Electronic Funds Transfer: Exploring the Difficulties of Security

Mpakwana Annastacia Mthembu
University of South Africa, South Africa
mthemma@unisa.ac.za

Abstract. Generally the banking laws, regulations and supervision were designed primarily to address the fundamental principle relating to safe and sound business practices by financial institutions. In order to maintain safe and sound business practice it is of outmost importance that customers are protected against losses resulting from inadequate remedies available to them. Banking by its very nature is a high risk business. However, the major risks associated with banking are legal risks, credit interest rates and liquidity. Internet banking has increased some of these risks by creating new ones. Electronic funds transfers are based on technology which by its nature is designed to extend the geographical reach of banks and customers. This kind of a market expansion extend beyond borders, therefore there will be problems which banks will try to avoid like regulation and supervision. Other regulatory and legal risks include, the uncertainty about legal requirements in some countries and jurisdiction ambiguities regarding the responsibilities of different national authorities. Customers and banks may be exposed to legal risks associated with non-compliance with different national laws and regulations including consumer protection laws, record keeping and report requirements. Due to insecurity created by electronic funds transfer, it of importance to analyse measures under South African Law and whether these measures can effectively prevent insecurity and what lessons can be learned from abroad.

1 Introduction

South Africa relies to a large extent on common-law principles of the law of contract to solve the many potential legal problems posed by electronic funds transfers the primary sources of law relating to payment by electronic funds transfers are the law of mandate and the law of contract. There is no legislation in South Africa dealing directly and exclusively with electronic funds transfers. Although the Electronic Communications and Transactions Act 25 of 2002 ('ECTA') provides a wide and general framework for the facilitation and regulation of electronic communications and transactions, including electronic transactions for financial services, especially S42 it does not deal exclusively with electronic banking services. The Regulation of Interception of Communications and Provisions of Communication Regulated Information Act 70 of 2002 is another example of a statute that may be relevant to electronic banking which provides a wide and general framework for the facilitation and regulation of electronic communications and transactions, including electronic transactions for financial services, however, it does not deal exclusively with electronic banking services. (Schulze 2004)

1.1 Electronic Funds Transfers

It is a custom that banking laws are designed mainly to address fundamental principles relating to safe and sound business practices by financial institutions (Van Jaarsveld, 2000). South Africa is regarded as one of the countries with most advanced banking systems. For years there has been a steady increase in the number of electronic funds transfers, utilisation thereof and it has become the most popular method of payment in South Africa (Schulze, 2007). Electronic funds transfers are defined as an instruction by a client to his bank to transfer funds from the client's account to a beneficiary's bank account. Fein (2000) opines that there are three main forces underlying the revolution of electronic funds transfers, namely changes in information technology, changes in communications technology and globalization. Electronic funds transfers are effected through the banking system by electronic techniques which promise financial benefits for banks and potential inconveniences for customers (Schulze, 2004).

Electronic funds transfers are recognised and accepted globally. Meiring (1996) states that electronic funds transfer are based on technology which by its nature is designed to extend the geographical reach of banks and customers. This kind of a market expansion extend beyond borders, therefore there will be danger which banks will try to avoid like regulation and supervision. Other regulatory and legal risks include, the uncertainty about legal requirements in some countries and jurisdiction ambiguities regarding the responsibilities of different national authorities. Customer and banks may be exposed to legal risks associated with non-compliance with

different national laws and regulations including consumer protection laws, record keeping and report requirements.

Due to insecurity created by electronic funds transfer, it is of importance to analyse measures under South African Law and whether these measures can effectively prevent insecurity, infringement of the right to privacy and what lessons can be learned from abroad. There are few reported court decisions dealing with electronic funds transfers, however, these decisions evade clarifying the issue of security and jurisdiction. The aim of this article is to briefly examine and explain the issues of electronic funds transfers, security and privacy of transactions pertaining to internet payments.

2. Internet Banking

Electronic banking has been around and accepted by customer in the form of ATM's and telephonic transactions; however, internet banking has transformed electronic banking and serves as a remote delivery channel. According to Mann (2003), internet has introduced significant changes in commercial interaction. Internet banking is primarily regarded as a business priority and a strategic necessity by most financial institutions. Internet banking removes traditional geographical barriers and reaches out to customers in different countries. Internet banking is a system enabling customer to access accounts and general information on banks products and services through their personal computers by connecting to the banks website. Internet banking as a global phenomenon, it is the driving force which shaped the banking industry. Maturation of internet has brought about changes to the method of payment. It allows customers to access banking 24 hours and empowers them to choose when and where they conduct their banking while saving money and time (Mann, 2003). Internet banking is advantageous because there is no intermediary in its framework, the transaction on the account is directly taken to the bank.

3. Security in Internet Payments

Security means the protection of the integrity of Electronic Funds Transfers systems and their information from illegal or unauthorized access and use. The security of Electronic Funds Transfer systems is of important public concern and potentially a major policy issue because of the increase of its use, in comparison with other payment systems. Electronic Funds Transfers appear to have some additional vulnerability for customer. Security requirements, from a user's point of view, fall into three categories relating to the privacy of the consumer, the trustworthiness of the retailer, and the safety of the payment itself. Customer want a payment mechanism which is safe, to be able to make and receive a payment and get assured that no-one can divert such payment or impersonate them in order to steal their funds (Peter Buck, 1997).

3.1 Privacy of the consumer

South Africa does not have comprehensive data protection legislation. Malan and Van Jaarsveld (2000), state that secrecy is important for the proper conduct of banking business because the consumer discloses certain personal and financial information to the bank. The bank is therefore forced to keep this personal and financial information of the consumer confidential. The duty of secrecy is enforced by contractual and delictual remedies. The Constitution of the Republic of South Africa Act of 1996 provides that every person has a right to privacy.

Privacy rights protecting information generally limit the ability of people to gain, publish, disclose or use information about others without their consent. Section 11 of the Protection of Personal Information Bill B9-2009 provides that personal information must be collected directly from the data subject except the information is contained in a public record or has deliberately made public or the data subject has consented to the collection of the information from another source and such collection will not prejudice a legitimate interest of the data subject.

However, internet banking undermines this fundamental right which the Constitution is trying to protect as well as the provisions of the Protection of Personal Information Bill. The bank is entitled to release confidential information about customer without their express consent to other companies within their own group.

3.1.1 The Banks Duty of Confidentiality

In examining the scope of the duty is not any special law of bank confidentiality but the general principles governing the general principles of breach of confidence. A duty of confidence comes into being when

confidential information comes to the knowledge of a person (banker) in circumstances where he has notice, or is held to have agreed, that the information is confidential. The courts in *Aschkenasy* case and *Tai Cotton Mill* case ((1934) 51 TLR 34) have held that the relationship of the banker-customer is of a contractual nature. This contract is essentially implied, rather than explicit (*Tai Cotton Mill Ltd v Liu Chong Hing Bank* [1986] AC 80) . When emphasising the contractual nature of the banker-customer relationship the Wickrema (1994), concurs with the decision of the Privy Council which stated that:

> "There is no doubt that the relationship between banker-customer is contractual and its incidents, in the absence of express agreement, are such as must be implied into the contract because they can be seen to be obviously necessary."

Alquash (1995) opines that the duty of confidentiality includes the non-disclosure of information which was acquired by the bank from its customers, directly or indirectly. Any information acquired by the bank in connection with, the relationship the bank has with the customer will be confidential, unless, such information is regarded as public information. Any information about the customers supplied by a third person, other than in a course of banker-customer relationship falls outside the scope of the duty of confidentiality. The duty of confidentiality is based on the implied term in the contract between the bank and the customer.

The Cape Provincial Division in Abrahams case (1914 CPD 452) recognised the duty of secrecy when Searle J stated that:

> 'the …rule is that a banker will be liable for any actual damage sustained by his customer in consequence of an unreasonable disclosure to a third party of the state of his account. This seems certainly as far as one is warranted in saying that the English Law goes; indeed, doubt has been cast by some judges on the principle, and it has been stated that the obligation not to disclose is a moral rather than a legal one. I incline to the view that the rule which would now be adopted according to authorities, in the English courts, is that a banker would be held liable if he, without sufficient reason, disclosed the state of a customer's account to a third party and damage resulted.'

It is however, clear from this decision that liability is based on the breach of contract, not on the wounded feelings or insult of the customer. Willis opines that the principles of equity require that the disclosure of information should be done only with the knowledge and consent of the customer. Equity does have a role in protecting confidences in disclosure situations independently of contract. Equity also provides assistance through its remedy of the injunction to underpin any contractual duty. Cranston (1997) states that Posner, is concerned that confidentiality (or privacy) is not always economically efficient. There are arguments in favour of imposing the duty of confidentiality on banks, namely, the commercially sensitive nature of business information and the value of the individual in protecting personal autonomy. If there are public interests in the law obliging banks to keep customers' financial information confidential, so too are there public interests on the other side of the equation.

The landmark decision of *Tournier v National Provincial and Union Bank of England* (1924)1 KB 461 established the common law duty of confidentiality. It was held that the disclosure by the bank constituted a breach of the bank's duty to the plaintiff. Disclosure of confidential information is prohibited, provided such disclosure falls within the scope of one of the recognised exceptions. His Lordship in Tournier's case classified the qualifications as:

a) where disclosure is under compulsion by law;
b) where there is a duty to the public to disclose;
c) where the interest of the bank require disclosure; and
d) where the disclosure is made by express or implied consent of the customer. (see also Lipkin Gorman v Karpnale Ltd [1989] 1 WLR 1340)

When dealing with the issue whether the bank can cede its rights to a third party, the court in *GS George Consultants and Investments v Datasys* 1988 (3) SA 726 (W) erred by concluding that a banker cannot cede or pledge its personal rights against its customer. The court held that "in the absence of agreement to the contrary, the contract of a banker and customer obliges the banker to guard information relating to his customer's business with the banker as confidential, subject to various exceptions, none of which is presently relevant; that such duty of secrecy imports the element of *delectus personae* into the contract; and that the banker's claims against his customers are accordingly not cedable without the consent of the customer."

The Appellate Division in *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) when interpreting the notion of *delectus personae*, stated that a cession by the banker of his claim does not involve a *delectus personae*. The court stressed correctly that the fact that performance to the cessionary does not amount to something essentially

different form the performance of a cedent. It was accordingly held that a cession can be effected without the disclosure of confidential information. Scott opines that a banker may freely cede his personal rights against his customers, provided there is no disclosure of confidential information regarding his relationship with the customer and where the banker does not disclose information such as the name of the customer, therefore such a disclosure will have to be treated as falling under the third exception, which allows disclosure where the interests of the banker require it.

In addressing the banker's duty of confidentiality the court held that the decision of GS George holds no water in that there was no circumstance relieving the bank of its duty of secrecy. Referring to the exceptions established in *Tournier's* case ((1924)1 KB 461) where the interests of the banker require disclosure, the court held that, as the bank wished to dispose of its claim, it had an interest to disclose of its claim. It had an interest to disclose the existence of such a claim to the proposed cessionary. Thus there seems to be no ground for prohibiting a banker from ceding his personal rights against his customers. The object of the cession can be described without revealing any confidential information regarding the exact relationship between the banker and the customer (see also Lipkin Gorman v Karpnale Ltd [1989] 1 WLR 1340).

In *Densam (Pty) Ltd v Cywilnat (Pty) Ltd* 1991 (1) SA 100 (AD) it was held that the right of action may be ceded freely, there was no principle of law by which the appellant could preclude the respondent from enforcing the claim in its own name. In *First National Bank of South Africa Ltd v Budree* (1996 (1) SA 971 (NPD)) the facts briefly are that the Plaintiff instituted an action against the respondent for the payment of various sums of money lent to the respondent. The court held that the only damages which could properly be awarded for breach of contract or an *actio ex lege Aquilia* for the negligent breach of a duty of care by wrongfully dishonouring a cheque were damages in the sense of patrimonial loss (damnum) and dignity, or reputation.

Section 24 (3) of the Drugs Trafficking Offences Act provides that the disclosure of information shall not be taken as a breach of any restriction upon the disclosure of information imposed by the contract. Walton opines that where such disclosure is due to the duty to the public, the bankers tend to rely on the exception that such a disclosure is required under compulsion of law as expounded in *Tournier's* case. Certain legislation require the disclosure of in information which besides the legislation the Banker will be breaching the contract.

Section 10A (2) of the South African Reserve Bank Act, empowers the Governor of the Reserve Bank to determine from time to time a percentage of a total amount of a bank's holdings of Reserve and subsidiary coin that may be taken into account in calculating the minimum reserve balance that the bank is required to maintain in an account with the Reserve Bank. The Home Loan and Mortgage Disclosure Act requires the financial institutions in their financial statements to disclose the total number and rand value of home loan applications received, declined and approved in respect of categories of borrowers and geographical areas. Section 4 of the said Act requires that such a disclosure should be done to the office of disclosure. The disclosure office has duty to analyse and interpret the required information and making available to the public information that indicates whether or not financial institutions are serving the housing credit needs of their communities. The imposition of the disclosure obligation on the financial institutions imposes a hidden tax on these institutions and draws a rational distinction between the Housing Finance institutions and other institutions that could possibly be challenged as a violation of equality in terms of section 9 of the Constitution.

3.1.2 Safety of the Payment

Internet banking crime is often difficult to detect because funds/data can be removed or manipulated by instructions hidden in complex computer software; the dynamics of the criminal action may be understood by only a few experts within the institution. Internet banking crime offers a sporting element, or intellectual challenge, that perhaps is as enticing to some as the opportunity for financial gain. Internet banking systems reduce the effectiveness of or eliminate altogether some of the traditional methods of controlling and auditing access to financial accounts. The level of internet banking security violations is difficult to assess at present because there is underreporting of internet banking crime, a lack of information about internet banking security, and a lack of informed public discussion, which the public is entitled to know what risks they are exposed to in using internet banking services. The law enforcement agents and financial institutions would benefit by sharing information about vulnerabilities, defence strategies, and security-enhancing technologies.

4. Conclusion

Better information about internet banking privacy and security would allow the legislature to assess more effectively the possible need for new legislation and/or regulations. Existing legislation is not adequate and appropriate for prosecuting Electronic Funds Transfers (internet payments) crimes. High degree of security and privacy is of utmost importance to the future regulation, protection and use of internet banking because of the challenges it poses on the payment system. The failure to gain and maintain the confidence users could ultimately undermine the stability of banking institutions that have already heavily committed themselves to Electronic Funds Transfer systems and practices. There is an urgent need for the establishment of the Computer Security Response Team which must protect and secure information.

References

1. Fayyad Alquash "Banks Duty of Confidentiality in the wake of Computerised Banking 1995 JIBL 50.
2. Fein, M. L. (2000). Law of Electronic Banking.
3. Mann, R. J. (2003). Regulating Internet Payments Inermediaries. 376-386.
4. Meiring, I. (1996). "The South African Payment System". South African Mercantile Law Journal , 164.
5. Nigels Willis "Banking in South African Law" 1st ed (19181) p 40.
6. Ross Cranston "the Principles Banking Law" 1st ed 1997 p181.
7. Schulze, W. (2004). "E-Money and Electronic Transfer: A short list of some of the unresolved issues". South African Mercantile Law Journal vol 16 , 50.
8. Schulze, W. (2004). Countermanding an Electronic Funds Transfer:The Supreme Court of Appeal takes a Second Bite at the Cherry. South African Mercantile Law Journal , 667-684.
9. Schulze, W. (2007). Electronic Fund Transfers and the Bank's Right to reverse a credit transfer: One small step for banking law, One huge leap for banks. SA Merc Law Journal , 19, 379-387.
10. Scott Susan 'Can a Banker cede his claims against his customers?' 1989 SA Merc LJ 248
11. Van Jaarsveld, I. (2000). "Domestic and International Bank Supervision and Regulation-Defying the Challenges". South African Law Journal, vol 119 (Part1) , 19, 71.
12. Walton Carolyn 'The Drugs Trafficking Offences Act 1986: The Thin End of the Wegde for Bank Secrecy?' 1988 JIBL 5.
13. Wickerema Weerasooria & Nerida Wallace "Banker-Customer Resolving Banking Disputes" 1st ed (1994) p89.

Case Law

Abrahams v Burns 1914 CPD 452.
Aschkenasy v Midland Bank Ltd (1934) 51 TLR 34
Cywilnat (Pty) Ltd v Densam (Pty) Ltd 1989 (3) SA 59 (W).
Densam (Pty) Ltd v Cywilnat (Pty) Ltd 1991 (1) SA 100 (AD).
First National Bank of South Africa Ltd v Budree 1996 (1) SA 971 (NPD).
Lipkin Gorman v Karpnale Ltd [1989] 1 WLR 1340
Sunderland v Barclays Bank Ltd (1938) 5 LDAB 163
Tai Cotton Mill Ltd v Liu Chong Hing Bank [1986] AC80
Tournier v National Provincial and Union Bank of England (1924)1 KB 461

Legislation

Drugs Trafficking Offences Act 140 of 1992
Home Loan and Mortgage Disclosure Act 63 of 2000.
Protection of Personal Information Bill B9-2009
South African Reserve Bank Act 90 of 1989
Taxes Management Act of 1970, Finance Act of 2985 and Theft Act of 1968.
The Constitution of the Republic of South Africa Act of 1996.