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** On 1 July 2008, the Banking & Financial Services Ombudsman (BFSO), Financial Industry Complaints Service (FICS) and Insurance Ombudsman Service (IOS) merged to form the Financial Ombudsman Service (FOS).*

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Bank Surveys and Good Banking Practice

The role of the Ombudsman's Banking Adviser is to provide advice to the Ombudsman and his staff about what constitutes good banking practice, which is one of the criteria we must take into account when making our decisions.

The Ombudsman's Banking Adviser has in the last couple of years conducted bank surveys on issues arising during the course of our investigation of individual disputes. We have used the results of those surveys to reach conclusions about industry practice and the requisite standard of care and skill of a diligent and prudent financial services provider. It may assist users of the Scheme to be informed of the results of some surveys and the conclusions we have reached.

Mandate for Change of Signing Authority on Accounts

The Banking Adviser surveyed eight banks as to their requirements for adding a third party signatory to a joint account.

Five of the banks replied that their procedures required both account holders to consent to the addition of a third party signatory, irrespective of whether the account mandate was for both account holders to sign or for either to sign. The other three banks required only one account holder to sign the request to add the third party signatory when the method of operation was for either to sign, and both account holders were required to make the request if the account mandate was for both to sign.

Based on these results, the Banking Adviser considered that it would be good industry practice to require both account holders to request or consent to the addition of a third party signatory irrespective of whether the account mandate was for both to sign or either to sign.

In our view, the requirement for a joint mandate to add another signatory is a prudent measure as the funds are held for the benefit of each account holder, and the addition of another signatory increases the risk of disputed withdrawal of funds from the account. Therefore, both account holders should consent to the appointment of a third party as a signatory.

Similarly, in our view, it would appear appropriate that both account holders should request or consent to one of the account holders being removed from the account signing authority, or to a transaction which would in effect close the account or remove the whole of the funds in a deposit account from the control of one of the account holders.

Withdrawal Instructions Presented by a Third Party

There are circumstances which should alert a bank that its customer's interests may be prejudiced by certain transactions which, on their face, appear to be validly made by the customer. The general rule is that a bank should question a mandate when a diligent and prudent banker with knowledge of the relevant facts would consider that there was a serious possibility that the customer was being defrauded or that the monies were being misappropriated. While bank officers are not required to be

detectives, if the circumstances put the bank on notice of something untoward, what is the obligation of a banker?

With this issue in mind, the Banking Adviser was asked to survey banks to ascertain their process when withdrawal requests apparently signed by their customer were presented by a third party without the customer being present. In the case under consideration, it appeared that the elderly customer had signed the withdrawal forms but had not completed any other particulars such as the amount in words or numbers, and the withdrawal forms were being presented by her carer who was a volunteer and not related.

The Banking Adviser reported that the major banks follow different procedures in circumstances where a passbook and withdrawal voucher are presented to a teller to make a withdrawal by a person who is not the account holder. One bank requires prior arrangements to have been made by the customer with his or her manager, in which the customer authorises the third party to present the withdrawal request. Another bank requires the third party presenting the withdrawal request to produce a signed authority from the account holder, together with proof of identity in accordance with that authority. Another bank again will not process the withdrawal request unless it can contact the account holder to verify his or her instructions.

In our view, a financial services provider should follow a procedure similar to the selection above in order to meet good banking practice in relation to withdrawal requests presented by third parties who are not signatories to the account.

Guarantor and Third Party Income in Credit Assessments

We have seen circumstances in which guarantor and third party income has been taken into account in a financial services provider's credit assessment. The issue has arisen when the debtor has subsequently defaulted and the debtor and/or the guarantor have asserted that there was maladministration in granting credit as the debtor did not have the capacity to repay the loan from their own income sources.

Generally, a customer's application for finance is assessed on the customer's capacity to repay the debt, without reference to the income of proposed guarantors. This is because contractually the debtor is primarily liable to service the loan. A guarantor provides security to a financial services provider in the event of default by the debtor.

The Banking Adviser asked three banks about their credit assessment criteria when the principal borrower was a non-trading company with no history of income generation. In particular, the banks were asked to address whether, if a customer sought loans for investment purposes set up through a non-trading company, would they take into account the personal income of the directors of the company and/or the income of a related entity which the customer also controlled in their assessment of the company's capacity to service the loan.

The general response was that the directors' income would be taken into account in assessing serviceability. The income of a related entity may also be taken into account. However, this would only be on the basis that guarantees were taken from any individual or entity whose income was relied upon in making that assessment.

An observation was also made that each application must be considered on a case by case basis, also taking into account other factors such as the purpose for the loan, cash flow forecasts for the investment endeavour, experience and reputation of the management/controller and the proposed supporting security.

We can appreciate there may be circumstances in which the guarantors are so intrinsically connected to the borrower that their financial livelihood and that of the debtor are commonly sourced or aligned.

For example, directors of a company derive their income from the company's generated income. They have a duty to ensure that the company does not trade while insolvent, and therefore should ensure that the company is able to pay its creditors (such as its liability to service its financial accommodation) before they draw funds for their own purposes and benefit. In this circumstance, it may be appropriate to factor back into a company's available source of funds drawings made by directors.

We will consider each dispute regarding the assessment of a debtor's capacity to pay and the inclusion of a guarantor's income in the credit assessment on a case by case basis. As can be seen from the above comments and example, there may be circumstances in which it would be industry practice to take into account a guarantor's income. However, where a guarantor is not directly and regularly involved in the financial affairs of the debtor, a financial services provider should take extra care before approving an application for finance based on the income of a third party or guarantor.

We will consider what information was provided to the guarantor regarding the financial position of the debtor and the financial services provider's reliance upon the guarantor's income as well to approve the loan. If a guarantor was not in a position to know the financial position of the debtor in its totality, and was not fully informed of the financial services provider's credit assessment, we may consider that it was imprudent to include the guarantor's income in the assessment of serviceability. In that event, we may conclude that the financial services provider had engaged in maladministration in granting the credit facility.

Guide to the FOS Banking & Finance Division Terms of Reference

The new Financial Ombudsman Service ("FOS") will commence on 1 July 2008. The Banking & Finance Division of FOS will consider those disputes previously considered by BFSO.

The Terms of Reference for the Banking & Finance Division of FOS are essentially the same as the BFSO Terms of Reference. However, some changes have been made in light of the transition to FOS.

- References to "Scheme" have been changed to "Service".

- Clause 1 has been changed to better describe how the Banking and Finance Division fits into the wider FOS picture. The description does not alter how we go about dealing with disputes.

- Clause 5.1(c) provides that the Ombudsman cannot consider a dispute if it is based on the same facts and events as a dispute that has already been the subject of proceedings before an independent conciliation body (amongst others). In order to permit the Banking and Finance Division of FOS to re-open a dispute that was closed by BFSO (in circumstances where the BFSO would have re-opened the file) the following sentence has been added to clause 5.1(c):

  The Ombudsman may, however, in the Ombudsman's discretion, consider a dispute based on the same event and facts which was the subject of a dispute lodged with the BFSO.

- Clause 5.6 provides that the Ombudsman cannot consider a dispute if the subject matter relates to something that occurred before the member became a member (with a reasonable diligence test applying). The clause has been changed to ensure that the relevant date of membership is when the member joined FOS or BFSO, whichever is the earlier.

  The Ombudsman must only consider a dispute in relation to events which first occurred:

  a) on or after the financial services provider became a Member of FOS or BFSO, whichever is the earlier;

  b) on or after 6 July 1998 if the disputant is incorporated;

  This means that a matter will not be considered outside the Terms of Reference based on the date of FOS membership. If the member was a BFSO member, you must look at the date of membership of BFSO to determine if matter is outside the Terms of Reference.

- There is a new clause 15 that deals with the appointment of the Ombudsman. This provision previously appeared in the BFSO Constitution. As there is no similar provision in the FOS Constitution, it is now included in the Terms of Reference. As a consequence, the definition section has been re-numbered from clause 15 to clause 16.

- In the definition section, there are new references to BFSO, FOS and the Service. FOS has replaced a reference to BFSO where appropriate.

- The revision of the Terms of Reference provided an opportunity to rectify two typographical errors in the old Terms of Reference. One was to change 5.2 to 5.3 in the definition of "dispute" where it referred to a privacy dispute. The other was to insert the word "is" at the commencement of paragraph (b) of the definition of "financial service".

Otherwise the Terms of Reference remain unchanged and will be subject to the review of the Terms of Reference for all three Divisions of FOS to be conducted during 2008 and 2009.

Out With the Old – In With The New!

It is in a sense fitting in issuing this, the last Bulletin published by the Banking and Financial Services Ombudsman Ltd, before our business is consolidated into the Financial Ombudsman Service Ltd ("FOS"), to reflect on the Bulletins which have been issued over the years.

The first Bulletin was issued in August 1994 and referred to a range of matters, including the processes around receiving complaints and referring them to our members. It would be no surprise to anyone to know that, in the first Bulletin, one of the issues dealt with was unauthorised access at first attempt of accounts through ATM machines!

Since the first Bulletin we have issued a further 57 Bulletins on a very wide variety of subjects. We have ourselves found the Bulletins to be of great value and I know the feedback we have received from members over the years has been positive as well.

Future Bulletins will be issued in the name of the Banking & Finance Division of FOS. The first Bulletin, to be published in September 2008, will have a major focus on developments in the EFT Code, and will be issued by the Ombudsman – Banking & Finance, Philip Field.

Philip will assume his new role with effect from 1 July 2008. Philip has worked closely with me in the office of the Banking Ombudsman, first as Legal Counsel and, since early 2006, as General Manager – Corporate.

I and the Board of FOS are pleased that Philip has accepted the appointment and I look forward to continuing to work with him in my new role as Chief Ombudsman of FOS.

As is always the case, we welcome feedback on this Bulletin.

Colin Neave
Banking and Financial Services Ombudsman