

PART 6

THE IMPROPER CHARGING OF INTEREST

THE PRACTICE OF IMPROPER CHARGING OF INTEREST

OUTLINE OF SYSTEM

General

The system for charging interest on customer current accounts in branches remained unchanged for the period covered by the investigation.

Interest rates for individual customers are set at branch level following agreement with the customer on the provision of borrowing facilities. (For accounts with no agreed borrowing facility a standard default rate applies if the account becomes overdrawn). Data on the appropriate interest rate – base rate, DIBOR, etc, together with any additional margin – is input to the Bank's central computer system at the branch, and thereafter the calculation process is automated. The central system applies the appropriate interest rate to the cleared balance daily and accrues the interest charge until the quarterly charging date.

At quarter end the system applies the accrued interest amount to each account and an Interest Applied Report is produced for each branch, detailing interest charged to each account. This report does not require action by branch staff, but is produced for record purposes only.

Changes in interest rates

When the reference rate – base rate, etc – changes, details are entered centrally.

Changes in margin can be made at branch level at any time, and become effective, through the central system, from the following day.

Manual intervention in the interest charging process is provided for in the system:

- When an account is closed at other than a normal interest charging date, the branch is obliged to charge manually the interest due to date of closure. In addition to the amount accrued due on the system since the last charging date (which branch personnel can ascertain by on-line enquiry), it may be necessary to effect adjustments recorded in the Fee and Interest Amendment Book (see below), and there may be interest due in respect of lodgement items uncleared as at closure date. This latter necessitates a separate calculation by branch staff. The combined amount is charged to the customer's account by journal entry at branch level.
- The system also allows branch-originated journal adjustments to the interest charge in respect of amounts recorded in the Fee and Interest Amendment Book. This Book records errors requiring amendment of fee and interest charges to customers, and also additional interest charges arising from the suspension of cheques – ie where a customer cheque is "held over" rather than returned unpaid, allowing the customer time to put his account in funds to meet the cheque.

Branch Procedures Manuals made available to the Inspectors state that the Fee and Interest Amendment Book was to be used to provide branch staff with a day-to-day record of fee and interest adjustments to be made at the end of the charging period, or when the account was closed or transferred, whichever came first.

The Inspectors have received no evidence of improper charging of interest applied by the central system; the balance of this section of the report therefore addresses manual interest adjustments only.

MANUAL INTEREST ADJUSTMENTS

The Charging Regime

Introduction

As stated above, the system for charging interest is largely automated, but manual intervention is possible:

- to facilitate closure of accounts at dates other than the normal interest charge dates,
- to allow for the correction of errors, and
- to enable the charging of additional interest when cheques are suspended at a branch.

In a report entitled “National Irish Bank – Unauthorised Interest & Fee Amendments”, dated March 1999, passed to the Inspectors on 26 March 1999 (the “Unauthorised Interest & Fee Amendments Report” – see page 133 below), the Bank referred to the process in the following terms:

... the systems catered for manual adjustments to be made to correct genuine errors and to apply interest resulting from the practice of ‘suspending’ customers’ cheques to allow them time to introduce sufficient funds into their account to allow these cheques to be presented and paid.

Guidance Material Issued

The Inspectors have been informed by the Bank that the 1992 Branch Procedures Manual represented a consolidation of instructions and procedures then in force, and that this Manual therefore, for practical purposes, sets out the system as it operated in 1988. This manual sets out detailed procedures for calculating interest adjustments arising on closure of accounts and addresses the manner in which the Fee and Interest Amendment Book should be maintained.

This Manual states that the Fee and Interest Amendment Book was to be used to provide branch staff with a day-to-day record of fee and interest adjustments (eg correction of errors) to be made at the end of the charging period, or when the account was closed or transferred, whichever came first.

The Manual required that full details of the prospective adjustment, together with the reason therefor, be entered in this Book and initialled by the branch manager. The Manual specified that the Fee and Interest Amendment Book, in so far as interest amendments were concerned, should not include adjustments which branch staff might wish to make as a result of examining the interest applied report received at the end of the charging period.

The 1996 Branch Procedures Manual contains very similar provisions, the initialling process being re-assigned to a Signing Official.

Queried by the Inspectors as to why there existed a facility to further adjust interest charges after adjustments noted in the Fee and Interest Amendment Book had been incorporated in such charges, the Bank by letter dated 24 April 2001 advised:

This examination of the amounts of interest applied to customers' accounts allowed the management of the branch a final opportunity to overview an automated process for errors and to ensure that inappropriate interest charges were not levied. Any errors apparent to the reviewer could be rectified before customer statements were produced.

The Bank advised that it did not have an exhaustive list of reasons which would justify the amendment of an interest posting; examples given are waivers of an interest charge for various reasons.

Both Manuals provided that where an adjustment was made to the interest appearing on the interest applied report, the customer statement should be retyped to show only one interest amount – ie the original system-generated amount amalgamated with the adjustment effected at branch level. Accordingly, the customer would not have been aware from the bank statement that an adjustment had been made.

The 1996 Manual specified a routine designed to minimise the work involved in retyping statements.

Operation of the System

Internal Audit Reports – General Themes

Contemporaneous evidence of the operation of the system for interest amendment is furnished by the internal audit process. A number of themes emerge from review of branch audit reports for the period covered by the investigation:

- Interest amendment book not used, resulting in customer not being charged;
- Interest amendment book not used, while adjustment effected in customer's account;
- Interest adjustments recorded in the interest amendment book not adequately annotated or not appropriately initialled/authorised;
- Interest discrepancies highlighted on Account Closure Reports not signed, not explained;

- Interest adjustments not recorded, not annotated/explained on the Interest Applied Report;
- Manual interest calculations not appropriately checked;
- Failure to charge interest in respect of suspended cheques;
- Failure to obtain appropriate authorisation for interest refunds.

While the frequent inclusion of comments of this nature in internal audit reports indicates shortcomings in the operation of mechanisms for recording and controlling interest adjustments, in the audit reports made available to the Inspectors no note of improper charging is recorded until April 1990, notwithstanding evidence that fees had been charged as interest prior to that time, as indicated at page 130 below.

Internal Audit Reports – Unjustified Interest Amendments

In a number of instances in the period 1990 to 1993, internal audit reports make explicit reference to manual interest amendments which were inappropriate, in that they were effected without legitimate reason or cause, or were adjustments in respect of amounts said to be due to the Bank in respect of legitimate (non-interest) charges.

Several of these instances were treated as “Report Points” in the relevant audit report, and a full extract of the particular passage in each case is reproduced below.

The April 1990 audit report on ***Carrick-on-Shannon branch*** recorded:

WEAKNESS/POTENTIAL ADVERSE CONSEQUENCE

It was noted that Interest Charges were increased without legitimate reason or customers’ knowledge on twenty accounts in November 1989 and thirty-three accounts in February 1990.

The above practice could lead to loss to the Bank through customer dispute, litigation or adverse publicity.

REMEDIAL ACTION REQUIRED

Interest amendments may only be made to correct Branch errors. The practice of “loading” interest in this manner must be discontinued.

RESPONSE BY BRANCH MANAGEMENT

We note that as and from now only branch errors can be corrected using interest amendment sheets.

While we only loaded interest rates for customers who were very demanding, we were certain that we were safe in applying the additional interest charges. No queries ever came back from customers who (sic) interest was loaded.

We note and confirm that this practice will be discontinued.

The audit report of August 1990 on *Carndonagh branch* recorded:

WEAKNESS/POTENTIAL ADVERSE CONSEQUENCE

It was noted that interest charges were increased without legitimate reason or customer knowledge, on twelve occasions in May 1990 and thirteen occasions in February 1990. This practice also applied in 1989. The Debit Interest Applied Reports were not amended in respect of these alterations.

This could lead to loss to the Bank through customer dispute, litigation or adverse publicity, due to the issuance of an Interest Certificate for the correct amount, or a customer's accountant querying why an amended statement was issued at interest charging periods.

REMEDIAL ACTION REQUIRED

Interest amendments may only be made to correct branch errors. The practice of "loading" interest must be discontinued.

RESPONSE BY BRANCH MANAGEMENT

The practice of loading was initiated for accounts that were either constantly in excess of their agreed limits (as evidenced by appearance in the Morning Report), or were the subject of frequent urgent S/L reports. Through discussions at branch the implications of loading were highlighted, but for obvious reasons immediate cessation was not feasible. The practice has been gradually scaled down and will be totally eliminated before the next charging period.

The following was reported in respect of *Sligo branch* in October 1990:

WEAKNESS

Interest amendments were effected on twenty-two accounts in November 1989 and thirteen accounts in March 1990, without legitimate cause or customer authority. The Debit Interest Reports were not amended.

POTENTIAL ADVERSE CONSEQUENCE

Increasing interest charges could lead to queries from the customer or his accountant in respect of the non-computer produced statements at the interest charging periods. Interest Certificates could also be issued for amounts different to the statement figure. If a copy statement is requested by a customer the interest amendment could be highlighted in error.

RECOMMENDED ACTION

Interest amendments should only be effected for legitimate reasons.

BRANCH RESPONSE: *The practice has been discontinued.*

The May 1993 audit report on *Blanchardstown branch* recorded:

WEAKNESSES

The following weaknesses were noted:

- 1. Interest charges were increased without legitimate cause on eight accounts in November 1992 and on six accounts in November 1991.*
- 2. One instance was noted where a customer's interest was increased by £300 to offset bad debts of employees for (sic) that customer.*
- 3. Many instance was (sic) noted where interest was increased on closure of accounts to cover Management time charges.*

POTENTIAL ADVERSE CONSEQUENCE

Increasing interest charges without legitimate cause could lead to queries from customers or their accountants and result in loss to the Bank due to dispute or adverse publicity.

RECOMMENDED ACTION

In future interest should only be amended where there are legitimate reasons. Where Branch wish to apply additional charges these should be collected by way of a Fee.

BRANCH RESPONSE

We will ensure in future that interest is only amended when there is a legitimate reason.

Critical comments considered less serious were classified in audit reports as "Discussion Points" or as "Weaknesses of Lesser Significance". Matters reported in relation to interest amendments included:

Discussion Point, **College Green, Dublin branch**, February 1992:

Interest should only be amended when properly authorised by the Manager or Regional Office. Amendments relating to charges should NOT be included on interest amend (sic) sheets.

Weakness of Lesser Significance, **Walkinstown branch**, March 1992:

It was noted that on a few occasions interest adjustments were effected which did not relate to interest errors.

Weakness of Lesser Significance, **Fermoy branch**, May 1992:

It was noted that the fee for suspending cheques was incorporated in the quarterly interest charge. Interest should only be amended in respect of interest adjustments and all other charges should be incorporated in the fee.

Weakness of Lesser Significance, **Strokestown branch**, May 1992:

It was noted that amendments were effected to interest relating to charges for suspending cheques and telephone calls. Interest should only be amended in respect of interest errors. All other amendments should be incorporated in the fee charged.

Weakness of Lesser Significance, **Bray branch**, December 1992:

A significant number of the interest discrepancies resulted from the Branches (sic) practice of amending the interest calculated by Livelink by:

- a) in the case of debit interest increasing the amount charged and*
- b) reducing the amount paid in the respect (sic) of credit interest.*

Branch should cease this practice immediately and where deemed appropriate a fee is to be levied.

Weakness of Lesser Significance, **O'Connell Street, Dublin branch**, January 1993:

A number of instances were (sic) noted where interest adjustments were effected and the interest charged was increased for amounts between £10 and £50 without legitimate cause. One instance was noted where interest was increased by £150 in respect of Management time. In future interest should only be increased for legitimate reasons. All other charges should be collected by way of a fee.

Weakness of Lesser Significance, **Letterkenny branch**, May 1993:

It was noted that the £5 fee for each cheque suspended has been charged to customers (sic) accounts as interest. Please note that this charge should be applied as a fee in future.

In summary, the internal audit reports received by the Inspectors record the misuse on eleven occasions (four of which were considered at the time to merit a "Report Point" grading) of the facility to manually amend interest charges to customers.

Bank Investigation 1998/99

Investigations carried out by the Bank subsequent to news media reports on "interest loading", reported upon in March 1999 (discussed in more detail below) resulted in interest refunds totalling some IR£132,000 (before indexation) being made to customers of twelve branches in all:

<i>Branch</i>	<i>Period in respect of which refund made</i>
Baggot Street, Dublin	May 1990 to November 1991
Blanchardstown	February 1991 to May 1993
Carndonagh	November 1987 to November 1990

<i>Branch</i>	<i>Period in respect of which refund made</i>
Carrick-on-Shannon	November 1987 to November 1990
Cork	May 1988 to November 1990
Letterkenny	November 1987 to May 1993
Limerick	May 1988
O'Connell Street, Dublin	November 1988 to November 1994
Sligo	May 1988 to February 1990
Strokestown	November 1995 to February 1998
Walkinstown	May 1989 to November 1990
Waterford	May 1988 to August 1990

No refunds were made by the Bank (nor was the amount involved quantified) in respect of charges for suspending cheques which, though not interest, were included in interest amounts debited to customers' accounts, on the basis that such charges were "*clearly substantiated as being due to the Bank*" (see pages 20 and 21 of the Unauthorised Interest & Fee Amendments Report at Appendix 14). This Report makes clear that the practice of classifying as interest charges for suspending cheques was not limited to the twelve branches listed above.

The Inspectors regard as improper the charging as interest to customers' accounts of any non-interest charges, and therefore consider such charges should have been refunded.

Branch Staff Evidence

The Inspectors interviewed 37 current and former Bank branch managers and staff.

A number of those interviewed were at the relevant times managers of branches identified in news media reports as locations where "interest loading" was reported to have taken place – ie where interest charges had been increased without proper cause. In other instances, the Inspectors were aware at the time of interview that the Bank personnel had held positions of responsibility at the relevant times in branches where the Bank had made refunds of interest charged.

A significant proportion of interviewees stated that they had not participated in the practice of loading interest in the manner described, and that they were unaware of its occurrence at other locations.

It is evident from the manager responses to the "Report Points" in the 1990 branch audit reports cited above that the managers concerned did not regard themselves as charging customers other than for amounts due, albeit that these were not interest amounts. The majority of managers and others interviewed who worked at the branches where "loading" had taken place did not deny knowledge of its occurrence, but sought to justify the loading by reference to features of the account or the customer, and their understanding of Bank practice as observed at other locations.

Justifications offered by interviewees included:

At the time I considered it quite a legitimate charge. On reflection and with the benefit of hindsight, I certainly should not have charged it as interest, I should have charged it as fees.

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I had simply done what I had seen done in my previous office which was Cork.

... loadings were made ... for a variety of reasons, the most common one being that the account was troublesome in some shape or form, not necessarily a bad account, but where a good deal of additional time was taken up in respect of the account for various reasons.

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... you were not doing the interest on the basis of boosting revenue to the bank, you were doing it on the basis that the customer you picked was entitled, by virtue of the amount of additional work he had caused you, to pay this amount.

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... I condoned the fact that interest was increased by a smaller amount to cover the activity associated with the suspension of the cheque.

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Extract from note from manager interviewee passed to the Inspectors at interview:

At the interest charging periods the interest was amended by small amounts on the listed accounts which had been very troublesome during the year. Because we had no Control Clerk I felt that proper interest was not being collected on those accounts where many cheques were being suspended, returned, unpaid, recalled, received for collection and value given prior to lodgement, or paid against uncleared effects.

Extract from interview with the above-noted manager:

Inspector: They [interest adjustments] didn't relate to management time at all?

Manager No.

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And I would have decided -- the unpaid book was the record, and if Mr Brown's appearing in the unpaid book very, very regularly, we would have

made a crude estimate of saying we possibly should be charging this guy £20, £50 or £100 interest adjustment to recoup our loss. That was how it was done.

It would have been just a guess in relation to the number of cheques that were suspended.

The determining factor possibly was to basically recoup the lost interest for the bank and the extra work involved in doing what we did, which I honestly would have considered was a benefit to the customer rather than return his cheque for whatever reason, and letting the customer worry about it. We would have contacted the customer, said we have a cheque here, would you mind holding it, yeah, no problem. Possibly where we fell down was certainly we will hold the cheque, Mr [customer name], but it is going to cost you £5 or £10 or whatever. That is where we fell down.

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When questioned by the Inspectors on why charges were levied in this fashion, and whether customers would have been aware that the interest charge included an element of fee, interviewee responses included such observations as:

It was probably a sneaky way of making a charge that was seen to be properly due. I suppose it was easier than fighting with someone because of a fee. It was probably cowardly.

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You couldn't collect it by way of fee because it would have been noticed so it was applied by way of interest, and applied inappropriately.

Inspector: At the time it was done would the customers of the bank have been aware of the practice?

Manager: No.

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Inspector: Would the customers have known at that stage that their interest figure was being adjusted because they were being troublesome?

Manager: The interest charge was posted on the statement and sent out to them so it was left to them to query the interest charge if they wished.

Inspector: No, but would they have known?

Manager: They wouldn't have been advised in writing.

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Inspector: The customer sees interest on his bank statement, would it have been normal that he would have assumed that that related to interest, and not to charges?

Manager: I would assume -- he had every right to assume that, yes. ...

Inspector: Why would it [charge related to work in suspending cheques] not be put through as a charge?

Manager: I don't honestly know at this stage. It possibly should have been put through -- split and put through as a charge on it, and an interest amendment.

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Questioned on the extent of the practice throughout the branch network, interviewees who admitted participation in, or direct knowledge of, the practice gave as their understanding that the practice was to a greater or lesser extent widespread:

Inspector: Was this something you invented yourself?

Manager: Not at all. That is one of the points I made to our internal auditors. I told them that whatever was in the report ... I had not invented the wheel.

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Inspector: Have I understood you correctly to say that interest adjustment was a widespread practice within the bank?

Manager: I would have felt it was.

Inspector: There has been a suggestion that the practice existed in only the five branches that were named.

Manager: That is totally incorrect.

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At the time it [ie inclusion in interest charged of a fee element related to suspension of a cheque] was something that was not peculiar just to O'Connell Street branch, it happened in a number of branches, ...

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I was aware that it was fairly widespread.

A number of Bank personnel interviewed by the Inspectors have spoken of a practice, prior to the period covered by this investigation, and indeed prior to the introduction of the Bank's computerised accounting system, of "adjusting the decimal", a practice whereby interest charges to customers were increased to compensate the Bank for the time and trouble involved in servicing their needs. It was represented to the Inspectors that this practice was accepted by senior management of the day, and the practice reported in audit reports in the 1990/93 period represented no more than the continuation of this procedure into the computerised era. These managers believed that the inclusion of amounts for "time and trouble" in interest charges was accepted, if not overtly approved, by senior management in the Bank.

Dermott Boner stated in the course of his evidence that the practice of charging specifically for management time originated in a request in 1985 or 1986 from the Chief Executive of the day that management time should be recovered, and that interest charges were increased to reflect management time during his period as manager of the Cork branch. Since the purported request to charge for management time pre-dated the period being investigated by the Inspectors, they have not sought to verify it, nor to ascertain how it was intended that the charge should be made.

A number of managers who admitted that interest had been loaded by them or at their direction stressed that the practice was transparent as regards the internal records of the Bank, but had not been the subject of comment in branch audit reports prior to 1990. The manager of the Carrick-on-Shannon branch also placed some emphasis on the fact that the 1990 audit of his branch was the first branch audit carried out by the person who led the audit team on that occasion.

In summary, the majority of bank managers interviewed by the Inspectors denied participation in, or knowledge of, a practice of loading interest. Managers who admitted they had loaded interest indicated a belief that the practice was widespread and predated the period covered by the investigation; they believed senior management in the Bank would not at the time have disapproved of the practice.

ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE

The Chief Executive (Jim Lacey)

As noted at page 122 above, the practice of increasing interest "without legitimate reason" appears to have been first reported by Internal Audit to senior management in the April 1990 report on Carrick-on-Shannon branch. This report was circulated to the Chief Executive, Mr Lacey, the General Manager – Retail Banking, Frank Brennan, and the Regional Manager responsible, Kevin Curran.

On 21 May 1990, Mr Lacey issued a memorandum to Mr Brennan, with a copy to Mr Curran, stating, *inter alia*:

From the Branch Manager's response it would seem to me to indicate that he was somewhat surprised at this matter having been picked up by Audit and I would be obliged if you could let me have a bit more detail as to how this

practice came into being and also your view as to how widespread such a practice might be. It is a practice that we must cease immediately for obvious reasons. We have in place a variety of means of putting on additional charges to accounts where they are troublesome and cost a lot more to run, etc. This can be through additional fees and also, if necessary, we can charge higher interest rates but if we are they must be clearly communicated to the customer.

The General Manager – Retail Banking (Frank Brennan)

Mr Brennan's review of the Carrick-on-Shannon branch audit report, addressed to Mr Curran, also dated 21 May 1990, included the following:

The remarks under Report Point 1, Core 2 (ie the text reproduced at page 122 above) we discussed briefly in the recent past. The branch management response would seem to suggest that interest was loaded to compensate for a short fall in fee income from demanding customers. Given that the auditors found 33 cases of loading it would appear that branch have used the "soft option" principle widely and this is unacceptable. Report Point 4 indicates some refunds were made and no doubt you will see if there is a link between the two.

Mr Brennan wrote to both Regional Managers (Kevin Curran and Dermott Boner) on 5 June 1990 as follows:

In the recent audit of Carrick-on-Shannon branch it was discovered that there was an interest loading made on customer accounts without any prior agreement or notice to the customer. Some indication was given that this loading was in lieu of irrecoverable fees or simply a penalty for nuisance caused by the customer during the charging period.

I was not aware of such a practice in the branches and would wish to

- (a) know of all incidences where this practice has taken place and*
- (b) confirmation that it ceases immediately.*

I am sure you do not need me to tell you that it is quite wrong to surcharge a customer without proper notice. Should there be occasion to penalise an account holder for any reason, be it breaking an arrangement or causing a considerable amount of labour to service their (sic) needs, then there is a mechanism in place to make additional charges. What I do not want to see from any manager is use of the soft option of "hidden" costs and this must be stopped immediately.

Mr Brennan's review of the August 1990 Carndonagh branch audit report, addressed to Mr Boner, included the following:

I don't understand the management reply to Report Point 1, Core 2 (ie the text reproduced at page 123 above). If an account is in excess of the agreed limit

then the 6% loading should automatically apply. Was it a case of the loading being omitted at the static input stage and applied manually later or was it that interest over and above the 6% loading being (sic) charged? The frequency of the S/L report has nothing to do with interest rates but suggests that the limits are insufficient for customer needs or that customer is taking unauthorised credit which we would not support from Regional Office? In either case the matter should be addressed with the customer and if penalty interest is used to bring discipline notice should be given in advance to customer.

Mr Brennan has advised the Inspectors that the 1990 audit reports on Carrick-on-Shannon and Carndonagh branches and the memoranda referred to above are the only references he can find on the subject of improper charging of interest to accounts in the investigation period.

The Regional Managers (Dermott Boner and Kevin Curran)

While there is evidence that the Regional Managers addressed the issue with the branch managers concerned, and sought assurance from all branches within their respective regions that if such a practice existed it should cease immediately, the extent to which they received such assurance is unclear.

Mr Brennan has advised the Inspectors that he received no formal response from either Regional Manager to his memorandum of 5 June 1990.

Impact on Customers

Neither Mr Lacey's memorandum nor Mr Brennan's directed that refunds be made where interest had been improperly charged.

The Regional Managers did not instruct the branch managers to make refunds.

The Bank has confirmed to the Inspectors that it has found no evidence that refunds of such interest were made prior to the Inspectors' appointment.

ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS

Interviews with Bank Staff

Bank internal audit staff interviewed 210 staff following the news media allegations of interest and fee loading. The Inspectors, with a view to minimising the number and extent of interviews they themselves would be obliged to carry out, sought from the Bank copies of the notes taken at these interviews. The Bank claimed privilege over this material, and declined to make it available to the Inspectors. The Bank has however formally advised the Inspectors that all material otherwise requested by the Inspectors has been furnished to them, including all documentary material referred to at the staff interviews.

The Inspectors considered a Court challenge to the Bank's claim to privilege over the interview notes, but decided against it on the grounds that it was preferable to conduct a comprehensive interview programme themselves rather than become involved in what might turn out to be lengthy and costly litigation.

Bank Investigation Work: The Unauthorised Interest & Fee Amendments Report

General

The Bank's investigation of the allegations of interest and fee loading broadcast on RTE is the subject of a report dated March 1999 entitled "National Irish Bank: Unauthorised Interest & Fee Amendments", prepared by National Australia Group's European Audit function, hereafter termed the "Unauthorised Interest & Fee Amendments Report". A copy of this report was furnished to the Inspectors on 26 March 1999 and is reproduced at Appendix 14. Brief extracts from this report have been cited at pages 120 and 126 above.

Work Done

The work described in the Unauthorised Interest & Fee Amendments Report includes initial work carried out by the Bank's internal audit staff, work carried out by Arthur Andersen at the Bank's request, and work carried out thereafter by Bank staff.

The objectives of the investigation included the quantification of the impact on customers of any unacceptable activities which had taken place.

The scope of the review was restricted to current account adjustments. The Bank concluded that a "*targeted approach rather than a fully substantive one*" was appropriate and therefore directed its work at "*locations where the risk of occurrence was assessed as being high*".

The investigation team did not seek to verify the working of the system in either the interest or fee areas, but sought to consider the result of the amendment process.

Arthur Andersen work

In the interest area, the Bank's initial scoping exercise identified five branches where interest loading might have occurred, and the accounting firm Arthur Andersen ("AA") was engaged to establish "*whether additional interest charges have been debited to customer current accounts at quarter end without any contractual, statutory or other valid basis for doing so and, if so, the extent thereof at the following branches of the Bank for the following periods*":

- Blanchardstown February 1991 - May 1993
- Carndonagh October 1987 - December 1990
- Carrick-on-Shannon October 1987 - December 1990

- Cork January 1988 - December 1990
- Walkinstown January 1989 - December 1990

The timespan for review was later extended to encompass manual bulk postings of interest amendments within 5 business days of the quarter end posting date.

Following their review, AA classified the adjustments by reference to the explanations contained in the available documentation, and these findings are summarised in the Unauthorised Interest & Fee Amendments Report as follows:

	Number	Value IR£
Supporting evidence for interest adjustment found	332	128,201
Additional charge relates to management time	200	42,255
Unresolved	<u>574</u>	<u>58,257</u>
Total	<u>1,106</u>	<u>228,713</u>

Bank staff carried out further review work on all interest adjustments identified by AA, other than those found to be justified interest amendments or charges in respect of management time. Incorporation of the results of this additional work in the summary resulted in final summary figures as follows:

	Number	Value IR£
Supporting evidence for interest adjustment found	359	132,364
Additional charge relates to management time	382	55,112
No basis for justification	<u>365</u>	<u>41,237</u>
Total	<u>1,106</u>	<u>228,713</u>

The Report notes that the 365 adjustments for which no justification could be found relate to 171 customers across the five branches the subject of review.

Inspectors' Observation on Analysis of Adjustments

The title of the third class of adjustments in the review work carried out by Bank staff – “No basis for justification” implies that the inclusion as interest of charges relating to management time (the second class) was justified, which clearly it was not. In fact it was the practice which had been highlighted by Internal Audit as being improper. There could clearly be no justification for including a charge for management time as interest. The number of adjustments for which there was no justification should accordingly have been 747, and not 365.

Work carried out by Bank investigation team

Bank staff carried out additional work on manual interest amendments under a number of headings:

- Supplementary work on the five branches reviewed by AA, extending the time periods of review;
- Review of adjustments at branches where staff who had worked in branches where loading had been identified subsequently worked;
- Review of branch audit reports;
- Review of General Ledger postings, all branches, for round-sum adjustments in the quarters ended 31 May 1989 and 30 November 1990;
- Limited review of Interest Amendment Sheets;
- Investigation of customer enquiries;
- Review of all manual interest adjustments over IR£500, and all round-sum adjustments below that amount, effected during the period 31 March 1996 to 31 March 1998.

Only adjustments made at or about the quarter end date were reviewed, and with few exceptions, investigation was limited to “round-sum” adjustments.

Conclusions

The conclusions of the Unauthorised Interest & Fee Amendments Report in the interest area are as follows:

Some incidence of interest amendments, which could not be fully justified as interest, was found in all of the five named branches. In total this amounted to £100,513. Additional work carried out identified that of this total an amount of £59,275 could have been justified if it had been charged as a management time fee. This leaves £41,238 with no evidence of a justifiable charge being due.

The review of the wider network identified incidences of interest adjustments which could not be justified, as interest, in a further 8 branches totaling (sic) £34,816.

The relatively small incidence discovered in the remainder of the network, supported by the absence of repetitive interest loading findings in Internal Audit reports, indicates that the practice was not widespread and given the absolute amounts involved that the motivation was not to enhance Bank

profitability. No branches were identified through the review of external audit management letters.

The review of Internal Audit reports highlighted instances where branches were charging a management time fee for suspending cheques as interest. Although non compliant with procedures, on the basis that these charges could be fully substantiated they were not included within amounts to be refunded.

The system for interest charging was unchanged throughout the period investigated and, due to interest calculations being made on cleared balances, remains largely invisible to the customer. The requirement for interest amendments still remains although this process could be reviewed to give greater visibility to the customer which in turn would act as a control over the processing of unjustified amounts.

The review of the last two years showed that only one 'spoke' branch, Strokestown, was not adhering to the laid down procedures for interest amendments by recovering management charges through amending the interest charge. This amounted to less than £800 in total.

The Bank made refunds both of amounts where no justification could be established and of amounts representing management time, excepting time and other charges in respect of suspending cheques. As already stated at page 126 above, the Inspectors consider these latter charges should also have been refunded.

Inspectors' Observations, Unauthorised Interest & Fee Amendments Report: Findings on Interest Amendments

The Inspectors do not accept that the Bank, on the basis of the work done, was entitled, because of the scope limitations on that work, to reach the conclusion that the practice of interest loading was not widespread within the Bank.

The Inspectors do not disagree with the other conclusions of the Report as far as they go, but do not accept that the work done excludes the possibility that there were other incidences of improper interest charges in the branches reviewed or elsewhere in the branch network.

Customer Queries

The Bank set up and advertised a telephone helpline, which customers could contact with queries relating to interest or fee charges on their accounts.

The Bank has advised the Inspectors that on receipt of a customer query, it sought to review the customer's account for the entire period covered by the query, relying on the presence or absence of a request for a customer statement (to facilitate re-typing, as described at page 121 above) at or about the charge period end as conclusive evidence of whether a manual adjustment was made, requiring review. A prescribed review procedure was followed to establish whether a refund was warranted, to

prepare an inflation-adjusted refund if required, and advise the customer of the position.

Inspectors' Observations on Work done by the Bank

In course of their consideration of the work done and the conclusions reached in the Unauthorised Interest & Fee Amendments Report, the Inspectors indicated to the Bank their reservations regarding the scope of work undertaken, and their view that the work carried out did not adequately support the conclusion reached.

Further Work proposed by the Bank

By letter dated 10 April 2001, the Bank advised the Inspectors that it "*has embarked on a programme to review interest postings across the branch network for the period 1/10/1987 – 5/4/1998*" – see Appendix 15. The Bank subsequently advised the Inspectors that the details of the additional work carried out, the conclusions reached and the consequent action undertaken or proposed, would be included in its submissions in response to the Inspectors' provisional findings.

Following receipt of the Inspectors' draft report on 1 August 2003, the Bank devised a new programme, "Fees and Interest Refund Programme" which is set out in Schedule V of the Bank's Reaction Paper, reproduced in full at Appendix 19. How the Bank came to take this step is described as follows on page 4 of Schedule V:

In light of the views expressed by the Inspectors, and on reconsidering the decisions underlying its previous approach, the Bank has devised a further programme of work and refunds on which it has sought independent verification.

It is anticipated by the Bank, at page 4 of the Reaction Paper, that this programme will result in additional fees and interest refund payments to customers of Euro10.6 million.

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. During the period the subject of the Inspectors' investigation, the interest charged by the Bank to some customers in their quarterly account included sums which were not in fact interest.
2. The inclusion of such sums in the charge for interest was improper.
3. The sums which were improperly charged as interest should, on discovery by Internal Audit, have been immediately refunded by the Bank.

4. While the Inspectors note that since the commencement of their investigation, the Bank has refunded to customers an inflation-adjusted total of approximately IR£570,000 in respect of charges which could not be justified as interest on 564 accounts in twelve branches, they do not accept that the Bank, on the basis of its investigative work done, is entitled to conclude that all incidences of improper interest charges have been identified.
5. Refunds of sums improperly charged as interest made following the Bank's investigation should not have excluded sums charged for the suspension of cheques.