oak Incentives*, 2011 ONSC 3245 at [80].

By contrast, the Superior Court of Ontario (affirmed by the Court of Appeal) in *Oak* found the bank liable in negligence on the grounds that bank employees had not gone far enough in responding to red flags. These red flags included a major transaction occurring by means of cheque rather than wire transfer, despite agreement to the contrary. This difference in outcome between the *Oak* case and the *McDonald* case speaks to the role that Canadian courts expect banks to play in respect of providing financial services. In *Oak*, the Superior Court clarified that TD could reasonably be expected to ensure that its employees identify the difference in risk profile between a transaction by cheque and a transaction by wire transfer.

Canada case commentary: psychology analysis

The outcomes in both *Oak* and *McDonald* represent juxtaposing case studies in divergences between several important legal principles—principally, standards for the imposition of a duty of care, reasonable expectable decision-making (captured in the concept of the man on the Clapham omnibus), recklessness, negligence and wilful blindness—coupled with the influence of judicial interpretations of those principles solely from a legal perspective and, on the other hand, the psychological underpinnings of those principles.

While *McDonald* is governed by Ontario law, the trial judge's reasoning that banks do not *prima facie* owe a duty of care to customers unless the bank can be shown to have had actual or constructive knowledge of an underlying fraud appears generally consistent with the *Quincecare* duty in English jurisprudence, discussed in the section below (which obligates a bank to refuse a payment instruction if it has reasonable grounds to believe the instruction is fraudulent, particularly when given by an agent of the customer, and is an application of the general duty of care and skill). However, a bank and its customer are in a relationship of sufficient proximity to expect that the bank will take care against visiting foreseeable loss to its customer by its own neglect. Negligence is a conduct-based tort. We all know we are not permitted to drive around town in a car while texting on a smartphone without being held to account for damages for driving the car into a pedestrian causing serious harm. Equally, a banker should not be permitted to act with careless indifference to the harm the bank may do to victims of fraud facilitated by the bank. Negligence is not supposed to be conflated with an intentional tort. That is what happened, however, in *McDonald*.

Recklessness (also referred to as conscious disregard of apparent risk), is commonly understood to be the state of mind where a person deliberately and unjustifiably pursues a course of action while consciously disregarding any risks flowing from such action.

Most statutory definitions of a crime require showing that there was an intention to cause the particular kind of harm done or recklessness as to whether such harm should occur (i.e. the accused has foreseen that the particular kind of harm might be done and yet has gone on to take the risk of it). In England and Wales, this type of recklessness is referred to as "*Cunningham* recklessness".

Criminal law recognises recklessness as one of four main classes of mental state constituting *mens rea* elements to establish liability: (1) Intention: intending the action; foreseeing the result; desiring the result. (2) Knowledge: knowing of the falsity or wrongfulness of one's actions or knowledge of a risk that a prohibited result is likely to occur but proceeding anyway. This also includes wilful blindness in most jurisdictions, and recklessness in some others, where wilful blindness is having a subjective awareness that a risk could exist (but not necessarily full knowledge) but proceeding without adequate further inquiry to become better informed. (3) Recklessness: willingly taking an initial action that a reasonable person would know will likely lead to the *actus reus* being committed. (4) Carelessness (or negligence): failing to exercise due diligence to prevent the *actus reus* that caused the harm from occurring.

Recklessness is less culpable than malice, but more blameworthy than carelessness. The most culpable *mens rea* elements will have both foresight and desire on a subjective basis.

The corresponding and underpinning psychology of negligence and recklessness, also including groupthink, as discussed above in relation to the *TelexFree* case, are no less applicable in *McDonald*. Psychologically, the judicial assertion that, on the facts of the matter summarised above, the bank did not owe a duty of care, could not be deemed negligent or had not breached its duty defies credulity.

The trial judge's reasoning in *McDonald* is a textbook example of the age-old yet ongoing challenge for jurists to ascertain individual actors' and institutional leaders' knowing dishonesty, wilful evasion and reckless disregard as empirically validated psychologically sound principles in tension with but not contradictory to settled law.

This is of particular importance in instances of fraud and other economic wrongdoing involving banks and financial institutions, where facts and evidence may demonstrate unquestioning compliance with unethical institutional practices and cultural norms which, claims of justifiable ignorance notwithstanding, unequivocally facilitate policies and practices which derogate or ignore duties of care and exploit legal and regulatory loopholes.

McDonald exemplifies situations where the law, or a jurist's interpretation of the law, fails to hold wrongdoers accountable (which is often tantamount to permitting wrongdoing) as a result of jurisprudential misunderstandings (or wilful dismissal) of mental states deemed pivotal to a determination or ruling.

Oak might appear on the court's ruling to instantiate a more sophisticated understanding of *mens rea* elements in holding a financial institution liable for facilitating a fraud. However, there are indicators that suggest the

judges' decision-making processes in both *McDonald* and *Oak* were nearly identical and only departed in their determinations.

Juxtaposing the rulings and underlying legal reasoning in both *Oak* and *McDonald*, an inference (reductionistic but no less meaningful) can be drawn that the primary distinction between liability (in *Oak*) and dismissal (in *McDonald*) rests in the ostensible common-sensical obviousness of the tangible facts supporting actual knowledge of institutional negligence (for instance, in *Oak* failing to inform its customer of material differences in the type of transactional instrument) rather than in properly assessing the applicable elements of mind state contributing to the bank's complicity in the fraud. The ruling appears correct and just: TD was held liable for its failure to properly comply with required risk and anti-fraud protocols and thus participated in its customer, *Oak*, being victimised. But if mind state is to be seriously taken into account in determinations of liability, it must then be a part of the actual jurisprudential equation.

England and Wales

Claimants in England and Wales seeking to recover damages from banks that enable or turn a blind eye to Ponzi schemes and other major fraudulent activities typically state the following claims: breach of the *Quincecare* duty of care, dishonest assistance with a breach of fiduciary duty or knowing receipt of trust property.

To state a claim for breach of the *Quincecare* duty of care under English law, the claimant must typically establish the following elements:

- the banker of the claimant (the customer) executed an order;
- in executing this order, the banker had reasonable grounds (although not necessarily proof) for believing that the order was an attempt to misappropriate the funds of the claimant; and
- in breaching the duty not to execute the order in these circumstances, the banker caused loss to the claimant.[44]

To state a claim for dishonest assistance with a breach of fiduciary duty under English law, the claimant must typically establish the following elements:

- there must be a breach of fiduciary duty by the fiduciary;
- the defendant must have assisted in the breach of fiduciary duty; and
- the defendant must have acted dishonestly.[45]

To state a claim for knowing receipt under English law, the claimant must typically establish the following elements:

- a disposal of the claimant's assets in breach of fiduciary duty;
- the beneficial receipt of trust property by the defendant of assets which are traceable as representing the assets of the plaintiff; and
- knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.[46]

The following two cases, *Stanford International Bank* and *Singularis v HSBC*, are informative in identifying the factors that are determinative of liability in claims brought against banks that service fraudsters. In both cases, victims of fraud brought actions for breach of the *Quincecare* duty of care, and for dishonest assistance in breach of fiduciary duty, against banks that provided banking services to the perpetrator of the fraud. In *Stanford International Bank v HSBC*, the English Court of Appeal and UK Supreme Court found that the defendant bank had not breached the *Quincecare* duty of care. In *Singularis*, the High Court, Court of Appeal and Supreme Court found that the defendant bank had breached the *Quincecare* duty of care.

Stanford International Bank Ltd (in liquidation) (Appellant) v HSBC Bank PLC (Respondent)

Stanford International Bank Ltd (in liquidation) (Appellant) v HSBC Bank PLC (Respondent)[47] (*SIB v HSBC*) concerned the Stanford Ponzi scheme, which was a fraudulent investment operation led by Allen Stanford, a Texas financier. This was the same Ponzi scheme which led to the *McDonald v TD Bank* $4.5 billion damages claim in Toronto discussed above. To restate, Stanford promised investors high returns on certificates of deposit (CDs) through his Antigua-based SIB. However, Stanford was unable to generate the promised returns and instead used new investor money to pay off old investors. The scheme is estimated to have defrauded investors of over $4.5 billion.

In April 2009, SIB, the bank that had been used as a vehicle for the fraud, collapsed into insolvency. SIB's liquidators brought two claims before the English courts against HSBC Bank Plc (HSBC). HSBC was SIB's UK-based correspondent bank during the course of the Stanford Ponzi scheme. HSBC had operated bank accounts for SIB and had made payments to certain "early creditors" who withdrew their funds in full before the

[44] *Barclays Bank plc v Quincecare Ltd* [1992] 4 All E.R. 363, 376; [1988] 1 F.T.L.R. 507.
[45] *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] P.N.L.R. 30.
[46] *El Ajou v Dollar Land Holdings plc (No.1)* [1994] 2 All E.R. 685, 700; [1994] B.C.C. 143.
[47] *Stanford International Bank Ltd (in liquidation) (Appellant) v HSBC Bank Plc* [2022] UKSC 34; [2023] P.N.L.R. 10.

accounts were frozen in February 2009, at which point the "late creditors" were at risk of losing all their assets in the accounts.

There are factual parallels with the *McDonald v TD* case in Canada, which concerned the same Ponzi scheme. To restate, in *McDonald v TD*, the SIB liquidators brought an action against TD, which had operated as SIB's correspondent bank in Canada. In *SIB v HSBC*, the same liquidators brought an action against HSBC, which had operated as SIB's correspondent bank in the UK.

The first claim alleged that HSBC negligently failed to detect signs of SIB's Ponzi scheme, thereby breaching its duty of care to its customers (a *Quincecare* claim). The second claim alleged that HSBC dishonestly assisted Mr Stanford's breach of fiduciary duty.

Procedural history

Before the English High Court, HSBC sought to strike out both claims. The High Court struck out the dishonest assistance claim but allowed the *Quincecare* claim to proceed. Both parties appealed to the Court of Appeal, which affirmed the dismissal of the dishonest assistance claim and further struck out the *Quincecare* claim. SIB appealed in respect of the *Quincecare* claim. The Supreme Court of the UK dismissed the appeal and affirmed the dismissal of the *Quincecare* claim.

Legal reasoning: Quincecare duty of care

In England and Wales, to state a claim for breach of the *Quincecare* duty of care, the claimant must typically establish the following elements:

- the banker of the claimant (the customer) executed a payment order;
- in executing this order, the banker had reasonable grounds (although not necessarily proof) for believing that the order was an attempt to misappropriate the funds of the claimant; and
- in breaching the duty not to execute the order in these circumstances, the banker caused loss to the claimant.[48]

In the *SIB* case, at the Court of Appeal, the key legal issue was the issue of loss. Before addressing the issue of loss, the Court of Appeal first determined to whom HSBC owed the *Quincecare* duty of care. The court held that, while HSBC did owe a duty of care to SIB, HSBC did not owe a duty of care to SIB's creditors.

Second, the Court of Appeal addressed the issue of loss. The court held that SIB had not suffered a loss as a result of the payments made by HSBC before the accounts were frozen. Specifically, the Court of Appeal held that, although the HSBC payments to creditors reduced SIB's assets, they also reduced SIB's liabilities. The HSBC payments did not cause net loss on the balance sheet of SIB.

Third, the Court of Appeal identified the significance of distinguishing HSBC's customer (i.e. SIB) from HSBC's customer's creditors (i.e. SIB's remaining creditors who had not benefited from the HSBC payments). The Court of Appeal acknowledged that the HSBC payments did cause loss to some of SIB's creditors. The "early creditors" who withdrew funds prior to the freezing of the accounts escaped loss, while the "late creditors" who did not benefit from the HSBC payments were at risk of losing all their money. However, since HSBC's duty of care extended only to SIB, and not to SIB's creditors, HSBC was not liable for this loss.

On appeal, the Supreme Court affirmed the dismissal of the *Quincecare* claim. SIB's reformulated argument was as follows: as a consequence of HSBC's payments to the "early creditors", SIB lost the chance to discharge debts to "late creditors". The Supreme Court rejected this argument. It found that this "loss of chance" did not constitute actionable loss to SIB. The Supreme Court found that SIB, to whom a duty of care was owed, did not lose any "chance" to pay more money overall to its pool of customers, nor did SIB lose any "chance" to discharge more indebtedness. In other words, for the purposes of the loss inquiry, the relevant question was whether SIB, the customer of the defendant, suffered net loss. It was not relevant that the "late creditors", to whom HSBC did not owe a *Quincecare* duty of care, may have suffered the loss of a "chance" at accessing their assets before they were lost in the underlying Ponzi scheme.

Legal reasoning: dishonest assistance with breach of fiduciary duty

To state a claim for dishonest assistance with breach of fiduciary duty under English law, the claimant must typically establish the following elements:

- there must be a breach of fiduciary duty by the fiduciary;
- the defendant must have assisted in the breach of fiduciary duty; and
- the defendant must have acted dishonestly.[49]

In the *SIB* case, the key legal issue was the dishonesty requirement. The Court of Appeal held that the dishonesty requirement had not been satisfied for three reasons. First, the claim lacked a sufficiently specific perpetrator. SIB was unable to demonstrate that any specific HSBC employee had been dishonest or had suspected fraud and consciously decided not to investigate. Second, negligence does not constitute dishonesty. SIB advanced an argument of gross negligence to support the dishonesty claim. The Court of Appeal stated that gross negligence could not be a basis for a finding of dishonesty. Third, the claim lacked a sufficiently specific suspicion to support a claim

[48] *Quincecare Ltd* [1992] 4 All E.R. 363.
[49] *Twinsectra* [2002] P.N.L.R. 30.

of blind-eye knowledge. While a defendant may be liable for failing to enquire into a specific suspicion, a defendant would not be liable for failing to enquire into a speculative suspicion.

SIB did not appeal in respect of the dishonest assistance claim, so the Supreme Court did not address the dishonest assistance claim.

Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd

Singularis Holdings Ltd (Singularis)[50] was a company incorporated in the Cayman Islands that was set up to manage the personal assets of Mr Al Sanae, who was the sole shareholder of Singularis. Daiwa Capital Markets Europe Ltd (Daiwa) provided a range of financial services to Singularis.

In June and July of 2009, Mr Al Sanae instructed Daiwa to transfer US$204 million in funds out of Singularis' account into entities in Mr Al Sanae's business group. Mr Al Sanae did not provide justification or supporting documentation for the payments. Daiwa was aware that Mr Al Sanae was the sole shareholder of Singularis. Daiwa failed to make inquiries into the purpose of the payments and did not verify the authenticity of the payment instructions.

Singularis then went into liquidation. The liquidators brought the following two claims against Daiwa: breach of the *Quincecare* duty of care, and dishonest assistance in breach of fiduciary duty.

Procedural history

The High Court dismissed the dishonest assistance claim but upheld the *Quincecare* negligence claim. On appeal, the Court of Appeal affirmed the High Court decision and held that Daiwa had breached its *Quincecare* duty of care. On appeal, the Supreme Court affirmed the Court of Appeal decision, finding that Daiwa had breached its *Quincecare* duty of care.

Legal reasoning: Quincecare duty of care

The *Quincecare* duty of care is a legal obligation imposed on bankers to take reasonable care to prevent their customers from making unauthorised payments. The *Quincecare* duty of care requires that "a banker must refrain from executing an order if and for so long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the [customer]". A bank may be liable to the bank's customer where a banker fails to satisfy this obligation, and this failure causes loss to the customer.

In *Singularis*, the High Court focused on the "reasonable grounds for belief" element of the *Quincecare* test. Specifically, the issue was whether Daiwa had reasonable grounds to believe whether Mr Al Sanae's instructions to Daiwa to transfer US$204 million was an attempt to misappropriate funds. The High Court found that there were obvious signs that Mr Al Sanae was making payments for the benefit of himself, rather than for the benefit of *Singularis*. Evidence of Daiwa's awareness of these obvious signs included an internal email from Daiwa that identified "well-publicised" problems with Mr Al Sanae's business group, and that required Daiwa employees to exercise caution in handling Singularis funds. Consequently, the High Court found that Daiwa was liable for breach of the *Quincecare* duty of care.

On appeal, the Court of Appeal affirmed the finding of the High Court. The Court of Appeal further dismissed a range of defences adduced by *Singularis* (e.g. illegality or *ex turpi causa*, causation and contributory negligence).

On appeal, the Supreme Court of the UK affirmed the findings of the lower courts.

Legal reasoning: dishonest assistance in breach of fiduciary duty

To state a claim for dishonest assistance with breach of fiduciary duty under English law, the claimant must typically establish the following elements:

- there must be a breach of fiduciary duty by the fiduciary;
- the defendant must have assisted in the breach of fiduciary duty; and
- the defendant must have acted dishonestly.[51]

In *Singularis*, in the High Court, the key legal issue was the dishonesty element. The High Court found that Daiwa employees had neither behaved deliberately dishonestly, nor turned a blind eye. The employees did not know, and could not be expected to have known, the scope of Daiwa's legal duties in processing the fraudulent transactions. Therefore, the dishonest assistance claim failed.

England and Wales case commentary: legal analysis

The decision in *SIB v HSBC* illustrates the difficulty of bringing civil actions against banks that provide financial services to perpetrators of Ponzi schemes. The *SIB v HSBC* case clarified that, in *Quincecare* cases, if there is no loss, there cannot be a claim. Loss will be determined from the perspective of the bank's customer. Where the defendant is the correspondent bank, and the claimant is the financial institution (in liquidation) that perpetrated the Ponzi scheme, this definition of loss significantly restricts the likelihood of recovery for creditors. In

[50] *Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50; [2020] P.N.L.R. 5.
[51] *Twinsectra* [2002] P.N.L.R. 30.

consequence, a bank on notice of red flags will not be liable for paying out sums to early investors (i.e. investors who withdrew prior to the collapse of a Ponzi scheme) because the bank's customer (the financial institution that perpetrated the Ponzi scheme) did not itself suffer net loss from the payments to early investors. This presents a significant challenge to liquidators seeking to recover for creditors who failed to withdraw funds prior to the collapse of a Ponzi scheme. This legal reasoning leads to an outcome that is similar to the position in the US, where courts typically limit the scope of plaintiffs in Ponzi cases to aggrieved investors.[52]

By contrast, in the *Singularis* case, the court did find a bank liable for breach of its *Quincecare* duty of care. In that case, the smoking gun evidence of the bank being on notice was damning and directly on point. Specifically, an internal email from a senior executive of the defendant bank identified "well-publicised" problems with the fraudster and cautioned the bank employees to exercise caution in handling the fraudster's funds.[53] Evidence of this quality is few and far between. Notwithstanding the outcome in *Singularis*—the first of only two instances in which English courts have found liability for breach of the *Quincecare* duty—the case demonstrates that the threshold for liability in like cases is high.

The other is the recent case of *Hamblin and another v Moorwand Ltd*, which demonstrates a creative method for victims of fraud to recover from payment service providers (PSPs) or banks.[54] The appellants were defrauded of £160,000 by a fraudster who used a stolen identity to pose as a director of RND Global Ltd and open accounts with Moorwand (a PSP) under RND's name. After the appellants had transferred the money, the fraudster instructed Moorwand to pay away the funds. Due to the judgment in *Philipp v Barclays Bank plc*, victims of authorised push payment fraud cannot use the *Quincecare* duty to recover against banks where they had "authorized and instructed the bank" to make a payment.[55]

To manoeuvre around this, the appellants in *Hamblin* applied to bring a derivative claim on behalf of RND, the corporate customer of Moorwand Ltd. The appellants argued that the PSP had breached the *Quincecare* duty. The derivative nature of the claim foreclosed the PSP's ability to argue, as in *SIB v HSBC*, that it owed no duty of care because the victim was a customer of RND, not of the PSP.

The court found that errors in the information provided during account setup and significant inconsistencies between RND's stated business and the actual activity on the account put Moorwand on inquiry as to the authenticity of the payment instructions. The court held that Moorwand had failed to make proper enquires into the fraudster's instructions to pay away the £160,000 defrauded from the victims after being put on inquiry, and ordered that the £160,000 be restored to the Moorwand account held by RND.

England and Wales case commentary: psychology analysis

SIB v HSBC and *Singularis v Daiwa* are both factually and circumstantially complex. A deep analysis of the conflicts between legal and psychological uses and understandings of mental state elements in judicial determinations of civil liability of banks for facilitating fraud is beyond the scope of this article.

In brief, there are parallels between *SIB v HSBC* and *Singularis* and both Canadian cases (*Oak v TD* and *McDonald v TD*) cited here. One obvious superficial connection is the outcomes, one where the financial institution was not held liable (*SIB v HSBC*), and the other with the opposite result (*Singularis*). Another involves rulings that, for all intents and purposes, subordinate elements of mental states connected to breaches of duty of care and dishonest assistance that are crucial to understanding each institution's involvement in the criminal wrongdoing in favour of base transactional facts relating to financial loss and the presence of smoking gun evidence.

As discussed above in the two Canadian matters of *Oak* and *SIB v TD*, at focus here is examining the thresholds for liability in actions against banks that provide financial services to perpetrators of Ponzi schemes, including more sophisticated, accurate and contemporary understanding and applications of the psychology underpinning relevant mental states.

In *SIB v HSBC*, the court erroneously rejected the claim that the *Quincecare* duty of care was breached in part because it focused too narrowly on direct customer losses. The court failed to recognise that widespread institutional failures necessarily involve coordinated human decision-making, which should trigger liability standards such as willful blindness, knowing assistance and gross negligence under the *Quincecare* framework.

In civil law, the intentional tort of deceit typically refers to a false representation made knowingly, or without belief in its truth, or recklessly, with the intention that it be acted upon, causing loss. It is also fundamentally an act occurring in the context of a relationship. It involves dishonesty, deception, betrayals of trust and abuses of power between people and is predicated in ubiquitous human propensities to be hoodwinked and manipulated. In such matters, courts—already charged to weigh and balance complex claims and interests with objective

[52] *In re Bernard L. Madoff Inv Secs.* LLC, 2013 BL 163325, p.3 (2d Cir. 20 June 2013).
[53] Interestingly, in *SIB v TD Bank*, the court was provided with evidence that two bankers had actual knowledge of a 2001 *Philadelphia Inquirer* article which raised suspicions of (i) Robert Allen Stanford and SIB's alleged involvement in money laundering activity in Antigua, (ii) the Antiguan bank regulatory framework as being under the influence of Mr Stanford, and (iii) allegations that Mr Stanford had corrupted local public officials in Antigua. This article, the evidence showed, was not shared by the bankers who obtained it to the AML compliance department of TD Bank. It is difficult to see how a damning new article in the hands of a Daiwa Bank employee in *Singularis* led to a $204 million judgment against Daiwa; while the *Philadelphia Inquirer* article in *SIB v TD Bank* did not move the court to hold the bank to account to SIB, its customer, for the harm done.
[54] *Hamblin v Moorwand Ltd* [2025] EWHC 817 (Ch).
[55] *Philipp v Barclays Bank UK Plc* [2023] UKSC 25; [2023] P.N.L.R. 29.

equanimity—have a heightened responsibility to exercise greater degrees of scrutiny in assessing evidence adduced by both sides to ascertain when not everything is as it appears.

As these cases underscore, the law and psychology intersect most significantly in the figure of the judge. Mikolaj Pietrzyk, a researcher at the University of Silesia in Poland, explains that "… the process of interpreting and applying the law is affected by the natural human need for consistency between what a person knows, believes, and does".[56]

The notion that "justice is blind"—ensconced in the iconograph of *Justicia*, a blindfolded woman carrying a double-edged sword symbolising reason (or truth) and fairness, in one hand, while balancing the scales of a case's competing claims in the other—is meant to convey a court's impartiality and objectivity.

The decisions and interventions of jurists and other professionals in the courts can facilitate or hinder matters. They can also even serve, unwittingly and indirectly, as de facto enablers to fraudsters, money launderers and other corrupt actors.

As Pietrzyk, the Polish researcher, underscores:

> "… in an ideal world … judicial decisions should have a set of characteristics that would simply make them 'good' decisions. … However, we do not live in an ideal world … Laws are created by individuals, who may adhere to different moral values, have different concepts of what is just, and hold various views on the need to meet specific social needs.… One of the crucial cognitive elements influencing a judge's decision is the belief in some content of law. All modern legal systems share the common assumption that courts operate and adjudicate based on laws previously enacted by a democratically legitimized legislature."

Judicial and legislative decisions and policies are the products of individuals' ideologies, philosophies and personal predilections—their own psychologies—not just case law and precedent. Some jurists and policy architects are unabashed activists, will exceed their authority, or are allergic to impartiality. Their decision-making might favour political agendas, socially promulgated morals, or cultural and religious values. Or, these individuals may hold greater allegiance to placating special interest groups and influential business leaders rather than advancing socially just regulatory policy. Jurists, no less than fraud victims, are susceptible to having their judgment corrupted.[57] Judicial decision-making, while idealistically conceived as purely objective and grounded in legislative deference, is often shaped by a jurist's blind-spots, capacities and limitations to self-regulate their personal psychology, emotional needs and moral—or moralistically rationalised—impulses.

Evidence of these blind spots, caused by jurists' own psychologies, can be observed in criminal cases where juries are not allowed access to the opinion of experts, unless they are incapable of deciding on an issue: the issue is never the ultimate issue in the case. The result is the implementation of tests such as "the man on the Clapham omnibus", a classic English formulation of the reasonable person standard. When substituted for detailed expert testimony, tests such as the above can often lead to reductive conclusions, especially in cases involving complex psychological elements such as the level of a banker's awareness of the risk that a customer is using an account at the bank to facilitate a Ponzi scheme.

Conclusion

The mind is central to the law. Societies and courts have long relied on certain mental states as a necessary element of determining actionable conduct. Similarly, in the civil context, courts often examine the defendant's state of mind—such as knowledge of falsity or recklessness—as part of establishing liability for causes of action including fraudulent misrepresentation, dishonest assistance in breach of fiduciary duty and knowing receipt of trust property. While intent to harm is not always required, awareness or deliberate ignorance of unlawful conduct can be sufficient to ground civil liability in equity and tort. *Actus non facit reum nisi mens sit rea* permeates contemporary legal theory and practice.

Courts not only make determinations of fact and law, but also of how an actor's motivation, intent, knowledge of wrongfulness, and awareness of consequences led them to harm, deceive or disadvantage another. In this article, our focus has been how, and to what extent, financial institutions—which is actually to say their employees—can be found to have knowingly participated in or negligently enabled that harm.

While the jurisprudence around mental state elements is fundamentally settled, it is exceedingly complex psychologically. Courts face persistent challenges in uniformly defining terms and meanings relating to mental elements, interpreting applicable standards and determining which elements must meet these standards in particular conduct. Approaches to and understandings of mental states can be confused, vague or inconsistent across jurisdictions.

Our suggestion has not been to undermine or upend jurisprudence essential for determinations of liability because of challenges relating to mental states. Rather, our aim is to, when justified by the evidence, redress inequities and injustice in cases of financial institution misconduct to help victims of fraud by better educating and preparing jurists and aligning and harmonising settled jurisprudence with more sophisticated understandings of the underpinning psychology.

[56] M. Pietrzyk, "In Search of a 'Happy Ending' in Legal Interpretation: Cognitive Dissonance in Judicial Decision-Making" (2025) 38 Int. J. Semiot Law 1619–1638, *https://doi.org/10.1007/s11196-025-10247-2*.
[57] Stein, "Innovations and Strategic Applications in the Psychology of Fraud" in *ICC FraudNet Global Report 2023: Fraud and Asset Recovery in an Unstable World*, p.213.

We say that courts need to be made aware of the assistance which can be provided to them in their task of reaching correct decisions regarding the mind state of a banker who stands accused of knowingly or recklessly facilitating a fraud. The use of opinion evidence from experts in the psychodynamic nature of human conduct can help judges draw more accurate inferences of the mind state of a banker from the available evidence and reach more just results in cases involving financial institutions facilitating financial misconduct. This is of paramount importance because, as Clarence Darrow eloquently said in a now iconic closing argument delivered nearly a century ago,

> "Every human being's life in this world is inevitably mixed with every other life and, no matter what laws we pass, no matter what precautions we take, unless the people we meet are kindly and decent and human and liberty-loving, then there is no liberty. Freedom comes from human beings, rather than from laws and institutions" (*People v Henry Sweet* 1926).

2025 Volume 40 Issue 9
ISSN: 1742-6812

Journal of International Banking Law and Regulation

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