



Newsletter

February 2009

The second half of 2008 saw a dramatic rise in the number of complaints coming to my office, and in January 2009 we took in a record number of complaints and enquiries. We now have 240 complaints under investigation as against 91 at the end of January 2008.

The flood of complaints has been caused directly or indirectly by the global financial crisis and began in March 2008 with the freezing of two funds provided by ING New Zealand Ltd in which a number of investors had invested on the advice of bank investment advisers.

In the last quarter of 2008 we began to receive complaints relating to the cost of breaking a fixed rate loan, and these have also increased in the first weeks of 2009. Exchange rate fluctuations have been behind a small rise in complaints involving cross-border transactions, and we are also seeing a general rise in complaints from customers in financial difficulties who either consider their banks at least partly responsible for their problems or complain that they have been treated unfairly or insensitively when debt recovery action is taken.

Liz Brown
Banking Ombudsman

INVESTMENT ADVICE

We have now completed the investigation of over 60 disputes involving advice to invest in one of the two ING funds, the Diversified Yield Fund and the Regular Income Fund.

The funds were described as low to moderate or moderate risk investments. The fact that they have dropped substantially in value and withdrawals have been suspended does not in itself mean that the risk was higher than represented. However, in a number of cases I have found that:

- customers were recommended to invest an inappropriately high proportion of their savings in one or both funds
- advisers failed to give an adequate explanation of the funds and the risk attached to them
- the funds were recommended to customers when they were not suitable for the needs of that individual customer.

We have had good co-operation from the bank involved in the majority of these cases and 37 complaints have been resolved by facilitation or conciliation when the bank agreed to buy back all or part of the investment, sometimes with other compensation as appropriate. In other cases the bank accepted my initial assessment of the complaint in favour of the complainant. Only in one early case was it necessary to issue a formal recommendation that the bank pay compensation to the customer.

We have also had cases where the investment advice was appropriate and the proper explanations were given. In those cases I have not upheld the complaint.

EARLY REPAYMENT CHARGES

The second main factor in our increased caseload is the number of complaints about the cost of repaying a fixed rate loan early.

Complaints about this issue began to be made in November 2008, and are increasing by the month.

There was a wave of similar complaints in 1998 and 1999, but since then the Credit Contracts and Consumer Finance Act 2003 has come into force and needs to be taken into account in considering complaints arising from loan contracts covered by the Act, which does not cover business loans.

The Act requires that any early repayment charge must be reasonable. "Reasonable" means that it must reflect the actual cost to the lender of breaking the loan early.

If retail interest rates are below the rate a customer was paying on the loan, then the bank cannot lend out the repaid funds at the same rate and incurs a genuine loss. However, some banks are calculating their loss by reference to their cost of borrowing on the wholesale market. This cost varies at a

different rate from retail interest rates and is more difficult to understand.

I have concluded that, if the only issue in the complaint made to me is compliance with the Credit Contracts and Consumer Finance Act, I should decline to investigate it and should refer the complainant to the Commerce Commission. However, many complaints raise other issues and I will investigate them. They include complaints of:

- misleading information about the likely amount or application of any charge
- failure to warn that a fixed rate loan was unsuitable for the customer's purposes
- the amount charged on repayment is much greater than the indicative amount quoted prior to settlement.

In relation to the last issue, I have included in this newsletter a case note from an earlier intake of complaints on this topic.

Case 1

Mr and Mrs C had two fixed rate loans. In August 1997 they approached their bank to enquire about a loan to assist in the purchase of an investment property. When the bank said that it would not be prepared to assist, Mr and Mrs C asked what it would cost them by way of early repayment penalties on their fixed rate loans if they were to repay them. They say the bank officer gave them a printout showing that the total penalty was approximately \$160 and indicated that the penalty could fluctuate, but that the amount of the fluctuation should not be more than a few hundred dollars.

Mr and Mrs C then arranged to refinance elsewhere. They were shocked to be advised on settlement day, approximately one month later, that the early repayment penalty required by the bank was nearly \$2,000.

Mr and Mrs C complained that they had been misinformed by the bank about the extent to which the early repayment penalty could fluctuate. The bank said that the difference between the quote and the actual cost was caused by a 0.52% fluctuation in wholesale interest rates. It maintained that it had made it clear to Mr and Mrs C that the figure quoted was indicative only and subject to daily fluctuations.

After investigation I was satisfied that Mr and Mrs C had been led to believe by the bank officer that the quoted figure could change, but that the amount of any change would not be more than a few hundred dollars. They were certainly not told that there could be a very large deviation from the quoted figure.

Although the loan agreement clearly stated that any estimate of the early repayment penalty was indicative and not binding on the bank, I formed the view that, in order for a figure to be "indicative", it must indicate something. In this case the figure quoted could not possibly be said to have indicated to Mr and Mrs C that they might face a penalty of nearly \$2,000 one month later. I found that Mr and Mrs C had not been given sufficient information by the bank to enable them to make an informed choice to best suit their needs. Had they received adequate information about the possible extent of fluctuation they may well have decided not to proceed with the purchase and refinancing.

I also observed that, to better inform customers who may not appreciate the effect of the volatility of the money market on the calculation of the early repayment penalty, the bank should state both verbally and on any quotation form when providing an estimate of the early repayment penalty, that the quote given was for that day only and that it was possible for the amount to fluctuate widely from day to day.

I recommended that the bank refund to Mr and Mrs C a substantial part of the early repayment penalty, that is, the difference between \$500, which was the maximum amount Mr and Mrs C were expecting to pay, and the amount eventually charged on the date of settlement. This equated to a refund of approximately \$1,440.

DEBT-RELATED COMPLAINT

We are also seeing an increase in general debt related complaint. While this manifests itself in many different ways, we are seeing a particularly high number of complaints claiming that a bank should not have made a loan to a customer or should have lent a lesser amount.

The Code of Banking Practice provides at clause 5.1(c) that banks will “... *only provide Credit to you or increase your Credit limit when the information available to us leads us to believe you will be able to meet the terms of the Credit Facility. We have the right to decide not to provide Credit to you.*”

As a general rule, I am unlikely to uphold a complaint of a breach of clause 5.1(c) when the loan has been made to an

adult customer who is not under any sort of disability and who has requested the loan. Matters may be different when the loan was unsolicited, as is sometimes the case with a credit card limit increase.

Many of the complaints focus on lending to young customers between the ages of 18 and 25. Banks do not generally have special processes for lending to young people in this age group and indeed they have an obligation not to discriminate against their customers on grounds of age. A young person may, however, have limited ability to repay the loan and this should be taken into account. The two case notes below demonstrate the approach to this sort of complaint.

Case 2

Mr and Mrs Y applied to their bank for a loan to fund an investment venture. When the bank first considered their loan application, it did not meet the basic servicing criteria. However, their personal banker decided to submit the application to the bank’s credit committee for consideration for a number of reasons, including:

- Mr and Mrs Y’s favourable account and lending history
- their ability to offer unencumbered security
- Mrs Y’s imminent return to paid employment from parental leave
- the anticipated short duration of the investment

The bank took these factors into account and decided to approve the loan, with interest only payments for two years at a fixed rate of interest.

The investment venture failed and Mr and Mrs Y lost the capital they had invested. They complained to me that the bank should not have approved the loan in the first place.

After considering the background to the bank’s lending decision, I concluded that while the decision to lend may have been marginal in terms of Mr and Mrs Y’s ability to service the loan, the bank was entitled to consider the application in the light of all the circumstances. There was nothing to suggest that the bank’s decision making process was deficient or that it had made its decision based on erroneous information or without making sufficient enquiries. I told Mr and Mrs Y that I could not take the complaint any further.

Case 3

Mrs P complained about a bank’s decision to allow her eighteen year old son to borrow \$8,500. She felt that the bank had made no effort to establish whether he had sufficient money management skills to act responsibly with the funds advanced. She believed that the bank officer should have made more enquiries, including consultation with his parents, to ensure that their son would be able to maintain repayments on the loan.

The bank explained that eighteen is the legal age of consent and that her son did not need parental consent to enter into a credit contract. It considered it had a robust lending policy and criteria. It reviewed the application and confirmed that it met the bank’s personal loan lending criteria.

Case 3 continued on next page

Case 3 continued

I explained to Mrs P that the bank was under no obligation to have a policy in place to consult the parents of youthful applicants who are legally adult and that, in the absence of such a policy, the bank was not in breach of any obligation or duty owed either to her or to her son.

Paragraph 18(b) of my Terms of Reference does not allow me to consider a complaint about a bank's commercial judgement in a lending situation but I can look at the decision making process, taking into account the relevant section of the Code of Banking Practice. Section 5.1(c) of the Code says that a bank will only provide credit when the information available to it suggests that the customer will be able to meet the terms of the credit facility.

In this case there was no evidence to suggest that the bank's lending decision was deficient or had been made without taking relevant information into account. I noted that the application required information about employment status and earnings and that a statement of position had been completed and signed as accurate before the lending was approved. I concluded that there were no grounds to further investigate Mrs P's concerns.

CHANGE TO THE PUBLICATION DATES FOR THIS NEWSLETTER

Observant readers will have noticed that this newsletter is being published in February and not, as usual, in December. We have decided to issue newsletters in August and February in future, to avoid the newsletter arriving just before the Christmas break and often being left unread until January or February. Feedback on the new publication dates would be welcome.