



# The Banking Ombudsman



## Case Note Compendium 2001-2002



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# INTRODUCTION

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In looking back over the ten years of the Banking Ombudsman scheme, much has changed in the type of complaint made to the Banking Ombudsman, but much remains the same. Some of the cases recorded in this compendium could equally well have arisen in 1992 but others involve changes in systems and technology that could hardly have been contemplated ten years ago.

In making a selection from the 399 dispute investigations completed during the year ended 30 June 2002, I have borne in mind the new and the old, focussing on types of complaints that may become more common in the future as well as those continuing a well established trend from the past. Other cases are included because they illustrate the workings of the complaint handling process or simply because they indicate the diversity of complaints brought to my office.

Among the newer types of complaint are those found in the section on investments which reflects the increase in this type of complaint, on which I have commented in my annual report. The new approach to “mortgage underfunding” cases is illustrated in the section on lending and debt recovery. On the other hand, the section on account operation records some cases of a familiar kind as well as some that relate to options that have only recently become available to bank customers.

Both the annual report and the casenote compendium for the year ended 30 June 2002 were written before the New Zealand Bankers' Association had completed its review of the Code of Banking Practice. The Banking Ombudsman is not, in any event, bound by previous decisions but there may be need for extra caution this year in considering the approaches I have developed to common types of complaint if these approaches may need to be adjusted to accord with changes in the Code.

# 1 - Surveys of Banking Practice

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Once again, it has not been necessary to carry out many surveys of the banking industry in order to establish the principles of good banking practice. One survey carried out, however, was quite extensive and covered a range of issues raised by different complaints to do with credit card chargebacks. The other two surveys, to do with the application of the proceeds of an insurance policy on the death of a borrower, and with non-transferable cheques, were much more specific.

## **Chargeback Process**

This survey was conducted in the light of complaints that a bank had refused to charge back credit card transactions where goods or services had (in the customer's opinion) either not been supplied or not being supplied as described. It also related to complaints by merchant customers of banks that transactions had been charged back in circumstances where the merchant considered they should not have been.

The chargeback process is a complex one conducted through the international credit card organisation under whose auspices the relevant card has been issued. Generally speaking, a cardholder's entitlement to reimbursement from the bank in respect of a disputed transaction will depend on the terms of his or her contract with the bank. These will, at least to a certain extent, reflect the bank's own rights and obligations under its contract with the international organisation but occasionally circumstances arise which are not specifically covered in the bank's contract with its customer. If a bank is able to charge back the transaction in such circumstances it will normally do so and reimburse its customer.

The questions asked of banks and a summary of their responses are set out below:

1. Question: What is the bank's policy for chargeback transactions where the customer has advised that the goods or services have not been supplied?

Answer: The customer must supply signed written notification that the goods or services have not been received. In some circumstances evidence is required of an attempt by the customer to resolve the matter with the merchant or the merchant's liquidators. Evidence of liquidation may also be required.

Certain time limits apply. There is a waiting period before the chargeback can be processed and the chargeback must be processed within a certain time frame.

There is no distinction between mail, phone or internet orders and transactions where the customer and card are present.

2. Question: What is the bank's policy where the customer advises that goods or services have not been supplied "as described"?

Answer: The customer is required to produce the transaction receipt, other documentation or any other written description of the goods or services as supplied by the merchant. In some circumstances where the order was placed by telephone and there was only a verbal description of the goods or services, a customer's letter outlining the differences will suffice. In other cases, in addition to the written description of the goods or services, the customer must supply a letter stating how the product or service was not as described and may also need to produce evidence that the goods were returned or the services cancelled.

Timeframes as above apply.

3. Question: Where the customer has advised the goods or services have not been supplied, to what extent does the bank make enquiries to verify the customer's statement?

Answer: Banks in general accept the customer's statement. However the merchant may refuse to accept the chargeback and will be expected

to provide documentation in support of the refusal.

4. Question: What is the bank's policy in respect to chargeback of the following:

(a) Payment for supply of tickets or vouchers, where there is a subsequent failure by a third party to perform, for example, where the cardholder has purchased tickets from an agent for a theatrical or musical event that fails to take place because of the failure of the promoter of the event?

(b) Request by customer to charge back a transaction where the card payment has been used to pay a deposit to secure the right for future provision of goods and services ie. where a further payment is required to secure the goods and services and the customer has become aware that such supply is either unlikely or the goods will not be supplied or will not meet the description?

Answer:

(a) A chargeback will be processed as above for goods not received or services not rendered.

(b) Chargebacks can be processed for goods or services not received as above. In some circumstances there is a limitation which means that the deposit cannot be charged back if the balance of the payment is neither authorised nor paid by alternate means.

#### ***Use of insurance proceeds***

This survey was carried out as a result of the issues raised by case 52 to be found on page 50 of this compendium. This was a case where tenants in common (in unequal shares) had borrowed from the bank and had provided life policies as security for the borrowing. On the death of one tenant in common, the other complained that the bank had paid the proceeds of the life policy to the estate of the deceased tenant rather than using them to reduce the outstanding loan.

The survey was somewhat inconclusive and only four banks responded. Two banks clearly agreed with the bank against which the complaint was made and were of the view that particularly where

the loan had been refinanced in full into the name of the survivor, there was no obligation to use the policy proceeds to reduce the borrowing.

The remaining two banks were of the view that they would discuss matters with the remaining borrower before making any decision and would ascertain whether she could meet the normal servicing criteria in respect of the outstanding loan balance.

#### ***Collecting "not transferable" cheques into trust accounts***

This survey was carried out as part of the investigation of the complaint which is noted in this compendium as case 28.

In that case a bank had collected into a sub-account to an accountant's trust account cheques made out to the accountant's clients and crossed "not transferable". The sub-account had been opened in the name of the clients but without their knowledge or consent.

I decided that I should conduct an industry survey to ascertain how other banks deal with cheques crossed "not transferable" and which are presented for collection into trust accounts. The results of the survey were that:

- two banks would in no circumstances accept a "non-transferable" cheque payable to the client of an accountant (or other professional) into a trust account or a sub-account in the name of the client.
- three banks would accept such a cheque into a sub-account in the name of the client under certain conditions, but two of the three would only do so if the bank was provided with an indemnity by the professional.
- one bank would only accept such a cheque if an indemnity was provided to the bank indemnifying the bank against any claim that may arise from accepting the cheque.

While the outcome of the survey was interesting it was of little assistance in determining the issues raised by the complaint.

## 2 - Lending and Debt Recovery

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The first three cases in this section have to do with lending against the security of a family home when there are difficulties in the relationship between members of the family.

Case 1 is a straightforward illustration of a common problem. It highlights the importance that lawyers who advise parties to a matrimonial or relationship property agreement should make it clear to their clients that such an agreement has no effect on their responsibilities to their bank. The agreement can only bind the parties to it.

Case 2 arose out of similar circumstances to case 1, but in this case the bank failed to be as careful as it should have been in maintaining the account records. Accordingly it had to take some responsibility for the difficulties that then arose.

A parent/child rather than a spousal relationship was the background to case 3. It is not unusual for parents effectively or actually to guarantee their children's borrowings. In this case the bank was meticulous in observing its obligations in setting up the initial loan but failed to make appropriate checks and take appropriate steps when it received an application for further borrowing.

In the past, where a bank error has caused customers to make insufficient repayments on their home loans, I had usually assessed the loss to the customer taking into account both the notional benefit received by the customer through making payments at a lower rate than required in the past together with the notional cost of making future repayments at a higher rate in order to repay the loan within the original term. The calculation was complex and difficult to explain to complainants (and sometimes even to banks). Accordingly I have concluded that a fairer starting point for the consideration of these cases is the customer's expectation that they be returned to the position they expected to be in, had all gone according to plan. Case 4 is an illustration of the new approach.

Fixed rate home loans continue to be a popular choice with bank customers seeking some certainty in their financial affairs. They are less suitable for those requiring some flexibility and cases 5 and 6 illustrate some difficulties in this respect.

Case 7 was one of the worst cases of multiple and serious errors that I have encountered. It is hardly surprising that the complainants developed a very strong sense of grievance. Unfortunately it also led to a claim for more substantial compensation than I was able to award.

The remaining cases in this section have to do with general lending and with debt recovery. Cases 8 and 9 involve problems arising after the death of the customer who had borrowed funds from the bank.

Failures in communication underlie a great many of the problems that come to my attention. Cases 10 and 11 are good illustrations of this in the context of debt recovery. In both cases good communication practices would have prevented the problem from arising in the first place and clear communication at a later stage would have prevented the problem from becoming as acute as it eventually did.

Case 12 also involved a communication failure, but also some contributory fault on the part of the customer.

Business lending does not in general result in a great many complaints to my office. Case 13, however, is a reminder that business customers, as well as personal customers, cannot always be expected to be familiar with the full range of products and services provided by a bank. A bank has as much of a duty to provide appropriate and accurate advice to its business customers as it does to its personal customers.

## **Case 1 – Matrimonial property agreements - not binding on a bank**

Mrs H was jointly liable for payments of a housing loan she had with her ex husband. The couple signed a matrimonial property agreement which specified, amongst other things, that the former husband would move into the property and would be responsible for making all loan payments whilst in occupation.

Mr H did not make the loan repayments and the bank sought recovery of the accumulated loan arrears and outstanding rates payments from Mrs H. Mrs H asked the bank to give effect to the terms of the matrimonial property agreement and to seek payment of the outstanding sum from her former husband.

The bank correctly argued that it was not bound to give effect to the matrimonial property agreement as it was not a party to the agreement, and that both Mrs H and her former husband were jointly liable for the debt in accordance with the loan contract.

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## **Case 2 – More problems over joint borrowing**

In this case, Ms D and her former husband had a loan from their bank secured by a first mortgage over the matrimonial property. When the couple separated, Ms D left the matrimonial home on the understanding that her former husband would be responsible for the payment of the outgoings on the home, including the loan repayments. She sought legal advice and said she was told that repayment of the housing loan was the responsibility of the spouse in occupation of the matrimonial home.

Ms D notified the bank of her change of address. She held three accounts with the bank in her own name and thereafter she received statements from the bank relating to these accounts. However, she did not receive any statements relating to the housing loan and it seems the bank failed to record her new address against this account. She asked the bank if her name could be removed from that loan, but was advised this could only be done if her former husband refinanced the mortgage in his own name. She discussed this with him, but he made no arrangements to refinance.

Almost three years later, Ms D discovered that the loan was in arrears. She immediately contacted the bank to discover that the account had been passed to the bank's debt recovery department. She then arranged with her former husband to sell the property, but on settlement there was a shortfall which the bank sought to recover from her.

Ms D considered as the bank had failed to notify her, as the party jointly responsible for the loan, that it was in arrears, she should not be held liable for the shortfall following the sale of the property. She argued that had she been advised of the situation earlier, she could have taken action to avoid or minimise the amount outstanding on the loan account.

It was clear that Ms D had notified the bank of her change of address. She could reasonably have expected that her new address would have been recorded on the loan account and that she would have been notified of any problems with the loan. The bank acknowledged that it had failed to communicate with her. Such a failure is in breach of clause 1.7.2 of the Code of Banking Practice which obliges the bank to provide its customers with timely and adequate information about their accounts. While I did not consider that the loan arrears were caused by the bank's failure to contact Ms D when the loan first went into arrears, its omission meant that she did not have the opportunity at that stage to explore what options might have been open to her. She was therefore disadvantaged by the bank's failure to contact her.

Although the bank should have written to Ms D whenever it wrote to her former husband about the joint loan account, it was clear that she also had a responsibility, as joint mortgagor, to ensure that repayments were

being made. Although she believed her former husband was responsible for the repayments, she was aware that her name remained on the account, but she made no inquiries of the bank about it.

In the circumstances, I recommended that the bank pay Ms D \$1000 in recognition of the loss of opportunity she experienced as a result of its failure to keep her informed about the loan account. The complaint was settled on this basis.

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### **Case 3 – The need for caution in making further advances**

Mrs A owned her home. Her bank had loaned her the funds to buy it and the loan was secured by a mortgage over the property. In 1996 there was only a small amount outstanding to her bank.

Mrs A's son wanted to borrow money from his bank. He did not have any assets of his own and so Mrs A offered to provide security to her son's bank in the form of a first registered mortgage over her property.

The bank loaned the funds to Mrs A's son (the first loan). Some of the funds were used to repay Mrs A's loan to her own bank. The rest was paid to Mrs A's son. Mrs A's son was the borrower; Mrs A was the guarantor.

The bank ensured that Mrs A obtained independent legal advice about providing her property as security. The bank also made sure that the Mrs A was fully aware that should her son default on repayment of the loan, she would lose the property as she could not afford to take over loan repayments.

Two years later, Mrs A's son applied for further funds from the bank. The funds were advanced to Mrs A's son (the second loan). The bank did not contact Mrs A as the bank officer who processed the application did not realise that Mrs A's son was not the owner of the security property.

Six months later, Mrs A and her daughter applied for a small loan from the bank (the third loan). At this time, the bank discovered that Mrs A had not signed the second loan agreement as guarantor. As a condition of granting the loan to Mrs A and her daughter, the bank required Mrs A to sign the second loan agreement as guarantor. Mrs A signed the second loan as guarantor.

Mrs A was uncomfortable about the second advance to her son when she found out about it, but felt unable to protest in case her own application for funds was declined.

Two years later, Mrs A discovered that although she had been making her loan repayments her son had not been making his. The bank began action to sell her home to recover the amounts outstanding on all three loans.

Mrs A complained about the bank's actions in granting a second loan to her son without notification to her and in requiring her to sign the second loan agreement as guarantor without advising her to seek independent legal advice. There was no complaint about the granting of the first and third loans.

I found that in situations where the mortgagor is not the borrower, there may be certain factors present that require banks to take particular care when assessing applications for finance. The factors in this case were:

- (a) the house was in the mortgagor's sole name;
- (b) the mortgagor was to get some but not all of the benefit from the loan; and
- (c) the mortgagor would not be able to meet the payments if the borrower defaulted.

The bank in assessing the first application for finance was conscious of these factors and ensured that Mrs A understood the risks of the transaction and received independent legal advice.

The factors that required the bank to take special care when assessing the first application remained when Mrs A's son approached it for the second advance. Mrs A should have been made aware of the application for further finance, and that it was proposed that it be secured against her property. Mrs A would then have had the opportunity to consider whether she wanted her exposure to the bank to increase. I found the bank acted incorrectly in granting the loan to Mrs A's son without ensuring she agreed to the advance and without advising her to seek independent legal advice. The bank's error arose out of its failure to check the security provided for the second loan.

I found on the balance of probabilities that Mrs A would not have agreed to the advance of the second loan had she been made aware of it. It is always difficult to predict how a person would have acted in the past had all the information been provided to them. In this particular case the evidence showed that Mrs A was unlikely to have agreed to the advance.

I proposed and both parties agreed that the bank release Mrs A from her guarantee obligations in relation to the second loan and pay Mrs A the sum of \$2,000 in recognition of the considerable inconvenience, anxiety and stress she had suffered as a result of the bank's actions.

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#### **Case 4 – An underfunded mortgage case**

As a result of an error on the part of their bank when setting up their home loan, it became apparent to Mr and Mrs G, over a year before the due date for the final repayment, that they would not have repaid the loan by that date. They had organised their affairs on the basis that the loan would be repaid by the due date as they would, by then, have only a single income. They telephoned the bank to discuss the matter, but got no satisfactory explanation. They lived some two and a half hour's drive from the nearest branch of their bank and it was some time before they could arrange a meeting with bank staff. Following the meeting, they received a letter from the bank explaining how the situation had arisen and offering them three options to correct the situation. None of the options was acceptable as they considered that the bank had breached the contract it had with them and should honour the loan agreement and absorb the loan balance still outstanding at the due date.

I came to the view that the bank should place Mr and Mrs G in the position they had expected to be in pursuant to the loan agreement. The bank calculated that the loan was underpaid by approximately \$4000. This figure took account of the fact that Mr and Mrs G had had the use of the funds that would otherwise have been used to repay the loan. It did not take into account any "contributory fault" on their part as the bank had acknowledged that it had made an error in setting up the loan and it seemed to very likely that if Mr and Mrs G had not raised the matter, the error would have gone undetected until the loan was due to end. I was satisfied that they had brought the problem to the attention of the bank as soon as they noticed it.

The bank's error had significantly inconvenienced Mr and Mrs G. They had planned that the loan would have been repaid by the time their first baby was born and they would be living on one income. Instead they were faced with making loan repayments which they were finding it difficult to meet. I considered that a payment of \$1000 as compensation for inconvenience would be appropriate. This sum, together with the \$4000 direct loss would equal the balance of the loan as at the date it was due to be repaid. I invited the bank to consider making an offer to credit Mr and Mrs G's loan account with the amount of the outstanding loan balance as at that date and to refund any loan repayments they had made since that date.

Both the bank and Mr and Mrs G accepted my proposed settlement.

## **Case 5 – Roll-over of a fixed rate loan - the need to check the provisions of the loan agreement and to ascertain the instructions of the customer**

Mr and Mrs W had a three year fixed rate loan with the bank. The fixed rate period was due to expire at the end of December 2000. The loan agreement provided that the interest would then be re-fixed for a further three year period at a rate to be advised by the bank prior to the end of the present fixed rate term.

In mid November 2000 the bank wrote to Mr and Mrs W to remind them that their current three year fixed rate term was due to expire and advising what the new rate would be. The letter went on to state that if the above arrangement did not meet Mr and Mrs W's current needs and they would like to discuss alternative arrangements such as a different fixed rate term or a variable rate for their loan, they should contact the bank so that suitable arrangements could be made.

At this stage Mr and Mrs W contacted the bank to discuss restructuring their loan and the possibility of increasing the amount of the loan by approximately \$10,000. A meeting was held with the bank officer in mid December to discuss the proposal.

A few days later the bank officer called Mr and Mrs W to say that the proposed restructure had been declined by the bank's lending department. Mr and Mrs W were very disappointed. The bank officer suggested that they approach a mortgage broker for assistance.

Shortly before Christmas 2000 Mr and Mrs W arranged to refinance with another institution. A few days after Christmas the bank wrote to Mr and Mrs W to advise that their loan had been fixed for a further three year term from 23 December 2000. Mr and Mrs W continued with their refinancing and repaid their loan to the bank at which time they were charged an early repayment fee of approximately \$1,700.

Mr and Mrs W then complained about the bank's actions in refixing their loan for a further three year period when it knew that they were seeking to refinance elsewhere.

The bank maintained that its officer had had a second meeting with Mr and Mrs W later in December 2000 at which the decline of the loan restructure proposal had been discussed. At the end of this meeting the bank officer said that he reminded Mr and Mrs W that their loan would continue as it was and would roll over for a further three year fixed rate period unless they advised the bank otherwise.

Mr and Mrs W denied that any such meeting had taken place and produced evidence to show that Mrs W could not have attended a meeting on the date alleged by the bank officer. Further, there was independent evidence from the bank with which they had refinanced that it had received an application for finance from Mr and Mrs W and had approved the application prior to the date of the alleged meeting.

I found that there was unlikely to have been second meeting between the bank officer and Mr and Mrs W; the bank officer had not advised Mr and Mrs W that their loan would roll over for a further three year fixed rate term; and it was or should have been clear to the bank that Mr and Mrs W were unhappy that their loan restructure proposal had been declined and that they were looking for finance elsewhere. In those circumstances, the bank should not have automatically refixed Mr and Mrs W's loan for a further three year period. The bank was on notice that Mr and Mrs W were likely to seek alternative finance elsewhere and that a fixed rate loan may not be fit for their particular purpose. The bank should have checked with Mr and Mrs W that they wanted their loan to be fixed for a further three year term before proceeding to refix it. I proposed that the bank should refund the amount of the early repayment fee to Mr and Mrs W.

Both the bank and Mr and Mrs W agreed to settle the complaint on that basis.

## Case 6 – Early repayment or increased repayments?

Mr L said he had explained to the bank officer with whom he had discussed his loan requirements that he wished to repay his fixed rate loan as quickly as possible. He noted that the loan agreement referred to the possibility of a charge being levied in the event of early repayment of the loan and sought details of the formula used by the bank for assessing such a charge. This document clearly stated that the formula only applied where a lump sum payment was made before the expiry of the agreed fixed rate period. Mr L said he discussed this point with the bank officer who advised that the formula did not apply where the monthly repayments were increased and the increased repayments were maintained until the end of the fixed term. The repayment cost would only be charged where a lump sum repayment was made.

Shortly after drawing down the loan, Mr L asked to increase his repayments by approximately 26%. His request was approved. When he later sought to make further increases in his repayments, he was told that the bank's policy was to allow increases in repayments up to a maximum of 20% of the original monthly repayments. Accordingly, in order to achieve his objective of repaying the loan as quickly as possible, he was forced to make lump sum reductions and incurred early repayment costs.

Mr L complained that the terms of his loan agreement allowed him to increase his monthly repayments without cost. He sought a refund of the costs charged and of the interest effectively charged on the costs. He also sought to recover the difference in interest between the loan interest rate and the rate paid on credit balances in his cheque account. He argued that because of the bank's refusal to allow him to increase his repayments by more than 20%, he had been obliged to accumulate lump sums in his cheque account. These funds had only earned minimal interest, whereas had he been able to credit the funds immediately to the outstanding loan balance, he would have been able to achieve much greater savings of interest on his loans. The bank declined his claim.

I came to the view that Mr L had been misled, albeit unwittingly, by the bank officer. Mr L, who had made it clear that he wanted to be able to repay his loans as quickly as possible, had understood from what he had been told that he could increase his monthly repayments to any amount without penalty. He had not been told that the bank's policy was to allow a maximum increase in repayments of 20% of the original amount. Indeed, it appeared that that policy had not been formalised until after he had drawn down his loans. The information he had received from the bank regarding its early repayment formula referred to lump sum payments, not to increased monthly repayments. Accordingly, even though there was no intention to mislead, the bank had probably breached the provisions of the Fair Trading Act 1986. I also formed the opinion that the fixed rate loan terms provided by the bank were not suitable for Mr L's stated intention of repaying his loans as quickly as possible. As a consequence it had breached the guarantee as to fitness for a particular purpose under the Consumer Guarantees Act 1993.

I considered that the bank should refund the early repayment costs paid by Mr L together with the interest that had effectively been charged on them and the difference between the loan interest rate and the rate paid on credit balances in his cheque account while he was accumulating the lump sum payments. The bank accepted my views.

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## Case 7 – A catalogue of errors

This was a classic example of a case where just about everything that could have gone wrong did go wrong. Mr and Mrs J had a number of personal and business loans from their bank. As a result of an error on the part of the bank, an incorrect interest rate was applied to one of the loans. This error was not noticed for eighteen months, despite initial problems with the way the account had been set up by the bank and the fact

that the loan balance was increasing. The bank then credited the account in an attempt to put it in the position it would have been had the error not been made. However, it made an error in calculating the amount that should have been credited to the account, and this was not discovered for another six months.

An error was also made in relation to a business loan when the bank incorrectly loaded the term as a five year term when it should have been an eight year term. The repayments were therefore much higher than they should have been and this directly and adversely affected Mr and Mrs J's cashflow position. In addition to these difficulties they experienced problems receiving loan statements and the overdraft limit on their current account was cancelled incorrectly causing them embarrassment when Mr J tried to use his EFTPOS card.

Mr and Mrs J's accountant wrote to the bank raising a series of complaints about the bank's handling of their accounts. The response did not allay Mr and Mrs J's concerns that the bank's errors had caused them financial losses in a variety of different ways. They said the errors had also caused them considerable stress and inconvenience and they had incurred substantial costs in trying to resolve matters with the bank.

The bank acknowledged that it had made an error in loading the interest rate on the loan account, and that it should have picked up the error earlier. However, it believed it had reimbursed Mr and Mrs J for the direct cost of the error. It did not consider it was responsible for any of the other losses.

Having examined all the relevant papers I was satisfied that the bank had reimbursed Mr and Mrs J for the direct loss caused by the interest loading error, although only after two attempts. As a result of the cashflow problems arising from the incorrect loading of the term on their second loan, together with the increasing principal as a result of the input error on the first loan, they decided they would have to sell their rental property. Their tenant vacated the property in January 2002 and the property sold with settlement at the beginning of April. The bank's errors were not discovered until February 2002. While, therefore, Mr and Mrs J could have withdrawn the property from the market once they knew the bank was going to remedy the errors, they would still have lost some rental income even if they had been able to find a replacement tenant. I therefore considered that the bank should compensate them for five weeks' lost rental income.

While Mr and Mrs J had not incurred any other direct loss as a result of the bank's poor handling of their accounts, they had incurred costs. These included accountants' fees and other expert fees associated with their endeavours to have the bank's calculations checked. Mr and Mrs J estimated they had also spent some 120 hours working on their complaints and as a consequence had lost income running their own business. While compensation for time so spent is normally based on actual and verifiable loss of income only, I was satisfied that in this case they had clearly had to spend time away from the business. I therefore concluded that they were entitled to some compensation for the loss of income they undoubtedly suffered while trying to resolve their complaints. They had also been enormously inconvenienced by the scale and number of errors that the bank had made in the management of their accounts.

In the light of my findings, I proposed that the bank compensate Mrs and Mrs J for the expenses they had incurred, including some of their own costs, as well as for the loss of rental income and the maximum I could award for the serious inconvenience they had suffered. While the bank was prepared to accept my proposed recommendation, Mr and Mrs J were not. They considered they had suffered other financial losses which I had not taken into account. Although they were clearly not in the financial position they expected to be in at the start of this saga, I was unable to identify any further loss that was directly caused by the bank's errors. Accordingly I confirmed my proposed recommendation.

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## **Case 8 – A failure to follow a customer's instructions**

Mr T was concerned that his elderly father was being taken advantage of by a third party and being used as a source of income by that party. He took his father to his local bank branch and requested closure of his

credit card account. At this stage Mr T also paid off a credit card debt of over \$5,000 for his father and the card was destroyed. Mr T advised the branch staff of his concerns about his father and instructed the bank that no further credit cards were to be issued.

When his father died some months later, Mr T discovered that the card he had asked to be cancelled had been reissued three times since the instructions to cancel had been given and had been used extensively. The bank was demanding repayment of approximately \$4,300 from the father's estate, of which Mr T was the executor.

Mr T complained that the bank had ignored his instructions and had given him the impression that he had taken sufficient steps to ensure that his father could not use and would not be reissued with a further credit card. The bank maintained that it would not be possible for Mr T to have complete control over his father's financial matters. Even if the account had been closed by Mr T (and the bank could find no record of a closure), there was nothing to stop Mr T's father going into a branch and making a new credit card application.

My investigations into what Mr T had been told as to the sufficiency of his instructions showed that branch staff did not deny that they had assured him the account was closed and that no more credit cards would be issued to his father.

The estate was wound up and distributed before my investigation concluded. In the circumstances the bank chose not to pursue the debt owed by the estate and wrote it off.

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## **Case 9 – Problems after the death of an undischarged bankrupt**

Mr Y died intestate. At the time of his death he held two accounts with his bank, a current account and a credit card account. A year prior to his death, Mr Y had been adjudged bankrupt. The bank's card services division was the petitioning creditor.

Mr Y had very few assets at the time of his death. One of his daughters, Ms A, was advised by her lawyer that it would not be worthwhile to obtain letters of administration. The Official Assignee disclaimed any interest in Mr Y's possessions, and told Ms A to dispose of them as she thought fit and use the proceeds towards the funeral expenses.

Ms A applied to Mr Y's bank to close the savings account and pay the balance to her. The bank closed the account but applied the credit balance to the credit card debt.

Ms A was advised by the New Zealand Insolvency and Trustee Service that as the sum owed to the bank's card services division related to a pre-bankruptcy debt, the bank was not entitled to use the credit balance in the savings account to offset the credit card debt.

Ms A also received legal advice to the effect that while it is a well-established principle of law that a bank is entitled to combine accounts, a bank can only combine accounts that are in the name of the same individual. At the time of Mr Y's death, the credit card account was in the name of the Official Assignee, but the savings account was in the name of Mr Y.

The bank for its part considered that its entitlement to combine accounts was not affected by the fact that Mr Y was an undischarged bankrupt when he died.

Ms A advised my office that no family member would contest her claim to the credit balance in the savings account. Ms A had arranged and paid for the funeral which cost considerably more than the funds in the savings account.

After considering the matter, the bank arranged for Ms A to sign a declaration for her claim to the credit balance in the savings account as a child of the deceased. She was also asked to declare that no person to her

knowledge intended to apply for probate or letters of administration of the estate of Mr Y, and to provide an indemnity against any claims which may arise in connection with the account and/or the payment of the credit balance to her.

On receipt of the declaration, the bank paid the credit balance of the savings account to Ms A, and I discontinued my investigation.

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## Case 10 – An escalating debt on a closed account

The dispute in this case arose following Ms G's decision to close her bank account in July 2000. There was a small balance in the account, and she expected that there would be some charges to pay. However, she discovered that the amount owing to the bank was considerably more than she had anticipated.

In August she rang the bank's customer service centre and learned that the outstanding amount included two automatic payment dishonour fees. She understood from the customer service officer that the dishonour fees would be reversed, leaving an amount owing of approximately \$33 which she should pay to her local branch. She said the customer service officer also told her that the automatic payments on the account would be stopped and that the account would be closed.

When Ms G went to the bank two or three weeks later to clear the outstanding amount, she found that the account was still open, and that she was still being charged automatic payment dishonour fees as well as other account fees. The amount outstanding on the account had therefore increased. Unable to resolve the matter with the teller, Ms G left the bank and thereafter ignored all correspondence from the bank until the end of November 2000 when she happened to open a letter advising her that her credit rating would be affected if she did not pay \$170 to the bank.

At the beginning of December she tried unsuccessfully to resolve the matter and then invoked the bank's internal complaints procedure. The officer dealing with the complaint conceded that the officer to whom Ms G had spoken in August had failed to cancel the automatic payments so dishonour fees had accrued. She undertook to send Ms G a closing statement excluding those fees. The resulting statement showed a balance owing of approximately \$140. Ms G did not accept this and, after further fruitless discussions, the bank passed the matter to its Collection Department.

In early January 2001, Ms G was advised that her account had been referred to Baynet and at the end of January a credit application she made was declined. It was at this point that the complaint was lodged with my office. In March the bank offered to resolve the complaint by withdrawing the Baynet listing and accepting the \$33 owing in August 2000. Ms G rejected the offer because it did not take account of frustration and stress she had suffered or of the embarrassment at having her credit application declined.

The first issue I had to consider was whether the bank had misled Ms G in August 2000 about the closure of her account and whether her understanding that the account had been closed was reasonable. From the information available to me it seemed unlikely that Ms G had been told that her account had been closed because it could not be closed until the outstanding amount had been paid. Had Ms G called at her local branch immediately following her conversation with the customer service officer in August 2000, the matter would likely have been resolved at that point. However, Ms G understood that there was no urgency about paying the \$33 owing, and had called at the local branch some two or three weeks later during which time further account fees had accrued. Clearly the officer had failed to stop the automatic payments and this resulted in the significantly higher amount owing on the account when Ms G called at her branch. These factors led to the chain of events which culminated in the complaint to my office.

From her dealings with the bank when she called to pay the amount owing, Ms G must have been aware that the account was still open and that fees would continue to accrue until such time as the account was closed. Her decision to ignore correspondence from the bank was therefore unreasonable. In the absence of any communication from her, the bank's action in sending the letter of November 2000 was understandable. However, it was clear that from early December the account balance was the subject of a dispute and that Ms G had invoked the bank's complaint procedure. The bank's decision to list the debt with Baynet in early January was, therefore, premature. It should have allowed the matter to proceed through its complaint process and, if necessary, be referred to my office.

Having regard to the correspondence Ms G had received from the bank in December 2000, she was aware that the bank was referring her account to Baynet. Accordingly, she should not have been surprised her credit application was declined. While it was undoubtedly embarrassing for her, the situation was to some degree of her own making.

In the circumstances, I proposed to recommend that the dispute be settled by the bank paying Ms G compensation in the sum of \$300 for the inconvenience she experienced as a result of its failure to cancel the automatic payments in August. That amount was to be reduced by the amount that would have been owing on her account on 4 December 2000 (being the date on which she contacted the bank to try to resolve the problem) had the bank cancelled the automatic payments on 16 August. I did not consider that an apology was called for but I did suggest that the bank consider removing the Baynet listing. The complaint was settled on this basis.

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### **Case 11 – Poor communication and continued confusion**

In July 2001 Ms V called at her local branch of the bank to arrange to close her cheque account, change her address details and set up an automatic payment to repay the student loan she had earlier taken out with the bank from her new bank account with another bank. She was advised she could not close her cheque account and would have to arrange to make payments into that account from which the loan repayments would be made. She did not consider the bank's requirements were reasonable, and as the bank was not prepared to change its requirements, she decided that the bank could continue to make the loan repayments using the \$3000 overdraft facility available on her cheque account.

Some months later Ms V received a letter, which had been sent to her old address, advising her that her cheque account was overdrawn and that she had incurred penalty charges. She called at the branch to explain that she was using her overdraft facility to pay her loan. She pointed out that the bank had failed to amend its records with her new address, despite have been asked to do so on two previous occasions and she again tried unsuccessfully to arrange to make the loan payments from her other bank account. Ms V left the branch believing that her overdraft facility was being used to repay her loan. In March 2002 she received a telephone call from a collection agency advising her that her account had been passed to it and that over \$3500 was outstanding. The caller also advised her that the bank had been sending correspondence about the account to her old address. The mail had not been forwarded to her.

Ms V was concerned that the bank had yet again failed to record her new address and, as a consequence, she was unaware of the bank's actions with respect to her accounts. In this regard, she pointed out that the bank had both her mobile and work phone numbers but had not telephoned her about her accounts. She met with a bank representative who apologised for the poor service she had received. The bank officer undertook to ensure that the debt was removed from the Baynet listing; to refund incorrect penalty charges; and to take back the accounts from the collection agency and manage them.

The bank subsequently confirmed that it had removed the credit listing; refunded the penalty charges and arranged a \$3550 overdraft facility on the account which was to be repaid at \$100 per fortnight. Ms V was not satisfied with this response because it failed to take account of the fact that she had already paid \$1000 to the collection agency and arranged an automatic payment to reduce the outstanding amount of debt. Furthermore, she was not satisfied that the amount of the refund reflected the full amount of incorrect penalty charges she had incurred.

During the course of my investigation, there was continued confusion. Despite the bank's undertaking to retrieve her accounts from the collection agency, Ms V continued to receive calls from the agency. On one occasion it demanded that she repay the entire debt that day.

As a result of my inquiries, the bank offered to resolve the complaint by accepting the arrangements which Ms V had made to repay the outstanding amount of her debt, refunding all the incorrect penalty charges and making a payment of \$500 to her as compensation for the inconvenience caused by its failure to address correspondence to her at her new address. Ms V accepted this offer.

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### **Case 12 – Fault on both sides**

Mrs P, a mother with four children who lived in a small community with no banking services, complained about the manner in which the bank had managed her accounts. Her benefit was credited to her account on a regular basis and the bank had structured her loan repayments to coincide with the benefit payments so the account operated in credit. She used the balance in the account for other living expenses.

At a time when the bank's computer systems were updated, the bank failed to deduct two loan repayments from her account. Neither she nor the bank noticed this at the time and Mrs P used the funds in her account on the basis that the repayments had been made. Further complicating factors were that there was a change in benefit payment dates at this time and the bank changed her loan repayment dates. As a result her account fell into overdraft when loan repayments were deducted the next month and the situation was further exacerbated when the bank, having discovered the loan was in arrears, debited her account with the amount owing without first advising her. Mrs P considered that her predicament had been caused by the bank's poor management of her accounts and its failure to communicate with her adequately.

The bank had clearly failed to deduct the two loan repayments from her account and this had undoubtedly contributed to her financial problems. Furthermore, although the bank had no general obligation to inform Mrs P that it proposed to exercise its right of set-off and deduct the loan arrears from her account, in this particular case its decision to do so was neither fair nor reasonable, given her underlying financial situation. However, it was equally clear that Mrs P had contributed to the situation in which she found herself. Given her normal pattern of expenditure, she must have realised that she had spent more than she would usually have had available if the loan repayments had been made. In the circumstances, I formed the view that the bank's actions had caused her considerable stress and inconvenience and that it should recognise this by paying her \$400 compensation, but that it had not caused her any other loss. The complaint was settled on this basis.

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### **Case 13 – An unfamiliar process for a small business**

Mr and Mrs Q operated a small manufacturing company and had enjoyed a good business relationship with their bank for a number of years during which time the bank had often agreed to provide overdraft facilities

for short periods of time. In September 1999 Mr and Mrs Q received an order to supply component parts for a product being manufactured by another company. While they sent a pro forma invoice for the supply of the components, they were not prepared to enter into a contract to supply them until the manufacturer of the end product guaranteed payment.

Mr and Mrs Q were aware that a letter of credit had been established in favour of the manufacturer, guaranteeing payment once the order for the end product had been completed and delivered. They therefore approached the bank about obtaining a letter of credit guaranteeing payment to them for the components. They had no experience with letters of credit and therefore relied on the bank's advice. In their discussions they made it clear to the bank that they would not proceed with the order unless they had a guarantee of payment. They left the bank with the understanding that a letter of credit was being completed which would meet their requirements.

In October Mr and Mrs Q received a message from the bank which referred to "assignment of proceeds", and the following day they were advised by telephone that the letter of credit was now complete.

On 1 November Mr and Mrs Q received an "advice of assignment" from the bank showing that the bank had an irrevocable authority from the manufacturer to assign to them the proceeds of a letter of credit which the manufacturer had from another bank. The bank's guarantee was therefore limited to making payments to Mr and Mrs Q if and when the funds were made available to the bank. This was not what Mr and Mrs Q had asked the bank to arrange. However, by this time they had paid their suppliers and they had a contract with the manufacturer to produce the component parts.

Mr and Mrs Q completed their contract at the end of December and in January 2000 asked the bank to arrange for payment to them. Nothing happened until May 2000 when the manufacturer defaulted on its debts. Mr and Mrs Q were therefore left with a significant debt.

Mr and Mrs Q maintained that the bank had led them to believe that it would provide them with a letter of credit guaranteeing payment for the components and should therefore compensate them for the losses they had sustained as a result of not being paid. The bank declined to meet the claim for compensation. It said it could not have set up a letter of credit in the circumstances. The only product it could make available to Mr and Mrs Q was the assignment of proceeds it had set up. The bank therefore argued that it could not be held responsible for the losses.

It became clear during the course of the investigation that Mr and Mrs Q had taken no steps to commit themselves financially to supplying the order until after they had received oral advice from the bank that what they understood to be a letter of credit guaranteeing payment had been arranged. On this basis I accepted Mr and Mrs Q's contention that they had not committed themselves to a contract to supply the components before approaching the bank to discuss guaranteeing payment.

As to the question of the arrangements Mr and Mrs Q made with the bank, it was clear that they had sought an arrangement which would guarantee that they would be paid upon completion of their contract. The bank did not accept that it had ever agreed to provide a letter of credit, because it could not have done so and could only ever have provided an assignment of the proceeds of a letter of credit. If this was the case then it should have informed Mr and Mrs Q at the outset that it was not possible to arrange matters so that payment was guaranteed. They would then have had the option of declining the order from the manufacturer. The bank was unable to produce any file notes relating to the discussions with Mr and Mrs Q about the nature of the payment arrangements it was able to set up and the person with whom they had held those discussions was no longer employed by the bank and could not be contacted. Mr and Mrs Q had clearly not understood that it was not possible to arrange the guaranteed payment that they required. On the contrary, they believed that they had a guarantee of payment so long as they fulfilled their part of the contract.

In the circumstances, I concluded that the bank had failed to provide Mr and Mrs Q with the service they had requested from the bank and which they had been led to believe had been arranged for them. I therefore proposed to recommend that the bank meet the direct loss suffered by Mr and Mrs Q.

It proved impossible for Mr and Mrs Q and the bank to agree on the amount of the loss and the complaint was eventually resolved when the bank accepted my formal recommendation that it pay Mr and Mrs Q compensation of \$65,000.

### 3 - Account Operation

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This section groups together a number of disparate cases linked by the common thread that accounts and the processes associated with them did not function in the way the customer expected (or said he or she expected). Case 14 is one of the first cases I have received to do with internet banking and as with most of these early cases, the problem was a technical one rather than the more common human error associated with most complaints that reach my office.

A business will often seek to protect itself against fraud by employees or others by requiring the authority of two persons on transactions. By their very nature, however, telephone banking systems can be operated by one person only. Businesses need to be alert to the possibility of fraud using the telephone banking system but at the same time banks may need to draw their customers' attention to the need to take precautions. In case 15, both parties were to some extent at fault.

While many customers lodge all their deposits with a bank over the counter, it is increasingly common for banks to encourage customers to place their deposits in an envelope which is then put into a locked box (a "drop box") in a branch for later collection and processing by the bank. I have received a number of complaints from customers who claim to have made a deposit in this way and who say that the funds failed to reach their accounts. It is important that banks have clear and rigorous procedures for clearing drop boxes and recording and processing their contents. In case 16 it proved impossible to determine whether the customer had misplaced the funds that he intended to deposit or whether they had gone missing in the bank. In case 17, which concerns a slightly different deposit system, the bank had an excellent tracking process and I was satisfied that it was highly likely that no deposit had been made.

Case 18 involved another missing deposit, but this time a deposit alleged to have been made over the counter and for which a receipt was issued. A receipt, however, is not conclusive evidence that a deposit was made and in this unusual and puzzling case, I concluded that it was not reliable evidence of the deposit.

Credits to and withdrawals from transaction accounts can now be made in many different ways and some customers can become confused about the different processes for setting up, altering and cancelling the various transaction services. Case 19 was a case where the bank could have been clearer in its communication with the customer while case 20 is a reminder that while there are a number of mechanisms by which an account can be debited, it is still necessary to have the customer's authority to make the debit.

Case 21 is a case of exceptionally poor customer service. The customer was operating an account for the benefit of her small daughter in a legitimate manner and there was more than a suspicion that the bank was using its genuine interest in protecting its position as a constructive trustee to make life difficult for her and

persuade her to transfer to an account with a different and more expensive fee structure. The inconvenience was substantial.

Closure of accounts gives rise to a number of problems. Under the Code of Banking Practice, a bank is obliged where possible to give reasonable notice of closure. I have noted previously that in most circumstances reasonable notice involves enough time for the customer to make arrangements for regular payments of income to another account. In case 22 the need to receive regular income was considered in the context of the complainant's limited understanding of financial affairs and a notice of closure given some time before the actual closure.

Finally in this section, case 23 is a reminder that a bank may reasonably require a customer to produce evidence of identity but that where a customer does not have the more common identification documents, some assistance may be needed to help him or her satisfy the bank's requirements.

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### **Case 14 – Paid Today - Gone Tomorrow**

Mr T was the director of a small company with several employees.

He used his bank's internet banking facilities, including a service for making payroll payments. The system enabled him to enter the details to be credited to his employees' accounts in advance of the due date. When he finished inputting the payroll details, the system provided him with confirmation that he had completed the task.

To his dismay, he discovered that one of his payroll batches had not been processed on the due date and therefore some of his employees were not credited when they should have been. The employees, including himself, were inconvenienced and it was embarrassing for the company.

He complained to the bank. It said after investigating the matter that generally the system worked, however, it had found a "very small number" of transactions that were affected by a system problem. When the bank could not give Mr T an undertaking that future payments would be made on time or advice as to progress with resolution of this problem, he complained to my office. An investigation was commenced and Mr T made alternative arrangements meanwhile to pay his employees.

When asked for its report, the bank advised that the problem was elusive and that it was making strenuous efforts to identify and to fix it. The bank did not make it clear whether or not it had contacted the users of this particular service to inform them of the problem.

There were discussions about an interim solution, including notifying users of the problem, but before a conclusion was reached, the bank advised me that its technical software advisers had identified the fault and made the necessary system changes after some extensive testing.

Mr T was asked if the bank needed to take any other action to put things right. He replied that a refund of some additional fees charged (as a result of the error) would suffice. The bank agreed to refund the fees immediately and the matter was settled on that basis.

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### **Case 15 – A fraud through telephone banking**

This complaint concerned the unauthorised withdrawal of \$70,000 from JKL Ltd's account. The loss occurred as a result of an unauthorised person using the telephone banking system to access the account, set up a bill

payment number, transfer the \$70,000 without the knowledge or authorisation of the company's directors and then change the password on the account. The company's agreement with the bank required two authorised signatories to sign cheques or other requests for payments. No authorised signatories were party to this transaction.

It was ascertained that the transaction had been undertaken by a former director of the company who had left shortly before the unauthorised withdrawal. This director had undertaken all the company's banking and paid the wages and accounts. In this role, she had access to the company's telephone banking ID and password. Despite this, the company did not change either its ID or password following the director's departure. On this basis, the bank did not consider it had any liability to the company for its loss.

When JKL Ltd had originally set up its account, the former director had had sole signing authority on the account. Later, and after telephone banking access had been set up, the signing authority for the company's account was changed to require two signatories. The bank did not suggest that the company reconsider the use of telephone banking services at that time and it did not appear to have occurred to the other directors that the telephone banking service could be operated by one person only.

The Code of Banking Practice has very little material on the use of telephone banking systems and accordingly I made enquiries in the banking industry to determine what is good banking practice in the circumstances. The results of my enquiries indicated that it was not accepted banking practice to permit business customers the facility to set up new payments by means of the telephone banking system when the normal operation of their accounts requires the authority of more than one person.

It seemed to me that there was an inconsistency in a process whereby two authorised signatures were required on cheques, for setting up automatic payments and other types of transaction whereby funds could be withdrawn or transferred from the account but that a new bill payment could be loaded by one person by telephone. I was of the view that if the bank continued to offer its telephone banking services to businesses, it should alert them to the potential risks.

At the same time I considered that JKL Ltd ought to have taken steps to ensure that it changed its telephone banking password immediately following the former director's departure.

In all the circumstances of the case I concluded that JKL Ltd should bear the responsibility for 80% of its loss and the bank for 20%. Both parties accepted this conclusion.

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## **Case 16 – A vanishing deposit**

Mr Y said that he deposited \$600 cash, placing the cash and a printed deposit slip in an envelope, which was then placed in his bank's deposit box.

Several weeks later he discovered that his account had not been credited and he asked the bank to investigate it. Despite a thorough search of the box, the premises, and reference to the bank's computer audit trails it could find no sign of the missing deposit. Mr Y complained to me and asked for the matter to be fully investigated.

The bank was asked to report on the steps it took to find the deposit and its procedures for dealing with such deposits generally. The search had been made more difficult since the customer could not be certain exactly which day he made the deposit. It was eventually narrowed down to two days, and he was also able to indicate the likely time of deposit, though he was not certain of this. He also showed that he had withdrawn the cash from another bank account at the appropriate date.

In its report the bank showed that it had spent substantial time checking and viewing videotapes for the days and times specified, checking all cash deposits of similar amounts, and also checking teller processing records particularly those of the specific teller responsible for processing deposits from the locked deposit box. There was no evidence on the videotape of the customer making the deposit at the times specified. Nor were there records of any deposits of similar amounts for which the bank could not account. However, there was no system in the bank by which it could keep track of deposits before they reached the desk of the teller responsible for clearing the box, at which point they were recorded in the same way as deposits made over the counter. Moreover, the box was cleared by a single teller and opened with a single key.

Having regard to the industry survey I had conducted, I found that this bank's procedures were below the industry standard for checking deposits made through drop boxes, but also noted that the customer was uncertain as to when he had made the deposit.

The customer had shown that he had the money to deposit and the bank had shown that no deposit entered its system. It was possible the deposit went missing after being lodged, but equally possible that the customer had every intention of making the deposit but had mislaid the envelope. Since there were no documented checking procedures as used by other banks, it could not be determined whether the deposit had gone astray before or after it was lodged with the bank. I suggested that the two parties should consider sharing the loss equally. The complaint was settled on that basis.

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### **Case 17 – A good tracking system**

This case concerned a dispute as to whether Mr and Mrs O had deposited funds using their bank's automatic deposit service. They were adamant that they had deposited a specific amount on a particular date, but because the machine was not printing receipts at the time the deposit was made and because the bank's video pictures at the relevant time were of such poor quality that the transaction could not be confirmed by that means, they were unable to prove that they had made the deposit. For its part, the bank had no record of the deposit having been made and did not consider itself liable for the loss claimed. The cheques which formed part of the deposit had not been presented which tended to support its view that no deposit had been made. The bank therefore considered that Mr and Mrs O should obtain replacement cheques and make a claim on their insurance for the lost cash.

The investigation raised three issues for consideration. First was the question of whether there had been a malfunction of the bank's systems. A thorough examination was conducted of the bank's automatic deposit system. This showed that the bank maintains a complete audit trail of all deposits made through the system. Deposits can only be made using a magnetic card encoded with a card number and this number is recorded together with the unique bag number in which the deposit is placed. The amount, time and date for each transaction is tracked and I was satisfied that the system complies with the bank's obligations under the Code of Banking Practice to "ensure the security and integrity of the banking systems".

The second matter for consideration was the failure of the system to print a receipt. The investigation showed that the machine functions even when the receipt printer has run out of paper. There was no evidence to suggest that any problems had arisen with respect to any other transactions conducted while the printer was not producing receipts. Accordingly, I was satisfied that this could not have caused the loss.

I also considered whether it was possible that Mr and Mrs O had made the deposit at another branch of the bank. However, there was no evidence to suggest that the bank had received, lost or misapplied the deposit in question at any other branch or through any other means of deposit.

As I could find no evidence that the bank's system contributed directly to the loss of the deposit, I concluded that the complaint should be withdrawn.

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## Case 18 – Another missing deposit

Mrs S wanted to reduce the family business overdraft before going overseas. She kept funds in accounts with several banks and collected them to deposit at the bank where the overdraft was held. She collected together \$20,000 which she deposited on one day. She said she intended to make a further deposit of \$20,000 the same day, but by the time she had made up the deposit and written up the deposit book, the bank was closed and she had to wait till the following day. By that time she had accumulated a further \$10,000, so she made out a further deposit slip in her book and made both deposits at the same time. She recalled in some detail the circumstances of the deposits and the two tellers involved and was able to produce stamped receipts for all three deposits

When Mrs S was reconciling the company's accounts about a month later she noticed that \$20,000 was missing. The bank's records showed that \$20,000 had been deposited on one day, but only one deposit of \$10,000 had been made the next day and an extensive search of its records and the premises failed to produce evidence of another deposit of \$20,000.

Mrs S and her family were long-time customers of the bank and were entirely reputable. It was abundantly clear both to the bank staff involved in investigating the case and later to me and my staff that Mrs S genuinely believed that the deposit had been made as she described, and indeed she had a receipt for it. The difficulty was that all the other evidence supported the bank's contention that there had been a mistake.

The fact that Mrs S held a receipt for the deposit was significant, but not conclusive evidence that the bank or its staff had received the funds. It was possible that a mistake had been made. The bank's own documentation which showed that the branch books balanced on the day in question tended to rule out a processing mistake after receipt by the teller, but it did not rule out a deliberate action by bank staff prior to processing. However, there had been two tellers dealing with deposits at the relevant time, a senior teller who was training a more junior one, and both would have had to have been involved in any fraud.

The bank also had diary notes which had been completed by the branch commercial manager on the two days in question. The first note referred to Mrs S having advised that she had deposited \$20,000 that day. The second note on the day in question refers to advice that a further \$10,000 had been deposited that day. There was no mention of a further deposit of \$20,000. These were contemporaneous notes and the bank's system ensured that diary notes or other records could not be created or altered at a later date.

A detailed examination was undertaken of the bank's procedures for handling cash deposits and of the physical arrangements at the branch in question. From all the evidence produced in the course of this examination, I was satisfied that the bank had a robust system for balancing and controlling cash handled. The branch cash and the tellers' cash was in balance for the day before and the day of the disputed transaction and I could find no evidence of a \$20,000 surplus or that such a sum had been credited in error to another account.

I did not consider fraud on the part of bank staff was at all likely. The staff would not have known that Mrs S was going to come into the bank with a large sum of cash and therefore could not have planned the theft in advance.

An individual cash docket is written by each teller for each cash deposit. They have pre-printed sequential numbers and a duplicate copy is kept of each completed docket. There was a record of the \$10,000 deposit together with the docket number. Other cash deposits were also included in the report with their docket numbers, but there was no record of the docket number immediately preceding that of the \$10,000 deposit.

The bank explained that it is not unusual for an error to be made on a cash docket and when that happens the cash docket is discarded immediately. The error would be copied on the duplicate sheet, which would be retained for a short period. By the time this complaint was received, the duplicate copy had been destroyed, so it could not be verified that a mistake had been made and the slip discarded. However, if the teller had completed the docket with an amount and then deliberately destroyed it in order to hide the receipt of that amount, this would have become obvious when the duplicate sheet was checked when the daily reconciliation was carried out. I also considered it unlikely that the two tellers involved would have conspired to steal the funds, or that one could have stolen the money without the other realising, or indeed other tellers observing the theft given that \$20,000 in cash is a substantial number of bank notes. I therefore concluded that it was more likely that a mistake had been made and the docket destroyed.

I therefore considered whether Mrs S could have been mistaken about the second \$20,000 deposit. The most straightforward way of determining whether she had deposited a further \$30,000 the day after the first deposit would have been for her to provide independent confirmation of the source of the total of \$50,000 she said she had deposited on the two consecutive days. She was only able to provide information showing she had withdrawn a total of \$20,000 from other bank accounts. Clearly she also had access to a further \$10,000 because she had deposited a total of \$30,000 according to the bank's records, but the source of those funds could not be established. Nor could she show where the 'missing' \$20,000 had come from. At a very late stage in the investigation, she suggested that there had been funds in a home safe. She had not mentioned this previously to the bank, to the various lawyers from whom she had sought assistance, or to my office.

After weighing up all the evidence, I concluded that Mrs S was mistaken in her view that she had made the deposit and that the most likely explanation was that the deposit receipt had been made out in the expectation of depositing \$20,000, that a second receipt was made out when she found she had only \$10,000 to deposit and that the teller had erroneously stamped both receipts. I therefore recommended that the complaint should be withdrawn.

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### **Case 19 – A problem with a direct debit**

Mr H lost his credit card. His bank issued a new one and at the same time sent him a standard letter saying, among other things, that it could not transfer direct debits to the new card account.

Mr H had a direct debit going out of his old card account and assumed he could regard it as cancelled.

In fact the direct debit was not cancelled. It continued to be taken out of the old card account and the bank transferred the debt thus created to the new card account. Mr H could not understand what was happening and when he made enquiries he got contradictory explanations from the bank.

After Mr H complained to the Banking Ombudsman, the bank explained its process. It agreed that its letter was confusing and should be altered. It also offered to refund Mr H his annual account fee as a gesture of goodwill. Mr H was happy to accept.

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### **Case 20 – Authority for debiting an account**

Ms M left her employment with a bank. A month later, without notice, the bank debited \$228.48 from Mr and Ms M's joint account.

When Ms M requested information regarding the reason for the bank's debit, it was slow to respond. The eventual answer given for the debit was that Ms M had made a series of personal overseas phone calls in the course of her employment with the bank and had not paid for them.

Ms M maintained that she did not make the calls because they had all been made at the same telephone in the bank and her role within the bank meant she was relieving in various departments of the bank and not at one desk with one telephone.

The bank argued that she did make the calls and that by virtue of the employee/employer nature of the matter the Banking Ombudsman had no jurisdiction because Ms M was not in receipt of a banking service. I considered that a claim that a bank had debited any customer's account without authority was within my terms of reference. Ms M was no less in receipt of a banking service than any other customer.

The fact that the bank was a party in the position of attempting to recover its debts did not authorise it to seek to recover a disputed debt by debiting an account without authority.

If such a debt is incurred outside of the banker/customer relationship, as in this case, the customer could have provided authority to debit the account, but the complainant in this case gave no such authority. The bank had argued that the debt occurred as a result of Ms M's employment and it was therefore entitled to exercise any legal remedies available to it in order to settle the debt. However, the bank's right of set-off did not extend to debiting an account held jointly by Ms M and her husband for a debt owed outside of the banker/customer relationship. After I had issued an initial assessment to this effect, the bank refunded \$228.48 to Ms M.

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## **Case 21 – A customer substantially inconvenienced**

Ms C had full signing authority over an account she held in trust for her young daughter. Ms C's daughter's father would deposit funds into the account fortnightly, for the daughter's living costs.

Ms C had been withdrawing money from this account for about seven years when the branch at which she was a regular customer began asking her questions about the purpose of the withdrawals. Sometimes Ms C would be asked to write down the purpose of the withdrawal; other times she would not be asked to explain the withdrawal at all.

Ms C complained that such inquiries were unnecessary and were a breach of her privacy. In a letter of complaint to the bank, she questioned the consistency of the bank's policy, the justification for it, and the effectiveness of such a policy. She said if she really were defrauding her daughter, she would not tell the bank.

The bank explained that the purpose of the questions was to fulfil its legal obligations as constructive trustee for the daughter's account. It maintained that in order for its position as trustee to be protected, it had to take due care to ensure that the account was being operated in the beneficiary's best interests.

The bank later told me that the account was not being used for the purpose for which a trust account is made available. It said the account was not meant to be used as an ordinary transaction account. It appears that questioning the withdrawals may have been in part an attempt to persuade Ms C to use another type of account (which would have been more expensive to operate) or make less frequent withdrawals.

I considered that the bank did have a potential liability as constructive trustee, but that in order to be held liable at some future point for a breach of its obligations there would need to be actual dishonesty on the part of the bank, once it knew that the account was being used for an improper purpose.

The secondary basis for justification of the bank's practice had no merit at all. Ms C was not in breach of the conditions on which the account had been opened and there was no restriction that affected her right to make regular withdrawals.

After a lengthy process during which I suggested several alternative arrangements that should have satisfied the bank's expressed concerns about its potential liability, all of which were rejected by the bank, I proposed an arrangement between the bank and Ms C whereby Ms C would sign a declaration to the effect that she would be withdrawing a certain amount at regular intervals for her daughter's benefit.

This proposal was made after consultation with the banking industry led me to conclude that while the bank did have an interest in protecting its legal position, it would be good banking practice to work out an arrangement with the customer so she was not subject to the continual questioning every time she wished to withdraw money.

In view of the embarrassment caused to Ms C over a substantial period of time, I also proposed payment of \$500 by way of compensation for inconvenience. Both parties accepted the proposal, and the complaint was settled accordingly.

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## **Case 22 – Reasonable notice of closure**

Mrs P failed to keep her account within its credit limit and it was often in overdraft. In September 2000 her bank wrote to her saying that she had to keep her account within its agreed credit limit or the account would be closed without further notice. According to the bank's records Mrs P also spoke to bank staff around the time she received the letter and understood she had to remain within the specified limits, but over the next two months she continued the same pattern of spending beyond her credit limit.

Mrs P's account was closed without further notice in early December 2000. She complained that the bank had not supplied her with reasonable notice of the intended closure. Mrs P said she had not had time to make arrangements to redirect social security payments arriving from overseas before the next one was due and suffered hardship when the payment was reversed out of her closed account.

Although it appeared Mrs P had been given over two months notice of the intended closure, I considered that for a number of reasons the bank had failed to give reasonable notice in the circumstances. These reasons included Mrs P's conceptual difficulties in understanding financial matters (which were known to the bank) and the bank's allowing the unsatisfactory account conduct to continue for several weeks before taking action.

If the bank had closed the account once it became apparent that Mrs P was not complying with its requirements, it would have been justified in doing so without further notice. Instead it allowed her to continue in the previous pattern and then closed the account shortly before a social security payment was due.

It became very apparent during my investigation that Mrs P did not understand the nature of her obligations to the bank and its instructions that she keep the account within the credit limit. When the bank did not close her account although the pattern of overspending continued she seems to have become more confused. In such a situation further notice was appropriate.

I recommended that the bank pay \$200 compensation for stress caused by its failure to give reasonable notice of the account closure so that Mrs P was left without funds. This was accepted by both parties.

## Case 23 – An unidentified customer

One of the more unusual cases to cross my desk arose from the refusal of a bank to allow the complainant access to funds in an account at the bank. The account had been established with a financial institution whose business had later been taken over by the bank. In 1989 the account holder had signed an authority permitting Ms F, his partner, to operate the account. Some 12 years later, and in reliance on the 1989 authority, Ms F decided to transfer the funds in the account to a joint account operated by her and her partner with another bank. The bank refused to transfer the funds or to give Ms F any information about the account. In view of the changes in ownership of the original institution in the period since 1989, the bank required a fresh authority from the account holder for her to operate the account.

Although Ms F had provided a written statement from her partner authorising the bank to give her access to all accounts in his name, the bank was not satisfied that the identity of the account holder had been properly established. Establishing his identity proved to be more difficult than might have been expected and the case came to me when the bank refused to accept the limited evidence of identity that Ms F could produce.

Ms F advised that the account holder lived an itinerant lifestyle and did not have a driving licence, a passport or an IRD number. In the circumstances, it was not unreasonable for the bank to decide that before releasing the funds it required some independent verification of the identity of the account holder. Eventually, about six months after the complaint was first made and after a number of attempts to find suitable identification, the account holder called at a branch of the bank with a person who had known him for some time and who was also known to the local court registrar and a suitable declaration of identity was completed in front of the registrar.

## 4 - Cheques

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Although electronic transactions make up a much larger proportion of banking business than they did in years gone by, cheques continue to be used and to cause problems. Indeed, it may be that there are more problems with cheques now that they are used less often and customers are less familiar with, for example, the common types of cheque crossing. The first five cases in this section all have to do with the identification of the payee of a cheque and the application of the rules about cheque crossings.

Case 24 concerned a cheque that was not crossed in any way but was made out to a named payee. The words “or bearer” had not been deleted. Most banks ask customers presenting such a cheque to provide proof of identification. I have received a number of complaints from people who objected to being asked for such proof because they considered that a cheque of this kind should be as freely negotiable as cash and that a request for identification is a breach of their privacy. The matter has been considered by the Privacy Commissioner who came to the view that banks have a lawful interest in preventing losses through fraud and that the practice of requesting proof of identification either prevents fraud by deterring it in the first place or materially assists in the detection of the persons responsible for it. In case 24 the question was not so much whether the bank was entitled to ask for identification but what standard the identification offered would be expected to meet.

Case 25 concerned another uncrossed cheque. The case is the reverse of case 24 in that in this instance the cheque had been stolen and was presented by the thief. Precisely the same form of identification was offered as in case 24. However, it needs to be recognised that although banks may require identification of those presenting cheques to be cashed, they have no obligation to do so. Case 26 involved yet another uncrossed cheque.

Generally, if the words “or bearer” are not crossed out, a cheque may be paid to the account of anyone who presents it. If the cheque is not crossed, it does not have to be paid into a bank account but may be cashed. A bank customer who wishes to be sure that a cheque can only be paid into an account belonging to the payee named on the cheque should cross out the words “or bearer” and cross the cheque itself, writing “a/c payee only” or “not transferable” between the lines of the crossing. A bank which accepts such a cheque into the wrong account is likely to be acting negligently and to be responsible for any loss through fraud.

In cases 27 and 28, the cheques in question were crossed. In case 27 the customer had done everything within its power to ensure that its cheque could only be paid to the account of the intended recipient and I found it was entitled to recoup its loss. Case 28 raises a rather different point and the issue of principle underlying the consideration of this matter has yet to be fully determined. It is not clear whether a cheque which is crossed either “not transferable” or “account payee only” can be accepted for deposit by a bank into a trust account operated by a third party but in the name of the payee. It seems to me reasonable that when a professional, such as an accountant or solicitor, opens a sub-account in the name of a client, the bank should require some evidence that the client has consented to the opening of the account.

Stopping and dishonouring cheques can lead to as many problems as paying them. I have noted in previous reports that dishonoured business cheques can result in substantial disadvantage to a small business. However quickly a bank acts to mitigate that damage, there is always a likelihood that rumours about the business’ financial stability will circulate, particularly in a small community. As in case 29, substantial compensation for inconvenience can sometimes be warranted. In case 30, however, compensation for inconvenience alone was not acceptable to the customer. This complaint brought into question the fact that I can only award compensation for direct loss or damage caused by a bank’s wrongdoing. Unlike a court, I am not empowered to award damages and there is nothing in my terms of reference that permits me to award compensation in the nature of exemplary or punitive damages. In this case, the failure to stop payment of the cheque did not cause the complainant any financial loss.

A bank is generally entitled to dishonour cheques drawn against uncleared deposits. When making a decision whether to allow a customer to draw cheques against uncleared deposits, a bank is exercising its commercial judgement. It assumes a credit risk if it decides to do so because the cheques deposited may be dishonoured by the bank on which they are drawn. However when exercising its judgement in this respect, a bank should do so in a reasonable and consistent manner. In case 31 the complainant was disadvantaged by his bank dishonouring his cheques when he had every reason to believe that they would be honoured.

Crossings are not the only potential trap for an unwary customer. Post-dating cheques and signing blank cheques are both unwise. In case 32, the customer had taken sensible steps to avoid financial difficulties and the bank was to some extent at fault, but it was foolish to have signed blank cheques in the circumstances.

Case 33, the final case of this section, arose out of rather unusual circumstances when a bank dishonoured a cheque twice, but for different reasons on each occasion.

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## **Case 24 – The question of identification for cash cheques**

Mr S went to bank A to cash a cheque drawn on that bank payable to him. He was asked to provide proof of identification and produced his debit card from bank B which bank A refused to accept as a suitable form of identification. He was shown a list of acceptable forms of identification which was publicly displayed in bank A, one of which was, “Debit/Credit card with your name embossed”. The debit card Mr S provided did not have his name embossed as it is a practice of bank B to issue unembossed cards. Mr S refused to provide

any other forms of identification such as a drivers licence or passport as he considered the unembossed debit card was adequate identification.

He complained to my office and asked me to investigate whether the bank was entitled to withhold payment of the cheque from him and whether the identification he had provided was acceptable. The complaint was referred to bank A. It considered that it had a legitimate interest in protecting itself against fraud by requesting standard forms of identification. As it did not hold on record the personal details of Mr S because he was a customer of bank B, it could not check whether the unembossed card was lost or stolen nor be assured that Mr S was entitled to the card. It said that acceptance of bank B's unembossed card as identification did not meet its identification policy.

I referred the bank's response to Mr S and asked him whether it satisfied his complaint. As I did not receive a response, I assume he was satisfied.

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### **Case 25 – A bank's obligations on accepting an uncrossed cheque**

Mr D wrote out a cheque and posted it. The cheque was not crossed, and "or bearer" was not crossed out. The cheque was intercepted in the post. The thief presented the cheque at the branch on which it was drawn, providing a debit card issued from another bank as identification. The debit card was not embossed with the name of the cardholder. The bank officer checked that the cheque had been signed by the account holder, Mr D. The cheque was then cashed.

Mr D complained that the bank should have contacted him before cashing the cheque. He also said the bank should have obtained identification from the presenter that included the presenter's name, and that there is a general misunderstanding among the public about cheques. Mr D believed that the changes to the law about cheques in 1996 effectively abolished bearer cheques and that all cheques must be paid to the named payee.

I found that the bank was entitled to pay the cheque to the bearer of it as long as it was not aware that the bearer had no title to the cheque. In this case the bank was not aware that the bearer had no title to the cheque. The bank was not obliged to ask the bearer of the cheque for identification, though this particular bank had a policy requiring presenters of cheques to provide identification. The policy was adopted to assist in the detection of fraud, but adopting a policy to protect against fraud does not create a higher duty than is required by the law with regard to the collection of cheques. Adopting a policy of asking for identification did not automatically require the bank to ask for a form of identification carrying the presenter's name.

The bank officer had followed the bank's internal procedures for the collection of cheques. While other banks may have internal procedures that require bank officers to telephone the issuers of cheques and confirm that the cheque is to be cashed, this did not create an obligation on all banks to do the same.

Further, Mr D was mistaken about the effect of the Bills of Exchange Amendment Act 1996. The Act clarified the effect of the crossing "not transferable". The effect of this crossing generally is to place liability on the collecting bank should a cheque crossed in this way be collected to an account other than that of the named payee. Mr D was not aware of this, but the bank was not responsible for his misunderstanding. As Mr D used none of the crossings the law had provided for cheque issuers to use to protect themselves from fraud, he was unable to claim the protection provided by Act.

I recommended that the complaint be withdrawn.

## Case 26 – No protection against a fraudulent accountant

Ms A was the director of a company. She arranged payment of GST owed by the business through her accountant, Mr X. Ms A issued a cheque made payable to “Inland Revenue or bearer” from the business account. The cheque was not crossed and the words “or bearer” were not crossed out. Mr X said he would arrange the necessary documentation and send the cheque to the Inland Revenue Department.

Three months later Ms A learnt that Mr X was being investigated for fraud as he had allegedly embezzled funds from his clients. Ms A then discovered that Mr X had banked the cheque into his own business account, and was later told that she was unlikely to recover any funds from him.

Ms A complained that the bank had been negligent in its collection of the cheque to an account other than that of the named payee. She said that the bank should have questioned Mr X’s payment to his business account as it was not standard practice for financial advisers such as accountants to deal with their clients’ funds in the way her cheque was handled.

I considered that if the bank had collected the cheque to the accountant’s personal account without enquiry, it would be arguable that the bank could be said to have acted negligently. However, in this case the cheque was collected to Mr X’s business account and it is not unusual for financial advisers to present cheques made payable to their clients for collection to their own business accounts for later disbursement. I therefore concluded the bank followed the instructions on the face of the cheque to pay “Inland Revenue or bearer”, and there was nothing unusual or suspicious in the circumstances to put the bank on notice that Mr X was not acting on his client’s instructions.

I recommended that Ms A’s complaint be withdrawn.

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## Case 27 – A cheque and a further question of identity

Company B had received an invoice for services rendered. In mid July it made out a cheque and posted it to the business address on the invoice. The cheque was made out to ‘Woods’ (the business name at the head of the invoice) and marked ‘not transferable. A/c payee only’. However, it never reached the intended recipient. It was instead intercepted by an unidentified third party.

In early August the cheque was presented at the bank by someone who had opened an account seven days previously. The account had been opened in the name of A. W. Woods after the person presented two unembossed debit cards as identification. \$18,000 in cash was withdrawn from the account a day after the cheque was deposited and a special answer obtained. A number of smaller transactions took place in the days following.

The bank refused to refund company B for the loss suffered when it was forced to pay the invoice again. It argued the company should have been more specific in the way it wrote its cheque and its negligence in this respect was the main reason for the fraud.

I considered that the bank was negligent in failing to satisfy itself as to the identity of the customer when the bank account was opened as required by the Financial Transactions Reporting Act 1996 and clause 4.1.1 of the Code of Banking Practice. It failed to follow its own internal policy guidelines by accepting two unembossed debit cards as sufficient identification when the new account was opened. There were a number of additional factors that, in my view, should have alerted the bank to the possibility the customer did not have good title to the cheque. These included the fact that after the account was opened there was no activity for

over a week until the cheque was deposited and that the date of the cheque predated the opening of the account.

As to the issue of company B's contributory fault in the way the cheque was headed, I considered that company B was entitled to rely on the name of the business as shown on the top of the invoice. It had marked the cheque in the safest way possible, that is "not transferable - a/c payee only". It is unreasonable to expect a person to search the telephone book and/or a business guide to check that there are no other similar trading entities before making a cheque out for payment. Company B was in no better position than the bank to be certain of the identity of 'Woods'.

I recommended that the bank reimburse company B the amount of the cheque.

(Please note that names in this case note have been changed to protect the confidentiality of those concerned).

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### **Case 28 Cheques paid into a trust sub-account**

Mr and Mrs M had engaged an accountant to process their tax returns and file them with the Inland Revenue Department (IRD). The accountant received a total of six refund cheques from the IRD. The first four he banked directly into Mr and Mrs M's bank accounts. The last two were paid into his trust account and from there he paid them into sub-accounts he had established in the names of Mr and Mrs M. He then deducted his fee, which was in dispute at the time, and paid the balance into Mr and Mrs M's own bank account. Mr and Mrs M had not authorised the accountant to bank their IRD refunds into his trust account, and were not aware of the sub-accounts. They therefore complained that the bank was in breach of its obligations in accepting the two cheques issued by the IRD for collection into the accountant's trust account. Mr and Mrs M sought a refund of the disputed amount of fees deducted by the accountant. They also considered they were entitled to compensation for the inconvenience the bank's actions had caused them.

The bank reported that traditionally solicitors, accountants and others received bank cheques on behalf of clients which may be payable to the clients. In this case, the accountant had received and banked the IRD cheques through his general trust account and into sub-accounts established in his clients' names. The bank considered that such a practice was in accordance with the law and argued that customers would suffer inconvenience if it refused to accept cheques into trust accounts in the name of the named payee.

During the course of the investigation I conducted an industry survey in an attempt to establish good banking practice with regard to the payment of cheques into sub-accounts. Unfortunately the results of the survey were inconclusive.

I concluded that a bank would not be in breach of its obligations if it accepted a "non-transferable" cheque into a sub-account opened and operated in the name of and for the benefit of the named payee on the cheque even though not necessarily opened or operated by the named payee. However, I found that the procedure at the bank for opening a sub-account is that a client's personal cheque is first deposited into the professional's trust account and a cheque is then drawn from the trust account payable to the bank care of the name of the client. The sub-account is then opened and account number allocated. I formed the view that the procedure resulted in a breach of the bank's obligations as it involved paying the cheque into the general trust account which by no stretch of the imagination could be said to be an account in the name of the client named as payee on the cheque.

I was also concerned that the accountant (and any other professional) could open and operate sub-accounts in the names of clients but without their knowledge or consent. It seemed to me that where a professional applies to a bank to open a sub-account in the name of a client, the bank should require them to provide

written authority from the client both agreeing to the sub-account being opened and operated by the professional and certifying that they have been provided with a copy of the terms and conditions applying to the account.

In the light of the findings of my investigation and of the results of the industry survey, I formed the view that all banks could need guidance on good practice in this area. I therefore referred the matter to the Banking Ombudsman Commission and the Chairman then wrote to the New Zealand Bankers' Association explaining the issue and asking it to consider setting an industry standard.

I also concluded that in the case under investigation the bank ought not to have collected the cheques in question to the accountant's general trust account and it ought to have satisfied itself that Mr and Mrs M had authorised their accountant to open a sub-account in their name. I then had to consider the question of whether they had suffered a direct loss as a result of the bank's actions. The loss they claimed was the disputed amount of the fees deducted by the accountant. It was not my function to determine whether or not the accountant was entitled to the full fees charged. That was a matter which had to be determined elsewhere. I could not therefore say that Mr and Mrs M had in fact suffered the loss claimed. In the circumstances, I formed the view that if they decided to take action against the accountant and were successful, but were through no fault of their own unable to recover any sum that might be awarded to them, the bank should reimburse them the amount of the award. I also concluded that they were entitled to a payment of \$250 by way of compensation for the inconvenience the bank's actions had caused them. Finally, I recommended that the bank cease collecting cheques crossed "not-transferable" made out to the clients of its professional clients into accounts that are not in the name of the payee of such cheques.

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## **Case 29 – Damage to a company's reputation**

Mr T was a director of a company that arranged a business loan of \$12,000 with the bank to clear a business overdraft.

The bank made a mistake and withdrew the company's previous overdraft facility before the new business loan was drawn down. This resulted in a number of the company's cheques and automatic payments being dishonoured.

In recognition of the embarrassment caused, the bank extended, as an offer of goodwill, a payment of \$300. Mr T was not satisfied with the offer, as he considered it insufficient compensation for the embarrassment the banking error had caused him, in addition to the potential risk it had posed to the success of the business, particularly as some of the dishonoured payments had been to business clients. He claimed expenses of \$1,472.85 plus GST for lost time plus the cost of toll calls and travel to attend the bank. He also sought compensation for inconvenience, including the extreme embarrassment and stress caused by the bank's actions.

Although there was no direct evidence of losses incurred by the business as a result of Mr T pursuing the complaint, I accepted that Mr T had spent a considerable amount of time during business hours investigating the problem and contacting creditors. This would not have occurred were it not for the bank's error. For this reason, I recommended the bank make a contribution towards Mr T's costs in pursuing the complaint.

As to inconvenience, I considered that the original offer of \$300 was insufficient compensation. This conclusion was based on common law authority that holds a bank can be liable in defamation for dishonouring a cheque in such a way as to suggest the drawer has insufficient funds when this is not the case.

I considered that in the circumstances of this case a reasonable person would have considered the dishonours meant that the payer had insufficient funds to meet the transactions and, in the absence of an explanation, could reasonably assume that payment was not going to be made. I acknowledged the bank's attempts to put the matter right by promptly providing a letter of explanation for Mr T to give to the affected creditors, but by that time the damage was only partially reversible. The company operated in a small town and it was very likely that rumours about its financial standing were already in circulation.

I found Mr T had suffered considerable stress, embarrassment and damage to his business reputation and proposed that the complaint be settled by payment of \$1,500 compensation for inconvenience, together with a contribution to his costs.

Both parties accepted my proposal and the complaint was settled accordingly.

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### **Case 30 – The distinction between compensation and damages**

ABC Ltd alleged that as a result of its bank's failure to act on its instructions to stop payment of a cheque to one of its suppliers it had suffered a loss of profits, resulting from cancelled orders and non-placement of future orders. The bank had acknowledged its failure and had immediately re-credited the value of the cheque to ABC Ltd's account, debiting its own suspense account. However, ABC Ltd did not regard this as an adequate remedy. It argued that when the bank paid the cheque to the supplier, it had lost an opportunity to pressure the supplier, with whom it had been experiencing delivery delays, to supply the goods. Without the goods, it was unable to supply its customers and therefore lost both existing and future orders. For its part, the bank was of the view that no loss had occurred because ABC Ltd had ultimately received goods to the value of the cheque and the proceeds from the sale of those goods. The bank therefore considered it was entitled to recover the value of the cheque from ABC Ltd.

The investigation of this complaint brought into focus my powers as Banking Ombudsman, in particular, paragraphs 14 and 14A of my Terms of Reference. I was at that time empowered to award compensation of up to \$100,000 for direct loss or damage and/or the sum of up to \$2000 for inconvenience (both limits since increased). Unlike a court, I am not empowered to award damages. An award of compensation for direct loss is not the same as damages in negligence and can be narrower in its scope.

In this case, as the bank had acknowledged its failure to stop the cheque, the focus of my investigation was directed at the question of whether ABC Ltd suffered a loss as a direct result of that failure and, if so, whether it was entitled to an award of compensation. I also considered whether it was entitled to retain both the proceeds of the sale of the goods purchased with the cheque as well as the value of the cheque.

I was not satisfied on the information submitted by ABC Ltd that any losses sustained could be attributed wholly, or even in part, to the actions of the bank. It was clear that difficulties had developed in the relationship between the company and its supplier relating to the supply of goods for on-sale. The supplier had not provided goods ordered and had been dealing directly with ABC Ltd's customers. It was not therefore evident that ABC Ltd would have been in any better position had the payment been stopped. Nor was there any loss in relation to the on-sale of the goods. Once supplied, they had been sold to the customer for the full price.

I concluded that it was not reasonable for ABC Ltd to retain both the amount of the cheque and the proceeds of the on-sale of the goods and that there was no objection to the bank requiring repayment of the amount of the cheque. I also considered that the bank's action in paying the cheque exacerbated an already difficult relationship between ABC Ltd and its supplier and that ABC Ltd's bargaining position had been prejudiced. I therefore proposed to recommend that the bank pay the company \$1500 compensation for inconvenience. I

also proposed to recommend that the bank reimburse the legal costs ABC Ltd had incurred in relation to the complaint, although after receiving further submissions from both parties I revised this proposal and recommended that the bank should contribute to the legal costs.

A substantial part of the costs had been incurred after ABC Ltd had been advised that I would not normally award the costs of legal representation in dealing with my office, and there seemed no reason why an exception to that rule should apply in this case.

Both parties accepted my recommendation.

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### **Case 31 – Inconsistency in permitting withdrawals against uncleared deposits**

This case raised the issue of a bank's entitlement to dishonour cheques drawn against uncleared deposits. When making a decision whether or not to allow a customer to draw cheques against uncleared deposits, a bank is exercising its commercial judgement. It assumes a credit risk if it decides to do so because the cheques deposited may be dishonoured by the bank on which they are drawn. However, when exercising its judgement in this respect, a bank must do so in a reasonable and consistent manner.

In this case, Mr W operated two accounts with his bank, one in Australia and the other in New Zealand. From time to time he transferred funds from the Australian account to the one in New Zealand and then drew cheques on the latter account. He had encountered no problems with this practice but in November 2000 two cheques drawn on the New Zealand account were dishonoured by the bank. When Mr W asked why this had occurred, the bank advised him in writing that the cheques had been dishonoured in error. It apologised for the error and refunded the dishonour fees.

In December Mr W proposed to deposit further funds from his Australian account into his New Zealand account prior to drawing cheques on that account. In light of his experience in November, he sought advice from the bank as to the amount that could be transferred from his Australian account without waiting for the funds to be cleared. He understood that provided each cheque drawn on the Australian account did not exceed NZ\$10,000 there would be no problem. Accordingly he lodged a number of cheques to his account none of which exceeded that amount. He then deposited funds from his New Zealand account into his credit card accounts. The bank dishonoured these payments but on re-presentation two weeks later it paid them.

Mr W considered the bank's actions were unreasonable and contrary to its previous practice. He believed that in light of its previous practice, of the letter of apology he had received following the dishonouring of the cheques in November and of the oral advice he had received, the bank was effectively estopped from dishonouring the December cheques. He said the bank had not given him a satisfactory explanation as to why it had told him that the two November cheques had been dishonoured in error, but that those dishonoured in December had not been dishonoured in error. It had simply said that in both instances it was exercising its commercial judgement and that it had a discretion not to allow funds to be drawn on deposits which had not been cleared. Mr W sought to recover the dishonour fees charged by the bank and by the credit card companies together with interest for late payment of the credit cards, amounting to a total of \$824.14.

The bank's position was that it was entitled to wait for international funds transfers to clear and the cheques drawn in December 2000 exceeded the cleared funds available. Although it had decided not to dishonour the November cheques, it was not obligated on every occasion to pay cheques against uncleared deposits. It believed Mr W was well aware that he needed to wait for deposits to clear before drawing against them and knew when he wrote the cheques in December that there was a risk of dishonour.

From an examination of Mr W's account in the months preceding November 2000, it was clear that he had been allowed to draw cheques on uncleared funds deposited from his Australian account. At no time had the bank warned him that in future it would not allow him to draw cheques against uncleared funds. It seemed likely that the written advice that the November cheques had been dishonoured in error was not in fact correct, but he was entitled to rely on what he had been told and he therefore had no reason to believe that cheques he wrote following deposits to his account in December would not be honoured.

In the circumstances, I concluded that the bank had acted wrongly in not applying its uncleared funds policy consistently and its behaviour had clearly led Mr W to believe that the bank was prepared to pay his cheques drawn against uncleared funds. The bank accepted my view and the complaint was settled by the bank paying Mr W \$824.14.

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### **Case 32 – It is never wise to sign a blank cheque**

Mrs A was concerned about her husband's overdrawing of their joint business cheque account as he was unable to control his expenditure. In order to avoid the account being overdrawn in future, Mr and Mrs A met with bank staff and arranged for the business cheque account to require both of their signatures to withdraw funds. Mr A's debit card was also destroyed at this time.

At a later date Mr A obtained a temporary overdraft limit of \$2500 on the cheque account and subsequently spent up to the overdraft limit. Mrs A complained to my office that the bank had acted contrary to the signing authority on the account by allowing Mr A to have the overdraft without her signature, and subsequently had caused her and her family extreme financial hardship and stress as they struggled to pay back the overdraft. Mrs A sought a refund of the overdraft amount and compensation for stress and inconvenience as a result of the bank's action.

I found that Mrs A had made it clear to the bank that she wanted the business cheque account structured so that it could only be operated jointly. However, the law provides that a bank may treat a cheque issued in excess of credit funds in an account or in excess of an agreed overdraft limit as a request for an overdraft, even when the customer is not aware of the lack of funds in the account. Mrs A had signed blank cheques for her husband and thus in effect approved the transactions he conducted and authorised the expenses he was incurring. Regardless of whether the cheques were dishonoured or honoured by the bank, the debt would have remained owing either to the bank or the payees of the cheques, and consequently Mrs A had not suffered a direct financial loss as a result of the bank failing to follow the signing authority on the account.

I also considered that despite Mrs A's role in signing the blank cheques it was not unreasonable for her to have assumed that the bank would adhere to the signing authority on the account and not formally extend further credit without her consent. Compensation of \$250 for inconvenience seemed appropriate.

Ms A did not accept the recommendation and indicated that she may take further action against the bank.

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### **Case 33 – Double dishonour**

This complaint concerned a bank's action in dishonouring a cheque given to XYZ Ltd. The bank advised that it had stopped the cheque because it had doubts about the signature. When the cheque was re-presented, it was dishonoured because the bank had consulted the drawer who had then instructed it to stop the

payment. XYZ Ltd argued that the bank had no reason to stop the cheque in the first place because the signature was the same as on a previous cheque which had been honoured.

I formed the view that the question of whether the signature was valid was a matter for the bank alone to determine, based on its judgment as to whether the signature on the cheque matched the one on its file. The fact that XYZ Ltd had previously received a cheque with a similar signature was of no consequence because the bank is entitled to make a decision about payment in respect of each individual cheque at the time it is presented. If it has any doubts as to the genuineness of the signature, it is entitled to decline to pay the cheque.

It is always open to a bank to contact the drawer of a cheque to ascertain whether it should be paid or not. This is what it did when the cheque was re-presented. XYZ Ltd suggested that this indicated that the bank was uneasy with its initial decision to dishonour the cheque. Irrespective of the truth of this assertion, and I had no way of knowing whether it was correct or not, the bank was entitled to make the initial dishonour decision based on its concerns about the signature. It was subsequently obliged to act on its customer's instructions.

In the circumstances, I proposed that the dispute be settled by XYZ Ltd withdrawing the complaint. As I heard nothing further from XYZ Ltd after issuing my initial assessment, I assumed it no longer wished to pursue the matter and I therefore discontinued my investigation.

## 5 - Foreign Exchange & International

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I am increasingly called upon to consider problems arising out of cross-border transactions and the conversion of funds from and into New Zealand dollars. Some cases of this nature will be found in the Cards and PINs section of this compendium but the two cases noted here had more to do with international transfer processes.

Case 34 sheds some light on the mechanisms whereby credit card transactions made in one country are debited to the customer's account in another country. This case also illustrates the difficulties that are typically encountered when a number of parties are involved in a transaction and it is difficult for a customer to determine where responsibility for problems lies. In this case the New Zealand bank was not at fault. In case 35 by way of contrast, the New Zealand bank had protected itself from liability for matters that were beyond its control, but the problem was eventually traced back to its own failure to send all the necessary information to ensure that the funds were credited without delay to the appropriate account.

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### **Case 34 – When good EFTPOS terminals go bad**

While Mr J was in Sydney, he paid his hotel account with a Visa credit card. The hotel's electronic funds transfer at point of sale (EFTPOS) terminal would not produce a transaction slip. The hotel receptionist then used another EFTPOS terminal to credit the amount to his account and re-debit it. The two debits appeared on Mr J's credit card statement for the same amount in New Zealand dollars (NZD) but the credit appeared as a lesser amount, a difference of some NZD50.00. The difference occurred because the credit from the hotel was processed using a different exchange rate from the debits. All three transactions appeared on the credit card statement with the same transaction and processing dates.

Mr J complained to my office and said that his bank had gained a windfall profit from the hotel's mistake. He thought that the debit and the credit should have cancelled out each other at the end of the banking day and was concerned that he, as the innocent party, had to pay for the mistake.

The bank responded to Mr J's complaint by saying that its role was to process the transactions and that Visa International and not the bank set the daily exchange rates. It said that it could not be responsible for the foreign exchange loss Mr J had suffered. Furthermore, it argued that the problem arose from an error on the part of the hotel for which, in terms of its Terms and Conditions of Use relating to credit cards, it was not liable.

I then sought to clarify the matter concerning exchange rates with Visa International. I asked whether an error such as that made by the hotel could be corrected without exposing the customer to an exchange rate loss. I was informed that had the hotel processed all three transactions on the same day they would have been converted to NZD at the same exchange rate. It therefore appeared that, while all three transactions appeared on Mr J's credit card statement on the same day, the credit transaction was actually processed on a different day. Visa International informed me that some credit card merchants have an arrangement with their bank whereby debit transactions are processed the same day but credit transactions are processed as a "batch" a few days later. I therefore wrote to Mr J and confirmed that the bank's Terms and Conditions of Use for credit cards state that Visa International determines the relative exchange rates on the day transactions are processed. I was also able to confirm that the bank in New Zealand first knew of the transactions after they were converted to NZD. It therefore had no involvement in the conversion process and did not receive any exchange profit that accrued. Visa International merely processed the credit transaction on the day it was processed by the hotel and whether there was any exchange rate "profit" as such was questionable because the transactions were not processed on the same day.

I advised Mr J that I had formed the view that the bank had not acted wrongly and that I should therefore decline to investigate his complaint further. I also suggested that he might wish to pursue the matter with the hotel to ascertain whether its method of processing credit transactions had contributed to his loss.

While Mr J did not accept my view and remained convinced that his bank was responsible for the exchange rate difference, he was unable to give any further reasons why this should be so, and I confirmed discontinuation of my investigation.

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### **Case 35 – Insufficient information and a costly delay**

This complaint arose from a delay in making a telegraphic transfer from Mr T's New Zealand account to an account overseas. Mr T completed an application form at his bank providing full details of the account to which the money should go. During the following week he checked with the bank and the overseas bank on four occasions to ascertain whether the funds had been sent and had arrived. He then discovered that the funds had been sent to the bank's 'corresponding' bank overseas for onward transmission to his overseas bank, but the bank had not sent the full details of the account and the 'corresponding' bank had sought further information. This information was sent and the following day the funds were credited to Mr T's overseas account. The process took two weeks to complete and, as a result of the delay, Mr T had to pay a higher price for a property he was purchasing in accordance with the contract he had entered into in reliance on the availability of the funds.

The bank denied liability for the loss, citing the disclaimer on the telegraphic transfer application form which stated that the bank was not responsible for any "errors, omissions or delays in the transmission or delivery of any message". The bank believed it had remitted the funds promptly and without negligence and that it

had not been in a position to assist to any extent until it had received the response from the 'corresponding' bank. As soon as that response was received, the bank had supplied the relevant information immediately.

The investigation of this complaint led me to the view that the cause of the problem was not a delay in the transmission or delivery of the message. The bank had not included all the relevant details of Mr T's overseas bank account as set out on his application form when sending the telegraphic transfer to its corresponding bank. It had simply provided the SWIFT code given to it by Mr T. This code was not sufficient by itself to identify the individual bank to which the funds were to be transmitted. The other necessary details had been provided by Mr T on the bank's application form but had been omitted by the bank when sending the transfer. Without the information the transfer could not be effected.

Despite the fact that Mr T had advised the bank on several occasions that the money had not arrived in his overseas account, it was not until the bank's corresponding bank approached it for further details that any steps were taken by the bank to ascertain what had happened to the telegraphic transfer. In these circumstances, it did not appear to me that the bank could rely on its disclaimer and decline Mr T's claim. Although the bank argued that the information it sent ought to have been sufficient to enable the transfer to have been made, it had not used all the information on its application form and this had caused the delay in completing the transfer.

Mr T had supplied the information requested on the form and had only added the SWIFT code as an afterthought when the bank officer taking the transfer information agreed it would be useful.

Having considered the sequence of events, I came to the view that in failing to include with the telegraphic transfer the information which it requested on its application form the bank had failed to exercise reasonable skill and care when carrying out the transfer and this was the principal cause of the delay in the funds reaching Mr T's overseas bank account. In this respect, the bank was in breach of its obligations under section 28 of the Consumer Guarantees Act 1993. I therefore recommended that the bank pay Mr T the direct loss he suffered as a consequence of the delay. I also recommended it refund him \$200 towards the costs he had incurred in trying to find out what had happened to his funds and \$500 in recognition of the inconvenience caused to him. The complaint was settled on this basis.

## 6 - Cards & PINs

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In 2002, for the first time in the history of the Banking Ombudsman scheme, more complaints were received about cards and PINs than about any other banking service. Nearly all these cases had a background in fraud, when the customer's debit or credit card had been stolen and used to make transactions on the customer's account. In some cases the cardholder had clearly been the target of professional criminals, in other cases members of the cardholder's family are likely to have been responsible and in other cases the identity of the offender remains a mystery. When a customer's card has been used to make unauthorised transactions, the card-issuing bank may have a duty to reimburse the amount of the customer's loss, less \$50.

Over the years, the approach to this type of case has been developed and refined but the underlying principles remain the same and are found in the Code of Banking Practice. It may be necessary to change the approach if the current review of the Code of Banking Practice results in alterations to the Code. At present, however, the approach is as outlined below.

Although the Code sets out the standards banks have agreed to observe in accepting responsibility for losses caused by the unauthorised use of cards, it is open to banks to offer greater protection to their customers if they so wish. The first step in ascertaining liability, therefore, is to consider the terms and conditions on which

the card was issued and which form the contract between the bank and its customer. In case 36, for example, the bank had not included in its conditions of use an exclusion of liability in cases where the customer had chosen an unsuitable PIN. Accordingly, it was obliged to reimburse a customer in circumstances where she had chosen her birth year as a PIN and it was reasonable to assume that the offender had ascertained her birth year from information kept with the card in her handbag.

In most cases a bank's conditions of use will echo the provisions of the Code. A customer will lose the protection against loss caused by unauthorised use if he or she has failed to take reasonable care of the card and/or PIN, selected an unsuitable PIN, kept a written record of the PIN, parted with the card and/or disclosed the PIN, or unreasonably delayed notification of the loss or theft of the card or the actual or possible disclosure of the PIN.

In many cases once the facts of the unauthorised use have been ascertained, the result is clear. In cases 37 and 38, there was a written record of the PIN with the card. In neither case had the customer had deliberately kept the PIN record but in both cases they had nonetheless failed to take reasonable care to ensure the PIN was not recorded and kept with the card. Case 38 also points out the necessity of clear and accurate advice from bank staff on questions to do with PINs.

There is often no direct evidence as to how the offender became aware of the PIN. I am satisfied that it cannot be obtained from the card itself and I have no evidence of deficiencies in the security of banks' technology. Accordingly, in the absence of any other explanation, it is most likely that an offender has obtained knowledge of the PIN from the cardholder. The question therefore is whether, on the balance of probabilities, the offender was able to obtain knowledge of the PIN through a breach by the customer of the conditions of use on which the card was issued. Generally speaking, if there is a reasonable explanation for the offender's access to the PIN and the explanation does not involve a breach of the conditions of use, then the cardholder is entitled to reimbursement. If there is no reasonable explanation that does not involve a breach of the conditions of use, then the cardholder is not entitled to reimbursement. Case 39 is a good example of the latter situation. In some cases there is doubt as to whether an offence has been committed at all. In case 40 the cardholder was convinced that there had been unauthorised withdrawals from his account made by a stranger or through some failure in his bank's systems but it was clear that the transactions in question had been made with his card and PIN and there seemed to have been little or no opportunity for a stranger to have access to either.

The most difficult cases are those where the most likely explanation of the offender's knowledge of the PIN is "shoulder surfing". In these cases the offender observes the cardholder entering the PIN at an EFTPOS or ATM terminal and later steals the card. A cardholder generally has an obligation to take care to avoid disclosure when entering the PIN but unless an EFTPOS terminal is particularly well shielded it is almost impossible to conceal PIN entry from a determined offender. The standard of care expected of cardholders is reasonable care and I have taken this to mean the sort of care that can be expected when using the card as an adjunct to everyday life. In case 41, for example, the cardholders were defrauded by their son who had had the opportunity to observe his mother's PIN when shopping with her. Similarly in case 42 the complainant had perhaps been unwise to use his card PIN for another purpose but not to the extent that he could not be said to have taken reasonable care of it. In case 43 there was insufficient evidence to find that reasonable care had not been taken of the PIN.

When a bank accepts a customer's claim for reimbursement of unauthorised transactions, it is entitled to take the necessary steps to bring the offender to justice and/or to recoup its own loss. As in case 44, it is reasonable for the bank to lay charges and it may also reasonably expect the customer to co-operate in any subsequent prosecution.

A credit card does not necessarily need a PIN for its operation and sometimes customers are unaware that a PIN loaded on to a previous card may transfer automatically to a re-issued card. It is important that banks

make this clear to their customers. In case 45 the bank had supplied its customer with the appropriate information but clearly the customer had failed to read or absorb it.

The fraudulent use of credit cards lies behind a number of complaints, and in case 46 the chargeback process was at issue. The international regulations governing the use of credit cards provide a mechanism whereby some disputed transactions may be reversed so that any loss is borne by the merchant who accepted payment by credit card rather than by the cardholder whose card was stolen or otherwise fraudulently used. The cardholder's entitlement to reimbursement, however, is governed not by the international regulations but by his or her contract with the card issuing bank. If, under the terms of that contract, the customer is entitled to reimbursement, then it is irrelevant from the customer's point of view that the bank is unable to charge back the transaction through the international process. In case 46, the time limit for a chargeback had expired by the time the case came to me so there was no prospect of the bank recouping its loss but it was nonetheless bound under its contract with its customer to reimburse her for the loss.

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### **Case 36 – A higher standard of customer protection**

Mrs B's handbag, containing her debit card, was stolen from her locked, alarmed car. She did not discover the theft until the following day when she was about to go shopping. She immediately reported the theft, but by this time nearly \$6000 had been stolen from her various accounts. She claimed reimbursement from the bank. The bank declined her claim on the basis that she had selected her year of birth as her PIN. Mrs B admitted doing so, but explained that English is her second language and she did not realise she must not do so.

The Code of Banking Practice clearly states that a customer may be held liable for loss caused by selection of an unsuitable PIN, of which a birth date is an example. However the bank's own terms and conditions for the use of cards, which formed the contract between Mrs B and the bank did not contain any such exclusion. The Code does not form part of the contract between the bank and Mrs B, rather it is a document setting out the standards of practice with which banks agree to comply. Clause 5.5.8 of the Code states:

"5.5.8 Individual banks may have their own terms and conditions applying to the issue, use, security and liability for cards, PINs and passwords, and for losses. These terms and conditions may be additional to, but must not be inconsistent with the provisions of this Code."

Banks may not impose on their customers terms more onerous than the Code permits, but may offer more favourable terms. I found that although Mrs B had selected her birth date as her PIN she had not breached the terms and conditions on which the card was issued and on this basis it was appropriate for the bank to reimburse the loss suffered, less the \$50 customer liability. Both parties accepted my recommendation.

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### **Case 37 – Keeping a record of a PIN with a card**

This case involved the theft of funds from Mr Z's account using a debit card. In order to obtain cash using such a card, a person must have both the card and its PIN. In this case, Mr Z was overseas and had left his card in storage at a friend's house. The card had been stolen from the house and the theft reported to the Police. However, Mr Z had left the card in an envelope and the PIN for the card was the same as part of the address on the envelope. The bank's records showed that the thief had entered the correct PIN on the first attempt.

Keeping a record of the PIN with the card constitutes a breach of the conditions of use for the card. While I did not believe Mr Z had deliberately stored the PIN record with the card, the fact that a written record of the PIN was with the card meant that he was not entitled to be reimbursed for the loss of funds from the account. I therefore concluded that Mr Z should withdraw the complaint.

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### **Case 38 – Using and recording PINs**

Ms S had a credit and a debit card with the same four digit PIN. When she began Internet banking she was required to select a five digit PIN and so chose her card PIN, with the addition of one number. She had difficulty remembering her Internet banking PIN and says she was told by bank staff to write it down, which she did in the front of her diary beneath the sticker provided by the bank with her Internet access code printed on it. In addition Mrs S wrote the word 'PIN' next to the number.

While at work Ms S left her handbag under the front seat of her locked car and her diary on the back seat. The nature of her job prevents her from carrying these items with her at all times. A thief broke into her car, stole both items and before Ms S discovered the loss, accessed her account stealing over \$2000.

Ms S's bank declined to reimburse her loss on the basis she had failed to safeguard her PIN. Ms S did not accept that she had written her PIN down. She maintained that the PIN written in her diary was her Internet banking PIN and not her card PIN. She gave the example that the number 207 is not the same as the number 7. In addition Ms S argued that her Internet banking PIN was not kept with her credit and debit cards.

The terms and conditions which formed the basis of Ms S's contract with her bank state that if a customer keeps a written record of their PIN they will not be protected from loss. I found it obvious that Ms S's four digit PIN was part of the same sequence as the five digit PIN. The number written in the diary was so similar to the four digit PIN it must be considered to be a written record of that PIN. In the same way, a customer with the birth date 25/12/56 cannot avoid responsibility by pointing out that 2512 is not the same as 251256. Although it was unfortunate that the handbag and diary were both in the car when it was broken into, and it may not have been Ms S's practice to carry these items together, the fact remains that they were together inside Ms S's car on this occasion and obtained by the offender at the same time. I considered that Ms S had breached the terms and conditions of her contract by keeping a written record of her PIN with her cards.

Ms S also submitted that she wrote the Internet banking PIN down on the advice of bank staff. On this basis she considered that the bank was at least as liable as she for the loss. Ms S provided a photocopy of the front page of her diary, which had been recovered after the theft. The Internet access code number on the sticker had been crossed out, and another Internet access code written beneath it. It seemed to me most likely that Ms S had been told by the branch staff to write down the Internet access code and that she had misunderstood this advice and written down the Internet banking PIN as well. On the basis that the staff member's advice might not have been as clear as it could have been I proposed that the bank refund \$200 of Ms S's loss.

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### **Case 39 – No reasonable explanation of PIN use**

This case involved the fraudulent withdrawal of funds from Miss K's account using her debit card. Miss K's handbag had been stolen from the back of her car which she had inadvertently left unlocked while she went

to a garage sale. The car was left unattended for about five minutes and as soon as she discovered her bag was missing she reported it to the Police and thereafter to the bank. In the meantime, the thief had accessed her account, after one unsuccessful attempt, and had withdrawn \$1500 from her account. Miss K was adamant that she did not keep any record of the PIN in her car or in her wallet and that she had never disclosed it to anyone. She sought reimbursement of the amount withdrawn from her account.

In this case, the thief was able to access the account on the second attempt which strongly suggested that he or she knew the PIN, or found a written record of it. The usual ways a thief comes to know a PIN are by being told it, by finding a written record of it or by observing the cardholder making an ATM or EFTPOS transaction. I do not accept that it is possible to guess a four digit PIN and in this case I was satisfied that the PIN was not an easily recognised number.

I accepted Miss K's submission that she did not disclose her PIN. She had last used it at a supermarket the previous day and it was unlikely that the thief watched her using the card and then followed her until the next day, waiting for an opportunity to steal the card. I therefore came to the view, notwithstanding Miss K's strong assertion that she had not written the PIN down, that on the balance of probabilities the thief had found a written record of the PIN among the contents of the handbag in the half hour interval between the first unsuccessful attempt to access the account and the second successful attempt. There was simply no other credible explanation for the thief coming to know the PIN.

In the circumstances, I concluded that Miss K had breached the conditions of use for her card and that she should bear the responsibility for the majority of the loss she had suffered. However, in this case the thief had left the account in overdraft. Miss K did not know her account had an overdraft facility of \$200 and the bank could not confirm that she had been advised of it when the account was opened. I therefore found that the bank should reimburse the amount by which the fraudulent use of her card had put her account into overdraft.

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#### **Case 40 – Probably not a case of fraud**

Mr C is a disabled man in his late 80's. He said that he only left his home when absolutely necessary to shop for groceries or to pay bills. His daughter started living with him and Mr C said that, as she was ill herself, she could not leave the house at all.

Mr C had two credit card accounts and, over a period of approximately one month, a total of \$1,119 was withdrawn from both accounts. Mr C complained to his bank that the transactions were fraudulent. He said that his cards never left his possession and were locked away. He also said that he had not written down the PIN for the cards because he had memorised it. The bank investigated the matter and concluded that Mr C had given his credit cards and PIN to his daughter. It said he had told them he had done this on previous occasions. Mr C complained to my office and said that he had not disclosed his PIN to his daughter nor given her his cards.

My investigation determined that the transactions did not conform to the usual pattern of credit card fraud seen by this office. This pattern consists of heavy use of the card over short period of time, after which the card is usually disposed of. In this case, as a number of legitimate transactions occurred between the alleged instances of fraudulent transactions, it appeared that the cards had been returned to Mr C before being used again. This occurred three times over the month in question. Mr C also identified several legitimate transactions on the same days as the unauthorised transactions.

Mr C said that his daughter was unable to leave his home because of her disability and therefore could not have initiated the fraudulent transactions. However, he was not prepared to provide me with evidence of her

immobility. In the circumstances, the only logical conclusion I could reach was that if the daughter had not made the withdrawals then Mr C had made the withdrawals himself and had forgotten about them. While Mr C disagreed with my conclusion he was unable to provide any further evidence to alter my view and I therefore recommended that he withdraw his complaint.

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## **Case 41 – Fraud in the family**

Mr and Mrs B reported their credit card stolen on 3 October, after their statement showed a series of unauthorised transactions dating back to 14 September. Most of the transactions were cash withdrawals that would have needed a PIN entry.

Mr and Mrs B's PIN was made up of a combination of digits from two different telephone numbers they had about twelve years previously. The credit card PIN was the same as for Mr and Mrs B's debit card.

It transpired that Mr and Mrs B's son had disappeared on 21 September 2001 and had somehow left New Zealand without a passport. As the majority of the unauthorised transactions occurred overseas (and included a purchase of airline tickets), it was apparent that Mr and Mrs B's son had taken the credit card from his parents.

The son had been living with his parents as a condition of his bail for a serious offence. From time to time he would accompany his mother to the supermarket, and she now believes that, without her knowledge, he observed her entering the PIN when using the debit card. Both Mr and Mrs B were adamant they had not knowingly disclosed their PIN to anyone, including their son.

The bank considered that because the offender was able to successfully use the credit card at an ATM, with the PIN entered correctly on the first attempt, the security of the PIN must have been compromised and Mr and Mrs B must have disclosed their PIN to their son.

Whilst a cardholder must take reasonable care to avoid disclosure when keying in a PIN, reasonable care will not always prevent entry from being overlooked by someone who is determined to ascertain the PIN. There is a limit to the precautions cardholders can take to protect their PIN, particularly when using an unshielded ATM or EFTPOS terminal. Mr and Mrs B had no special reason to be suspicious of their son and, as with most parents, would not expect their son to steal from them. The offence with which he had been charged was not an offence of dishonesty.

In this case I found there was insufficient evidence that they had failed to take reasonable care to prevent disclosure of their PIN.

The bank also suggested that the PIN selection was unsuitable as it related to personal telephone numbers.

I considered that the combination of numbers referred to in the bank's conditions of use refer to numbers currently in use, which may be known to, or easily found by other people. In this case, where old telephone numbers had been used, no breach of the conditions of use was found.

There was some contributory fault on the part of Mr and Mrs B after the date of their son's disappearance. In the circumstances, Mr and Mrs B should have realised that their son may have stolen money and/or their cards. Had this occurred, the bank could have been notified earlier and the card stopped.

As a result, I proposed that Mr and Mrs B be reimbursed for unauthorised transactions that took place before 21 September.

Both parties accepted my proposed recommendation for settlement.

## Case 42 – A PIN used for another purpose

Mr B took his young son to a swimming pool on a Saturday afternoon. In the changing rooms he decided to get a security locker for their clothes and other possessions. The locker was operated by a four digit PIN which was entered on a PIN pad similar to those at ATMs. Mr B used the same PIN as he uses for various other purposes, including his bank card, as he wanted a number that he could easily remember.

Mr B and his son enjoyed their swim, collected their clothes and other possessions and went home. Later that evening Mr B went to make an EFTPOS transaction and found that cards and cash were missing from his wallet. He went home and checked his banking records on the Internet to find that there had been a large number of unauthorised transactions on his account. He immediately notified the bank and stopped the cards.

On the next business day, Mr B went to his bank branch to complete the necessary paperwork to do with the disputed transactions. He claimed that all transactions made on the day of the theft had been unauthorised except for a cash withdrawal he had made himself early in the day. Later the same day he added to the form a note about a transaction made using his credit card. The note was ambiguous and it was not clear from the form whether he was claiming this transaction to be unauthorised or whether it was intended to be added as an exception to the list of unauthorised transactions.

The bank declined Mr B's claim for reimbursement of his loss and the complaint came to me for investigation. It seemed clear that Mr B had been overlooked entering his PIN at the swimming pool and that the cards had been removed from the locker while he and his son were swimming.

There is no provision either in the relevant terms and conditions of use for the card or in the Code of Banking Practice to prohibit the use of a card PIN for other purposes. Accordingly the question I had to consider was whether the complainant had taken reasonable steps to prevent disclosure of his PIN. Given that he was not aware of anyone watching him in the changing rooms, I considered it likely that he had seen no need to take extraordinary steps to prevent disclosure and that there had been no breach of the terms and conditions or of the Code.

There were a number of other issues to be considered in this particular case, the chief of which was the earliest time at which Mr B could have become aware of the theft from his credit card account. It had not been apparent when he checked his records on the day of the theft and the bank initially advised me that it would have been impossible for him to have known about it until some time after he added the information about the credit card transaction to the disputed transaction form. This raised the possibility that Mr B colluded in the theft.

It later transpired that although information about the credit card transaction would not normally have been available to Mr B at the time he amended the form, it would have been accessible to staff at the branch where he made his enquiries and completed the form. I therefore recommended that the bank reimburse his loss, less the \$50 customer liability.

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## Case 43 – Overhearing a PIN

Mr D had a credit card issued by the bank. The card also accessed his cheque account. He discovered the card stolen when he went to the shops and found the card he was holding in his hand had expired. He contacted the bank and blocked both accounts.

Mr D had last used his card on 5 April 2001. It appeared that the card was stolen on or about 7 April and between then and 12 April, a total of \$8,812 was taken from his credit and cheque accounts. All withdrawals had been accessed on the first PIN attempt.

Mr D maintained he had not knowingly disclosed his PIN to anyone else, nor had he kept a record of his PIN with the card. His PIN was a number originally devised from an old personal number from his Royal Air Force service days. Mr D also used this PIN for his home security system and as a password for certain telephone transactions with a non-financial organisation.

A young cleaning woman was a regular visitor to Mr D's home and had last visited him on the morning of 7 April. She had not returned since the unauthorised withdrawals began on that day. It became clear during the course of my investigation that this person had most likely overheard Mr D relay his password over the phone or had seen him key in his home security number.

The bank considered that Mr D had breached the conditions of use of his card by disclosing his PIN to this person, although Mr D maintained that he took all reasonable steps to shield the entry of his PIN. He was unaware that the young woman was standing close enough to see or hear the entry of his PIN.

Both the Code of Banking Practice and the conditions of use for the credit card cover two kinds of PIN disclosure. The first is active disclosure of a PIN, which is totally prohibited and intended to cover cases where a cardholder deliberately tells someone else their PIN or allows someone else to use the card with the PIN. The other kind is passive disclosure, where the obligation is on the cardholder to take reasonable steps to prevent disclosure of the PIN.

In this case Mr D had not deliberately or voluntarily disclosed his PIN. He had no reasonable cause to suspect that an employee in his own home would steal his credit card and know that his telephone password was the PIN for the card. There was also no evidence that Mr D had disclosed the fact that his password was the PIN for the credit card. In the absence of any evidence of a lack of reasonable care on Mr D's part, I concluded he had not breached the conditions of use for the card.

I recommended reimbursement of the total amount stolen, less \$50 maximum customer liability. Both Mr D and the bank accepted the recommendation

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## **Case 44 – Reimbursement of card fraud - the bank's right to take action against the offender**

Mrs C's Visa card was stolen by her son, who had been staying with her for a few days between moving from one town to another. The son used the card to make unauthorised cash withdrawals and purchases totalling over \$5,000. Mrs C had not seen or heard from her son since.

The bank at first declined to reimburse Mrs C for her loss as it took the view that Mrs C must have disclosed her PIN to her son. Mrs C then lodged a complaint with the Banking Ombudsman.

After reviewing the evidence, the bank accepted that Mrs C's son had "shoulder surfed" Mrs C to obtain her PIN without her knowledge and despite her taking reasonable steps to protect the PIN. In the circumstances it was prepared to reimburse her for her loss (less the \$50 standard customer liability).

The bank made it clear that, as it would then have suffered a loss, it would be laying a complaint with the Police about the actions of Mrs C's son and it was likely that the Police would charge Mrs C's son with fraud.

The terms of the bank's offer were explained to and accepted by Mrs C and her complaint was settled on that basis.

## **Case 45 – A PIN carried over to a new card**

In May 2001 Mr B's Visa card was stolen and \$1920 taken from his account after two unsuccessful attempts at PIN entry preceded a successful one.

The card that was taken was a reissue of a card that had replaced a previous card lost or stolen in February 1998. The replacement card had an expiry date of February 1999. The bank explained that cards which are lost or stolen are reissued for one year instead of the usual two.

It was established that Mr B would have loaded a PIN onto his replacement card in February 1998. This PIN would have been carried over to the reissued card which was sent to Mr B in February 2001. The PIN related to Mr B's date of birth.

Mr B said that when he was reissued with the card in February 2001 there was no information included to tell him the card would automatically carry the same PIN as the expired card. He said that he would have almost certainly read any information included with the new card. He assumed that he would have to personally load a PIN onto the card at a bank branch. As he wished to curtail his ATM usage, he did not load a PIN onto his new card.

In fact, the mailer which came with the reissued card stated that "if you had a PIN on your old card, there's no need to change it".

It was established that it would be virtually impossible for the bank to send the card without the mailer, as it acted as a kind of envelope for the card. It was therefore most unlikely that the relevant PIN information had not been conveyed to Mr B. The wording on the mailer made it clear that the previous PIN had been automatically transferred to the new card.

Because of the similarity of Mr B's birth date to his chosen PIN, it was concluded that Mr B had breached the terms and conditions of use for the card. He was therefore liable for the full amount fraudulently withdrawn from his VISA account.

Following my proposed recommendation, Mr B withdrew his claim for reimbursement of the stolen monies.

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## **Case 46 – Credit Card Theft - Beware the Signature Forgery**

When Mr and Mrs C's daughter (T) decided to travel overseas, Mr and Mrs C arranged for an additional credit card to be issued to her on their Mastercard account. The additional card did not have a PIN loaded on it. It was used by T only while she was travelling overseas.

Some time after T's return to New Zealand, and unbeknown to her, the credit card was removed from her wallet and was used over a period of six days to make purchases totalling over \$7,000. The card was recovered after a suspicious retailer called the bank who in turn contacted Mr and Mrs C. A few of the unauthorised transactions were able to be charged back to the merchants in question because the card vouchers had not been signed. This reduced the loss to approximately \$5,700.

Mr and Mrs C's bank advised that because the signatures on the remaining credit card vouchers that had been signed by the thief were of a "reasonable likeness" to T's signature on the back of the card, it was unable to charge back the remaining transactions to the merchants concerned. The bank declined to reimburse Mr and Mrs C for the remaining loss. It was of the view that the main contributing factor towards the fraud transactions was the length of time taken to report the loss of the card and it was also concerned that T had failed to reasonably safeguard the card at all times.

T said that, in hindsight, it appeared that her card had been removed from her wallet while she was at a party. She had left her wallet inside a locked house while she went to a party at another property. She believed that her handbag and wallet were safer there than being taken to the party. She did not notice that her card was missing because it was the only item taken from her wallet and she never had cause to use the card while in New Zealand.

After an investigation, I concluded that whether or not the bank could charge back the transactions, its obligations to its customers were governed by the terms of its contract, that is the conditions of use for the card. I found that there had not been any unreasonable delay in notifying the bank that the card was lost or stolen and thus no breach of the conditions of use for the card. Mr and Mrs C and T could only have reported the loss of the card once they became aware that the card had been lost or stolen or once they had reason to believe that the card may have been lost or stolen. In this case they had not been aware that the card was missing until contacted by the bank following the call from the suspicious retailer. They had no reason to be aware prior to that date that the card was missing given that the card was the only item stolen from T's wallet and given that T did not use the card herself while in New Zealand.

Although the bank had also raised the issue of whether T had reasonably safeguarded the card, I noted that under the bank's conditions of use for the card, failure to reasonably safeguard the card was not a reason for holding a customer liable in the event of unauthorised use of the card.

I also expressed my concern that the bank had not charged back the unauthorised transactions to the merchants in question. There was some suggestion that the original signature on the card may have been tampered with because of some smudging of the signature. Further, the signature on the card differed from other specimens of T's signature that I had seen. Up until this case, it had also been my understanding that where a customer's credit card was lost or stolen, and their signature forged on credit card vouchers, and they could satisfy the bank that they did not make or authorise the transactions in question, the bank would charge back the transactions to the merchants concerned.

In light of my findings that there had been no breach of the conditions of use for the card, I concluded that the bank should reimburse Mr and Mrs C for the loss of approximately \$5,700. Both the bank and Mr and Mrs C accepted this and the complaint was settled on that basis.

## 7 - Investments

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As mentioned in my Annual Report for this year, there has been a substantial increase in complaints about the sale of investment products, especially managed funds. Many of these complaints are still under investigation at time of writing but some patterns are discernible.

The sale of investment products is an area where the information imbalance between a bank and its customer is likely to be particularly acute. The complaints I have seen are mostly coming from older customers who need to provide for their retirement. Typically, they have substantial funds on term deposit or in a savings account and little or no experience or knowledge of any other kind of investment.

It is clear from my discussions with bank investment advisers that most of them have a good knowledge of the investment products their bank offers. Investment statements are generally well drafted and although their emphasis, not unnaturally, is on the positive returns that may be achieved, they do not neglect to mention negative returns and the possibility of fluctuations in value. For a moderately well educated investor who is accustomed to make decisions on the basis of reading the relevant material, they contain all that is necessary and I have not seen any investment statement that is misleading.

Many of the complainants I am seeing, however, attach far more significance to their discussions with investment advisers than to the written word. Some do not understand the graphs and tables that they may see or the terms used to describe the investment and its risks. It is a common misconception that “negative returns” means a possibility of losing some of the return on the original sum invested but does not mean that there is a risk of that sum itself diminishing. If an adviser is to avoid the risk of giving inappropriate advice to a customer of this kind, he or she needs more than a good knowledge of the bank’s range of products and a set process to follow. Nor can the adviser always expect customers to ask questions about the detail of the investment statement if there are items they do not understand. In some cases the customer will not realise that he or she has misunderstood important information and in others the customer will avoid asking questions for fear of being thought ignorant.

In most of the cases I have seen I am being asked to find (though possibly not in those terms) either that there was a breach of the bank’s obligations under the Fair Trading Act 1986, so that the customer was misled about the nature of the investment or a breach of the bank’s obligations under the Consumer Guarantees Act 1993 so that the investment sold was not suitable for the purposes the customer had made known to the bank. Sometimes both may have applied as in case 47.

Case 48 was another case where there were some deficiencies in the selling process.

Case 49 is a case of a rather different kind, where the customer claimed to have been sold a product that was not suitable for his needs in circumstances where the evidence indicated that either his needs had changed since he took advice or he had not made them known to the bank at the time of entering the investment.

In case 50 the problem was not so much the initial advice given to the bank customer as the failure to give advice at a later stage when it was needed.

Not all complaints about investment products arise out of the performance of the investment. In case 51, the issue was the cost of the fees associated with it.

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### **Case 47 – Investing for retirement income**

Mr and Mrs O were close to retirement age and had sought investment advice from their bank. They had several accounts with the bank, including a term deposit of \$160,000 earning interest of 5.35%. In July 2000, after taking advice they invested \$100,000 of the term deposit in a medium risk (“balanced fund”) investment with the bank. By March 2001 the value of their original investment had decreased. They approached the bank seeking the return of their lost capital and withdrawal of the sum originally invested from the fund on the grounds that they had been misled by the bank as to the nature of the investment. The bank did not consider it had acted incorrectly in the investment advice it had given them, and declined to pay them any compensation.

Mr and Mrs O explained that although they had other managed fund investments, they had understood that the product offered by the bank was of a different nature. It appealed to them because they would not have to keep reinvesting the term deposit. They said they had been assured by the bank that they would never earn less than 5% on the funds invested. They had also made it clear to the bank that the timeframe they had in mind for the investment was about three years as they would need additional income from 2002 when they turned 65. The only reason they had invested in the particular fund was that they had been told by the bank that they would get a better return on their money. They had put their trust in the bank’s advice and had suffered a loss as a consequence.

The bank officer with whom they had met said that he had discussed Mr and Mrs O’s investment options with them and had recommended the particular fund because it appeared to meet their needs. He said he had gone

through the investment statement with them and was satisfied that they understood that the investment was not in the nature of a term deposit, and that there was no guarantee of future performance. He also recalled mentioning that the fund needed to be assessed over a five year timeframe. The bank considered the fund was not an inappropriate product for a 63/64 year old person.

The questionnaire which Mr and Mrs O had completed at the time the investment was made indicated that they required an investment in a conservative as opposed to a balanced fund. The brochure they were given explained the nature of the investment and included a reference to the possibility that the value of the investment might fall on occasion, so investing in the scheme carried the risk of negative returns.

I formed the view that Mr and Mrs O genuinely did not expect that they would risk losing any capital by investing in the recommended fund. I was also satisfied that they had wanted an investment that would provide an income for them from 2002. I thought it likely that the bank assumed that Mr and Mrs O were more experienced and knowledgeable investors than they actually were. This was not entirely without reason, given the other investments they held, but it meant that the bank had pitched its advice and discussions at the wrong level.

The bank could not be held responsible for the market conditions that caused Mr and Mrs O's investment to lose value. However, it is important that the risks and negative aspects of an investment in managed funds are properly explained to customers. In this case, I was not satisfied that sufficient emphasis had been placed on the negative aspects and the risk of an immediate loss of capital.

Had the fund continued with the good returns it had been achieving up to July 2000, there is little doubt that Mr and Mrs O's investment would have gained in value and in 2002 they would have been in a position to draw down on the capital gains for income without affecting their initial investment. However, to the extent that there is always a risk of a loss of capital; and that the investment was viewed as being a medium to long term one; and bearing in mind that Mr and Mrs O were very close to retirement when making the investment and thus close to requiring an income from their investment, I was not satisfied that the investment was a suitable one for their requirements. I noted that had their money been invested in the bank's conservative fund, which their responses to the questionnaire indicated was the appropriate one, they would have lost considerably less.

I also concluded that there was a degree of contributory fault on the part of Mr and Mrs O in not reading a copy of the investment statement which showed that the fund in which their money was invested had a recommended five year timeframe for investment. It also mentioned the risk of negative returns. They were investing a reasonably large sum of money and ought reasonably to have ensured that they informed themselves fully about the nature of the investment rather than relying entirely on the advice they had received from the bank officer. I assessed their degree of contributory fault at 30%.

In the circumstances, I proposed that the complaint be settled by the bank reimbursing Mr and Mrs O for 70% of their direct loss. Both parties accepted my proposal.

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### **Case 48 – An unsuitable investment?**

Mrs Y had her retirement savings in a savings account and a short-term term deposit. In accordance with bank policy, when she went into her branch to make transactions and staff brought up her details on the computer, she was often asked whether she would like to discuss her savings with an investment adviser.

At some time in August 2000, Mrs Y agreed to see an investment adviser and a number of investment options were discussed. After the meeting, the investment adviser wrote to her, recommending an investment in a managed funds product offered by the bank. He later contacted her again and there was a second meeting

at which Mrs Y agreed to put her savings into the bank's managed funds product. She invested a total of \$280,000, \$100,000 of which was taken from a term deposit at 7% per annum, which had to be broken.

Some four months later, Mrs Y found that the value of her investment had dropped by nearly \$9,000. She was extremely upset and shocked and after some discussion with the bank, transferred the balance of her investment out of the managed funds product. By this time the value had dropped again.

Mrs Y complained first to her bank and then, having failed to receive what she regarded as a satisfactory response, to me about the process by which she had been persuaded to put her savings into the managed funds product. She considered she had been rushed into investing in an investment she did not really want or need and that she had been the victim of a high powered and overwhelming sales pitch. She did not really understand all the features and the nature of the investment product and also said she had not received a proper explanation of the reason for the decline in the value of her funds.

The bank agreed that its staff had approached Mrs Y about investment services and that it was its policy to make such an approach to customers who had substantial funds on term deposit. Very often another type of investment was more suitable for such a customer and it felt it was providing excellent customer service by taking the initiative in this way. However, it became clear during the course of my investigation Mrs Y was simply not a suitable customer for that type of customer service. She did not appreciate perpetually being asked if she was interested in other bank products. What the bank saw as excellent customer service was viewed by her as pressure and harassment to which she eventually gave in.

I was satisfied that the bank staff had explained the product to Mrs Y and that the investments recommended to her were reasonably appropriate after a full and careful consideration of her circumstances. Nonetheless I was not so certain that she fully understood the nature of her investment and in particular that it was possible for the value of her original capital to decrease substantially right from the start of the investment or that she could incur a substantial loss in a matter of months.

I also concluded that she received a reasonable explanation for the rapid decline in the value of her investment. It was due mainly to falls in the value of world and New Zealand shares because of the slowing down of the US economy, which in turn impacted upon the sharemarkets of other countries.

However, I was concerned that the bank did not provide Mrs Y with good advice when it persuaded her to invest nearly all of her savings in managed funds and in particular that it advised her to break the term deposit investment that was already producing a good rate of return.

Accordingly I proposed to recommend that the bank reimburse Mrs Y for the loss suffered on the part of her investment represented by the investment of the term deposit funds and for the loss of interest that she would have earned had these funds remained invested on term deposit.

Both the bank and Mrs Y accepted my proposed recommendation and the complaint was settled accordingly.

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### **Case 49 – An uncertain time frame**

Mr W was a young professional man who had saved about \$56,000 which was partly in a savings account and partly on term deposit. A staff member of his bank suggested he see one of the bank's investment advisers.

Mr W met the investment adviser and after discussing various options with him, the adviser prepared an investment portfolio for him. She recommended that he invest most of his funds in an international shares fund and just over \$10,000 in an international bond fund. Mr W accepted the recommendation and also set up regular monthly payments into the two funds. About three months later he made a lump sum addition to his

investments. The following month he received a statement and was concerned to see that the value of his investment had declined. It continued to decline over the next five to six months and he then ceased making regular contributions to the funds. He complained that he was sold an inappropriate product for his needs. He said, in particular, he had hoped to purchase a home or invest in a business in the near future and that a long-term investment was not suitable for his requirements. He also believed he had been misled about the level of risk attached to the investment. He said he understood there was a moderate level of risk, which he took to mean that there was a risk of a small loss, not a risk of substantial loss.

There was some disagreement between Mr W and the investment adviser as to precisely what he had told her about his future plans. They agreed that he had talked about purchasing a home or starting a business but the investment adviser understood him to say that he wanted to make the purchase mortgage free. This would clearly not be possible for a considerable period at his current rate of saving and for that reason she advised a longer term investment. Mr W, on the other hand, said he had always accepted he would need a loan to purchase a home, although possibly not to start a business. He had no fixed idea about when the need for the money was likely to arise. He said it could be in the next six months or up to five years or even longer.

I was satisfied that Mr W understood that his investment carried a level of risk. He seemed to have misunderstood the nature of that risk but it was clearly explained in the explanatory material attached to his portfolio and he had had three weeks to consider it before committing himself to the purchase of the investment. There was no suggestion that the investment adviser had misled him about the level of risk.

It was not quite so clear that the investment product was suitable for the purposes Mr W had made known to the adviser. If he had made it plain that he was likely to need access to all the funds in a comparatively short time, there would have been a real question as to whether a share based investment was suitable. Having interviewed Mr W myself, however, I concluded that he may very well have been rather vague about his future plans and not specific about time frames in his discussions with the investment adviser. Moreover, the portfolio prepared for him described his profile as a “long term investor”. As noted above, he had had three weeks to read the portfolio and to correct any mistakes or misdescriptions in it.

In the circumstances I found that Mr W was sufficiently informed of the risks associated with his investment and was not sold an inappropriate product for the needs he had made known to the bank.

I suggested that Mr W withdraw his complaint and he agreed to do so.

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## Case 50 – A poor investment choice

Mr B was a retired manual worker with little experience in investments such as unit trusts or managed funds. He and his wife approached their bank about retirement savings. They had about \$53,000 to invest. The bank recommended that they invest their money in its superannuation scheme in a conservative fund.

After eight months, Mr B saw that the bank’s “growth fund” had achieved a better rate of return and instructed the bank to switch his money from the conservative to the growth fund. Mr and Mrs B did not realise that the “growth fund” carried a higher risk of negative returns. The money was switched in August 2000.

By August 2001 Mr and Mrs B’s investment had lost over \$5,000. Soon after they discovered this, they withdrew their retirement monies from the fund. Mr B complained to the bank that he had not been told of the poor returns the “growth fund” had been making at the time of the switch nor was he sufficiently informed of the differences between the various managed funds on offer.

It became apparent during the course of my investigation that Mr B was provided with no information by the bank on the nature of the new higher risk investment. The bank also agreed that Mr B was supplied with insufficient information at the time of the switch and that the higher risk fund was an inappropriate investment for a man in Mr B's position.

The bank therefore offered to reimburse Mr B for the amount of the lost capital from the time that Mr and Mrs B made the switch to the date they withdrew their investment from the fund - a sum of approximately \$6,800. The complaint was settled on this basis.

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### **Case 51 – The cost of an investment**

Mr N stated that, acting on advice from his bank, he had invested a significant sum in a managed funds investment with the bank. His complaint concerned the level of fees charged by the bank. He said he had not been given the relevant investment statement nor had he been informed of the amount of the commission payable to the bank despite asking how much commission the bank charged. He maintained that if he had been aware of the level of the commission charged he would not have invested in the managed funds.

As a result of a number of complaints relating to the quality of advice offered by investment advisers, I have some concerns that some advisers do not always take adequate steps to ensure that prospective investors are fully aware of the nature and cost of a particular product. However, in this case the bank's records showed that Mr N had signed documents acknowledging that he was aware of the fees and charges and had received and read the investment statement. The bank also pointed out that Mr N had made three separate investments in the managed funds and that if he had been dissatisfied with the amount of commission charged on the first investment, he would presumably not have made the further investments. Furthermore, he had not pursued his complaint about the fees until some 20 months after making the investments.

Taking all the circumstances into account, I concluded that the complaint could not be upheld and recommended that it be withdrawn.

## **8 - Insurance**

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Most of the insurance-related complaints received in my office have to do with the administration connected with insurance policies or the selling process whereby a bank sells insurance to its customers. Case 52 concerns a matter of administration while case 53 is more concerned with the process whereby the insurance is sold to the customers. Case 54 is included as an example of speedy action on the part of both my office and the relevant bank to produce an outcome which, while it cannot be called happy, was at least satisfactory for those concerned.

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### **Case 52 – Unequal treatment of partners**

Ms A and her partner bought a house together. Ms A owned two thirds of it and her partner one third. When they obtained a loan from their bank for the purchase, the bank required a registered mortgage over the

property and also the assignment of suitable life cover or mortgage protection insurance (MPI). Ms A took out a new MPI policy with the bank recorded as the policy owner. Ms A's partner assigned an existing life insurance policy to the bank. Both of them signed an agreement with the bank about the life policies.

Two years later Ms A's partner died. Ms A had expected that the proceeds of her partner's life insurance policy would be applied to reduce the principal sum owing under the mortgage, for which she now had sole responsibility. She found, however, while she was arranging to acquire her late partner's one third share in the property, that the proceeds of the insurance policy had been released to her partner's estate, of which she was not a beneficiary.

It transpired that the arrangement as to insurance cover between her partner and the bank had been different from her arrangement. The assignment of her partner's insurance policy had not been registered and was therefore an equitable assignment. The bank actually owned the MPI policy that Ms A had taken out. She considered that the bank discriminated against her unfairly by not requiring both partners to have the same cover and understood that if she had died first the bank would have applied the proceeds of her MPI in repayment or reduction of the mortgage because, unlike her partner's policy, it had ownership of it.

It was clear that the bank had not taken the two insurance policies on the same basis and to that extent it could be said that there was discrimination by the bank. This was particularly so as the bank had not advised Ms A that it was treating her differently from her partner. Under the agreement that she and her partner had signed, the bank had no right to the proceeds of the partner's policy but in some circumstances it may have had a right to the proceeds of Ms A's policy. However I was satisfied that as the loan was not in default the bank would not have applied the proceeds of either policy to the loan, whichever partner had died first.

It was apparent that the bank's actions had not caused Ms A any direct financial loss, but she had been inconvenienced because the bank had initially misinformed her about the position regarding the policy and had delayed in telling her that it was releasing the proceeds to the late partner's estate. I also considered it would have been helpful if the bank had explained both to her and her partner at the time they signed the agreement that the assignment of the policies did not mean that the proceeds would necessarily be applied to the loan in the event that either of them died.

In the circumstances the bank agreed to pay Ms A \$250 compensation for the inconvenience it had caused her.

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### **Case 53 – Insurance a condition of a loan, but inappropriate policy**

As a condition of a loan to Mr and Mrs W the bank required them to take out loan protection insurance cover. Mr and Mrs W disputed that it was indeed a condition of the loan and submitted the bank had misled them into believing the loan would not be approved if they did not have the insurance cover. On perusal of the loan agreement it was clear that insurance was a term of the loan and I formed the view that the bank had not misled Mr and Mrs W. I proposed that this complaint be withdrawn.

Mr and Mrs W went on to say that incorrect advice from the bank resulted in them taking out insurance cover that was not suitable for their needs. Not only did they have death cover already, but they were excluded from some of the specified events in the insurance policy. The policy provided cover for death, bankruptcy, terminal illness or total and permanent disability, but the redundancy cover did not apply because Mr W was self-employed and Mrs W was employed by Mr W. Neither the total nor the partial temporary disability cover applied to Mrs W because she did not work more than 20 hours a week.

Although Mr and Mrs W had sufficient pre-existing insurance cover to provide for repayment of the loan in the event of the death of either of them, it differed from loan protection insurance in that the proceeds would not

necessarily be available to repay the loan. They would form part of the estate of the insured and could be used to repay other debts, for example. It was therefore not unreasonable for the bank to require loan protection insurance. It did, however, have an obligation to provide a policy that was suitable for Mr and Mrs W's needs. The policy provided by the bank was of some benefit to Mr and Mrs W, but part of the cover for which they were paying premiums was cover for which they could not qualify. I therefore proposed and both parties agreed, that the bank should reimburse such part of the premiums as applied to that cover.

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### **Case 54 – A lapsed life insurance policy - a claim for reinstatement**

In early 2000 Ms A was diagnosed with a terminal illness. A few months earlier she had taken out a term life insurance policy with her bank. The policy provided a terminal illness benefit whereby the bank could pay out the sum insured upon being given medical evidence that the life insured would not survive a further six months. However, Ms A's claim for the terminal illness benefit in early 2000 was declined because she could not produce medical evidence that she was likely to die from her illness within the next six months. Ms A was very upset as her partner had also recently died and she was concerned to make life as comfortable as possible for her two teenage children. As Ms A was no longer able to work due to her illness, she was finding it very difficult to make ends meet financially.

Approximately two years later Ms A's solicitors wrote to my office to advise that Ms A was very unwell and not expected to survive the next fortnight. The solicitors explained that in March 2000, when Ms A was having difficulty coping with her own affairs, she appointed them as her agents and asked them to deal with the bank on her behalf. The solicitors contacted the bank at that time to advise that they were acting as agents for Ms A, to confirm that an automatic payment was in place for payment of the insurance premiums and to give notice that it was imperative that the automatic payment for the premiums continue to be paid and that the bank was to consult the solicitors immediately if there was any problem. The solicitors did not hear anything further from the bank.

In April 2002 the solicitors discovered that Ms A's policy had lapsed in February 2001 due to non-payment of premiums. The bank had neglected to advise the solicitors about the non-payment of premiums or the lapsing of the policy. The solicitors complained about this and about the bank's perceived conflict of interest in being both the payer of the automatic payment and the recipient of those payments, raising the implication that the bank did not have Ms A's best interests at heart when it neglected to inform the solicitors, as her agent, of the situation.

Upon receipt of the complaint, my investigator immediately contacted the bank to discuss the details of this complaint and to request an urgent response from the bank. I advised the bank that, given the very serious state of Ms A's health, I was of the view that the decision by the bank as to whether or not it was prepared to reinstate the policy needed to be made as soon as possible.

After further consideration, the bank agreed, within one working day from receipt of the complaint, to pay the claim of \$100,000 to Ms A, subject to confirmation from her medical provider as to her current medical condition and prognosis. The bank accepted that it had known in 2000 that it would eventually be paying out the sum insured to Ms A or her estate and it had made provision in its books for payment of the claim. The solicitors were asked to send the necessary medical evidence to the bank as soon as possible so that the claim could be paid immediately.

Ms A was very relieved to receive the news and the claim was able to be settled before she died a few days later.

## 9 - Miscellaneous

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The first case in this section, case 55 concerns a matter of privacy. When a bank conducts a credit check on a prospective customer, it is collecting information from a source other than the relevant individual. In collecting such information, banks must have the consent of the prospective customer or must reasonably believe the prospective customer has consented (Information Privacy Principle 2 from the Privacy Act 1993). In this case the bank clearly did not have the requisite consent.

Case 56 arose out of somewhat unusual circumstances. When a bank customer has been the victim of fraud by a bank employee, as inevitably happens on occasion, a bank will normally be obliged to reimburse any loss. Unless there is some question of negligence or complicity on the part of the customer, I have never known a bank to fail to do this. The consequences of fraud may, however, go beyond the direct financial loss and in this case it was necessary to assess compensation for inconvenience and for the loss incurred by the customers in assisting the bank to detect the fraud.

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### Case 55 – A credit check without authority

Mr G applied to the bank as sole director and shareholder of ABC Limited (“ABC”) to open an account for ABC. Both Mr G and ABC’s manager, Mr H, were to have signing authority on the account. The account was duly opened.

A month later, Mr H applied for a further banking facility for ABC. The bank at this point carried out a credit check on both Mr H and Mr G. The bank then wrote to Mr G and advised that ABC’s application for the further facility was declined due to a payment default history recorded against Mr G’s name with a credit reference agency.

Mr G complained to the bank that he had not authorised the credit check.

A month later, the bank carried out another credit check on Mr G as it was concerned about the operation of ABC’s account. The bank had dishonoured a large number of cheques.

Mr G sought a copy of the information held by the credit reference agency about him. He discovered from the information that another credit check had been carried out by the bank some two years earlier.

Mr G complained to my office that the bank conducted three credit checks on him without authorisation.

The bank agreed that it did not have Mr G’s authority to carry out the first credit check or the check carried out when Mr H lodged an application on behalf of ABC for a further facility, but it believed that it acted correctly in conducting the credit check when it became concerned about the operation of ABC’s account. The bank explained that a credit check should have been carried out on Mr G as part of the account opening procedures. The credit check was not carried out until several months after the account was opened. The bank said it carried out this credit check under the verbal authority provided by Mr G at the time the account was opened. The bank believed the credit check, although performed late, was carried out with Mr G’s knowledge and consent.

I was not able to establish whether Mr G provided his consent for a credit check to be carried out when ABC’s account was opened, but Mr G certainly did not provide consent for a credit check to be carried out several months later. At this point, Mr G had already complained about an earlier unauthorised credit check.

The bank may have wanted to conduct a credit check about Mr G when he applied for an account for ABC for the purpose of assessing whether it wished to provide an account to ABC. If it gained Mr G's consent, it could only collect the information for that purpose. The bank was entitled to waive its own requirement to carry out the credit check at the time the application was made to open the account; it was not entitled to use any consent given at that time to carry out a credit check at a later date for another purpose. The credit check carried out in this case could not have been carried out for the purpose of assessing whether the bank wished to provide an account to ABC as it had already provided ABC with an account.

I proposed that the bank make a payment of compensation to Mr G in recognition of the stress and inconvenience he had suffered as a result of the repeated credit checks carried out without his authorisation.

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## **Case 56 – Fraud by a bank employee and compensation for inconvenience**

Mr and Mrs G were the victims of a series of fraudulent transactions made by an employee of their bank. Due to very difficult personal circumstances, the couple had given much of the responsibility for their day to day banking to this individual at her suggestion, including paying accounts with pre-signed cheques and setting up automatic payments.

After approximately six months, Mr and Mrs G began to notice irregularities in their accounts and creditors were telling them they had not been paid.

When the matter was referred to the bank's fraud and security department it was established that \$3,488.88 had been stolen, for which the bank reimbursed Mr and Mrs G. The bank made an additional offer of \$1000 as compensation for the stress involved, as well as further reimbursement of a disputed transaction of \$750 with \$250 for overdraft interest charged.

Mr and Mrs G approached my office at this point, claiming that \$1000 was not sufficient compensation for the inconvenience the actions of the bank's employee had caused them. They had spent a considerable number of hours researching the suspicious transactions before the bank's fraud department took up the case. Mr G was required to travel to the bank on at least nine occasions to attend meetings (which involved considerable time as they lived over 70km away from the bank branch). Mr and Mrs G also suffered embarrassment when creditors were not paid. They requested a formal apology from the bank and asked it to write a letter to each of the affected creditors explaining the reason for non-payment. They claimed \$25,000 for stress and inconvenience suffered.

The bank maintained that it could only begin an investigation when it was certain there was a sufficient basis for suspicion of fraud. Its own auditor did not have enough evidence against the employee to obtain a clear picture of her actions. Only after Mr and Mrs G were able to provide enough information about the discrepancies was the bank able to initiate an internal investigation. After this time the bank spent considerable time and resources on the claim. The bank considered that \$1000 compensation was appropriate.

I considered that under clause 1.7.2(iv) of the Code of Banking Practice, the bank has an obligation to act fairly and reasonably towards its customers in a consistent and ethical manner. In order to satisfy this obligation, a bank has a duty to reimburse a customer for loss suffered as a result of fraudulent and/or dishonest activities by one of its employees in the course of his or her employment.

Although Mr and Mrs G could have approached an independent source for budget assistance, I considered it reasonable that Mr G trusted the bank employee who volunteered her assistance at a very difficult time in the couple's lives. They did not have much time to reconcile bank statements and the paying of creditors was partly done by Mr G pre-signing blank cheques. While I considered these factors amounted to a small degree

of contributory fault on the part of Mr and Mrs G, it was not unreasonable for Mr G to believe that the bank's employee would be acting in the couple's best interests.

I recommended that in addition to the original reimbursement the bank should pay compensation of \$3,865 that included reimbursement of the disputed transaction, overdraft interest incurred, travelling costs, and toll calls as well as time spent investigating the matter, and compensation for inconvenience incurred by Mr and Mrs G.

In addition, I invited the bank to write a formal apology to Mr and Mrs G and an explanatory letter to any creditors of Mr and Mrs G, taking responsibility for difficulties with payments of their accounts, to ensure that their credit rating would not be adversely affected in the future.

Both parties accepted my recommendation.

