# PART 7

# THE IMPROPER CHARGING OF FEES

# THE PRACTICE OF IMPROPER CHARGING OF FEES

## REGULATORY REGIME

### Introduction

All financial institutions which provide banking services to customers in Ireland are required to hold a banking licence issued by the Central Bank. The Central Bank is accordingly the principal public authority assigned to regulate and supervise the operations of the domestic banks. The powers and functions of the Central Bank in this regard are derived from the Central Bank Acts, 1942-1997.

On 13 May 1996 certain regulatory functions were transferred to the Director of Consumer Affairs, under the provisions of the Consumer Credit Act, 1995. Under Part XII of this Act, the Director of Consumer Affairs is responsible for the regulation of all charges imposed by credit institutions "*in relation to the provision of any service to a customer or group of customers.*"

### The Central Bank Act, 1971

The Central Bank Act, 1971 provided the Central Bank with two main powers with which it might regulate the fees charged to customers by banks:

- Under Section 10, the Central Bank was given a discretion to attach to any licence granted, conditions which they believed would promote the orderly and proper regulation of banking, and

- Section 18 obliged licence holders to furnish to the Central Bank any information the Central Bank specified as necessary for the due performance of its statutory functions.

Prior to 1989 the Central Bank had no specific powers in relation to charges, but they were the subject of an informal agreement between the licensed banks and the Central Bank. Pursuant to its ongoing task of monitoring the business carried on by licence holders, the Central Bank would regulate the fees charged by banks to the accounts of customers, while the banks would keep the Central Bank informed of same. This agreement was strictly between the Central Bank and the banks.

The Central Bank Act, 1971 placed no specific obligations on banks to disclose to the Central Bank the level of (or changes to) fees charged to customers unless, of course, they were requested to make such disclosure.

### The Central Bank Act, 1989

Section 28, Central Bank Act, 1989 required that, within two months of the commencement date for this Section (1 September 1989), banking licence holders should keep the Central Bank informed as to the charges (and the terms and conditions of such) that were being levied for services provided.

Section 28 (1) required all licensed banks to notify the Central Bank of:

- All charges imposed by such licence holder in relation to the provision of any service to the public or to any class of the public, and

- Any term or condition upon or subject to which such service was provided.

Section 28 (2) stated the Central Bank must be notified of every proposal:

- To change any charge, term or condition previously notified to the Central Bank for the purposes of the Section, or

- To impose any charge, term or condition applying to the provision of a service to the public or to any class of the public not previously notified to the Central Bank for the purposes of the Section.

Section 28 (3) empowered the Central Bank to direct a licensed bank:

- To refrain from imposing or changing a charge, term or condition applying to the provision of a service to the public or to any class of the public, without the prior approval of the Central Bank, and

- To publish, in such manner as might be specified by the Central Bank from time to time, information on any charge, term or condition applying to the provision of a service for the public or to any class of the public.

Section 28, Central Bank Act, 1989 was repealed by Section 19 of the Consumer Credit Act, 1995 which came into force on 13 May 1996. Thus, the provisions summarised above were applicable between 1 November 1989 and 13 May 1996.

**The Consumer Credit Act, 1995**

The repealed Section 28 of the Central Bank Act, 1989 was replaced by Section 149 (1) of the Consumer Credit Act, 1995. The functions and powers formerly vested in the Central Bank under Section 28 of the 1989 Act were vested by Section 149 of the 1995 Act in the Director of Consumer Affairs and the obligations of banks (together with all other credit institutions) in regard to notifying charges, and alterations in charges, remained broadly similar to what they had been, save that the party to be notified became the Director of Consumer Affairs.

**Subsequent Changes in the Regulatory Regime**

Pursuant to the Orders of the High Court dated 30 March 1998 and 15 June 1998, the investigations cover the period from 1988 to 30 March 1998. Consequently, the regulatory regime summarised above is that which prevailed during the period of the investigations and does not take into account the further changes which were introduced subsequently.

## THE BANK'S FEE CHARGING SYSTEM, AND ITS DEVELOPMENT OVER THE PERIOD COVERED BY THE INVESTIGATION

### Introduction and Overview

At the outset of the period covered by the investigation, the system in NIB for the calculation of bank fees provided that a proportion of the charge was automatically recorded by the Bank's computerised accounting system, while the balance required manual adjustment by Bank staff. Since 1988, the system has evolved, with the progressive introduction of formalised charges for a wide range of account activity and an increase in the proportion of those charges automatically captured by the computerised system. There remains a facility for manual amendment of charges, but, since the introduction of pre-notification of fees in 1996 (see page 155 below), the only amendments which ought to be made are those necessary for the correction of errors.

### Fee Categories

***Personal Accounts***

The Inspectors have been advised by the Bank that at the outset of the period under review, in January 1988, fees calculated and charged to personal customers' accounts fell under three headings:

- Transaction charges
- Administration and management time charges
- Ancillary charges.

*Transaction Charges*

Transaction charges relate to the number of debit transactions (eg cheques) processed through a customer's account for the quarterly charging period. The Bank's computer system calculated this fee by applying the standard tariff for each type of transaction to the number of transactions processed in the period.

There was a minimum charge of IR£3.25 per quarter for all active current accounts. This charge applied for any level of activity up to twenty-five debit transactions in the quarter. Where a greater number of debit transactions had been processed, the normal tariff based calculation applied.

If an account remained in credit during the entire quarter, it was exempt from fees.

*Administration and Management Time Charges*

Administration and Management time charges arise from the provision of services "*outside the normal course of business*", which do not fall within the transactional or ancillary charge categories. The charges were based on a time measurement priced in 1988 at a rate of IR£10 per hour or part thereof.

*Ancillary Charges*

Ancillary charges relate to specific services rendered; these were charged as they arose, by effecting manual accounting entries to the customer account. Services and events giving rise to ancillary charges included the following:

- Accepting direct debit mandates
- Bank drafts/gift cheques
- Cheque cards
- Standing Orders
- Unpaid cheques.

***Business Accounts***

Business accounts were subject to charges on principles similar to those applicable to personal accounts, with two exceptions:

- For business accounts with more than 1,500 transactions per year, it was Bank policy that a costing be carried out, which monitored all account activities; based on this data a fee was agreed with the customer, subject to periodic review. This agreed fee could be a set amount per quarter, or expressed as a percentage of account turnover, resulting in the charge moving in line with the level of activity on the account.

- For business accounts which maintained cleared credit balances, an allowance was made against the charges at an agreed rate, based on the average balance maintained. (This abatement rate formed part of the published tariff information).

**The Fee Charging Process**

The computed charges for each account in each branch were listed quarterly on a "Fees to be Applied Report", which was despatched to the branch some days prior to the end of the quarterly charging period. At that time a routine circular was issued to all branches reminding staff of the review to be carried out, and the deadline for its completion.

Upon receipt of the Fees to be Applied Report, the branch was required to adjust the charge recorded therein both in respect of adjustments arising during the quarter as recorded in a "Fee and Interest Amendment Book", and in respect of administration or management time.

As outlined in Part 6 at pages 120 and 121, the 1992 Branch Procedures Manual, represented to the Inspectors as reflecting the instructions applicable to branch staff at 1 January 1988, 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 should not include adjustments which branch staff might wish to make as a result of examining the fee and interest reports received at the end of the charging period.

At the end of the charging period the net fee adjustment was to be transferred to the Fees to be Applied Report, "*together with any other adjustments which you may wish to make as a result of examining these reports* ". Senior Bank management have advised the Inspectors that the principal adjustment to be made in exercise of this discretionary authority was in respect of fees for administration and management time.

The 1992 Branch Procedures Manual also required that a branch official

> *Annotate, on the [Fees to be Applied] report, any changes which you wish to make, by replacing the Mainframe calculated fee with the fee which you wish to charge. Initial all changes and, where the fee is reduced, state the reason for reduction.*

Amendments effected in the Fees to be Applied Report were entered to the Bank's central computer system through branch terminals and a listing of amendments, termed the "Static Mark-off Report – Amended Fees Input Details" then issued to branches for checking purposes.

After the amended fees had been charged to customer accounts a Fees Applied Report was issued to each branch for record purposes, detailing all fees charged to customer accounts for the quarter.

Fees charged to customers at quarter end thus potentially comprised three elements:

- a combined amount for transactions charges (or, in the case of business accounts, a negotiated fee) and ancillary charges, as set out on the Fees to be Applied Report;
- adjustments recorded during the quarter in the Fee and Interest Amendment Book, and
- charges in respect of administration and management time,

the latter two being incorporated in the fee charged initially by way of manual amendment on the Fees to be Applied Report.

**Development of System**

The "three report" system described above remained in place throughout the period covered by the investigation. Developments during the period included:

- Adjustments to the standard tariffs.

- Increase in the hourly rate of charge in respect of administration and management time from IR£10 per hour to IR£25 per hour in 1992.

- Introduction of an account maintenance fee of IR£3 per quarter in September 1990, when the minimum charge was abolished. This maintenance fee was increased in November 1992 to IR£3.75 per quarter. Transaction charges were levied in addition to this charge.

***Form St.20 – Customer Action Pad***

On 24 July 1992 guidelines for charging management time were issued, together with a "Customer Action Pad" for recording, on a daily basis, details of services provided to customers outside the normal course of business.

***Time Recording Procedures to Facilitate Pre-notification of Charges***

In March 1996, prior to the introduction of pre-notification of charges, a detailed circular was issued to Bank staff setting out procedures for recording account administration time (formerly referred to as administration and management time), including a listing of standard times for many services and tasks. Time sheets for input on a daily, weekly or monthly basis to the Bank's central computer system were also introduced. A second circular, issued in April 1996, described systems changes arising from the introduction of pre-notification of charges.

***Ancillary Charges***

Ancillary charge development over the period arose through both the introduction of new charges – eg fees in respect of amendments to standing orders or direct debits, and the standardisation of charges, such as referral fees, previously accounted for by way of charge for administration and management time.

**Summary**

The Inspectors have not received any evidence of improper charging of fees in respect of transaction charges, ancillary charges or adjustments recorded in the Fee and Interest Amendment Book. It is not necessary, accordingly, to refer further to any of these charges or adjustments, and the balance of this Part of the report is therefore concerned solely with the purported charging of fees for administration and management time.

## CHARGES FOR ADMINISTRATION AND MANAGEMENT TIME

### The Charging Regime prior to 1996

***Introduction and Overview***

As stated above, in the period covered by the investigation, one of the categories of fee for which the branches were instructed to charge was administration and management time. Such charges are described as follows in a document entitled "Fee and Interest Procedures 1988 – 1998", furnished to the Inspectors by the Bank on 15 December 2000:

> *These charges accrue for the provision of services outside the normal course of business to customers and is* (sic) *not covered by either transactional or ancillary charges. The charges are based on a time measurement that is converted at a prescribed hourly rate.*

In a later paragraph in the same document, it is stated that:

> *Upon receipt of the Fees to be Applied Report the branch has the discretion to adjust the charge to reflect the appropriate level of administration or management time.*

In a document entitled "Evolution of Current Policy and Controls in National Irish Bank Limited" dated 28 May 1998, and furnished to the Inspectors on 21 October 1999, the fee amendment process was described as follows:

> *At each charging date, branch management review all current accounts, amending the actual printout to the required amount.*

At the end of each quarterly charging period, branch staff were obliged to go through the Fees to be Applied Report and decide which accounts should be charged for administration and management time and how much the charge should be.

Prior to July 1992, the Bank did not provide branches with any procedural guidance setting out how administration and management time should be charged, nor with any system prescribing how such time spent on customers' accounts should be recorded. As stated in the document quoted above, this was left to the discretion of the branch.

In the Unauthorised Interest & Fee Amendments Report referred to in Part 6 at page 133, the Bank described the fee amendment process in the following terms:

> *The fee system required a significant amount of manual adjustments to be made which, particularly in the earlier periods when there was little automation, was heavily reliant on the accuracy, judgment and integrity of the individuals processing and reviewing them.*

***Guidance Material in use at 1 January 1988***

The Bank has confirmed to the Inspectors that at 1 January 1988 there was no written instruction to staff on the maintenance of records of chargeable time.

Guidance in relation to charges as of 1 January 1988 was provided by a paper entitled "Guide to Costings, Northern Bank (Ireland) Limited, November 1987". This Guide set out details of fees chargeable on personal and business accounts, much of the Guide addressing costing methodologies. An appendix to the Guide provided a list of ancillary charges, specifying that they "*should be levied on an "on the spot basis"* ", and not, except in exceptional circumstances, be allowed to accrue and thus require adjustment at the end of the quarterly charge period. The Guide did not address the area of administration or management time in any respect.

The 1992 Branch Procedures Manual, represented to the Inspectors as reflecting the instructions applicable to branch staff at 1 January 1988, does not contain any guidance on the nature of work or service to customers which should give rise to an administration or management time charge, nor does it give any guidance on the form of record to be maintained by branch staff responsible for delivery of the service. As noted at page 145 above, the Manual refers only to "*any changes which you wish to make*" on the Fees to be Applied Report.

Every branch was however set an annual target for fees, and the charges for administration and management time were part of the fees which contributed to meeting this target.

Routine circulars advising the timetable for issue and review of the Fees to be Applied Reports in the period covered by the investigation contained no guidance on the form of amendment required or how it should be determined.

The fee charged by the Bank in the customer's quarterly account was a global amount, none of its constituents being separately identified, so customers were unaware of the level of charges for administration and management time.

***The Customer Action Pad, Form St.20, introduced July 1992***

As noted above, on 24 July 1992 Dermott Boner, then Head of Retail, issued a memorandum to all branch managers and staff in relation to fees and management time. Attached were guidelines for charging management time with the instruction that such a charge be "*applied to <u>all accounts</u> that are troublesome and time consuming*". It instructed managers that accounts "*should be monitored daily with details of services provided recorded* " on a new "***Customer Action Pad*** ". The memorandum stated that increasing fee income was "*one of our key targets for the present financial year*" and the branch managers were instructed to set "*a target for Management time for the quarter ending September '92* ". A copy of this memorandum, with attachments, is reproduced at Appendix 16.

A similar memorandum prepared by Mr Boner was issued on 24 August 1995, under a covering note from Michael Keane, General Manager – Banking.

The introduction of the Customer Action Pad did not bring about any improvement in how management time was recorded and charged. Managers found the system cumbersome and unworkable. So, notwithstanding the availability of the Customer Action Pad, the situation in regard to charging management time remained basically the same as it had been prior to its introduction.

The introduction of the Pad does however confirm that there had previously been no system in place for recording management time.

Branch managers, in evidence which the Inspectors accept, stated that the Customer Action Pad was rarely used; illustrative extracts include:

> *There was a time when they brought in what they call 'action pads' ... I would have to say that the completion of those was haphazard ...*
>
> oooOooo
>
> *... around 1992/'93, there was a system brought in of action pads ... it would be only fair to say that it was a guesstimate again of the action [pads] that you didn't complete.*
>
> oooOooo
>
> *The customer action pad was ... an unworkable system.*
>
> oooOooo
>
> *I would say 90% of the time they weren't used.*
>
> oooOooo
>
> *... they were not used widely. They were not used at all.*
>
> oooOooo

Bank management have suggested to the Inspectors that the memorandum covering the issue of the Customer Action Pad did not constitute an addition to the Branch Procedures Manual, and may not therefore have been regarded by Branch staff as a mandatory direction.

In thirty-one branch audit reports in the period October 1993 to July 1995 it was noted that the Customer Action Pad St.20 was not used to record management time.

**Operation of the System prior to 1996**

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

There was general agreement amongst these interviewees that between January 1988 and March 1996 there was no prescribed system for charging administration and management time, and no system for recording such time, apart from the attempt to introduce a "Customer Action Pad" in July 1992 referred to above (and a similar communication in August 1995). One branch manager did devise a system of his own, which appeared to work satisfactorily, but this was an exception to the general practice.

Descriptions of how the charging of management time operated in practice were very similar. Generally the bank manager, in some cases with assistance from senior officials within the branch, decided what charges to make. They went through the

Fees to be Applied Report and picked out the customers who, from memory, they considered should be charged, and set about determining what the charge should be. Their view of the procedure was that it was a guesstimate, unscientific, arbitrary, crude and clumsy. As regards matters which were taken into account in deciding which customers to charge, and the amount of the charge, the following is a summary of the evidence, which the Inspectors accept, of the managers interviewed:

- Business customers bore the brunt of the charges, particularly those who were regarded as “troublesome”.
- “Troublesome” personal customers were also charged.
- The charge for the previous quarter was the guideline. The current quarter’s charge would either be the same or slightly more.
- The charges were target driven. There was pressure to increase fee income.
- The branches were required to recover 125% of customer cost. (Interpretations of this requirement varied, and its application was limited in practice).
- Consideration was given to the level of charge the account could bear without the customer querying it.

Bank manager interviewees indicated that while the IR£10 per hour (later, IR£25 per hour) charge was applicable to the time spent in servicing customer accounts, no detailed workings were prepared to support the application of this composite rate to time spent.

As evidence of the subjective and random nature of amendments made, managers confirmed that if for any reason the amended Fees to be Applied Report were destroyed, and it was necessary to repeat the adjustment exercise, the revised charges to individual customers would probably differ from those determined in the first instance, though the total uplift would in all likelihood be the same or very similar to the original total.

***Bank branch staff evidence***

Illustrative extracts of evidence from present and former branch managers and staff on how the system operated at branch level, which the Inspectors accept, include:

> *Well, there was no rule of thumb, it was kind of a guess figure, you know.*

oooOooo

> *It was a guesstimate.*

oooOooo

*It would have been relative to the last quarter. ….*

*Well, it [the hourly rate of £25] would have been at the back of our head … I didn't apply, I didn't have a scientific rate. As I say, there was just a guesstimate that £100 would cover my time. …*

*A guesstimate, yes. It was my best, I wasn't being dishonest, I wasn't trying to load people or anything. It was my best guesstimate on what time I had spent or [my assistant] had spent or how troublesome this account was. It was a best guesstimate.*

oooOooo

*Well, I would have sort of thought what sort of nuisance has he been over the previous period and come up with a figure.*

oooOooo

*It was, at best, a decent guess as to the level of how the fee should be increased. …*

*Inspector:* *… would you have been conscious of the target that had been set for the branch in relation to charges?*

*Manager:* *Honestly, yes.*

oooOooo

*Well, fees there was no sort of organised – well structured way of collecting what we now call administration time in dealing with customers. So fees would have been added on if it was a troublesome account at each quarter.*

oooOooo

*… the bank never really had a system where management time was to be charged other than the fact that we were told to obtain 125% cost covered. …*

*There was no basis really. It was really just how much trouble you had with that account during the previous charging period, and it could have been as simple as just adding £10 or £5. There was no real basis, it was just depending on what happened.*

oooOooo

*Truthfully, I would say there was a lot of guesswork done on troublesome accounts, put on a bit here and there. …*

*There were a lot of things omitted from it that the system wouldn't pick up but there was no proper system in place to record things that should have been*

> *recorded. I would say there were people overcharged and people undercharged, if one were to go through the nitty gritty.*

oooOooo

> *Up until the fairly recent past, the Bank had no way of recording Management time and [it] had to be guessed.*

oooOooo

> *… the guideline was the previous fee and there would have been a certain amount of fees to be got in that quarter so it would really have to be the same fee as the last time plus a little bit more.*

oooOooo

> *There wasn't a system, what was there was archaic. You were relying on memory for a good number of years.*

oooOooo

> *There were no guidelines as to how to price, something which always annoyed me somewhat. All one really had to go on was the view of the previous manager in relation to the customer. In consultation with the Deputy manager, the Assistant Managers, the Accounts Department and perhaps the Foreign Box* (sic)*, you would come to a decision as to whether the customer merited a similar loading. It was really a very unsatisfactory exercise.*

oooOooo

> *I suppose the best way of putting it is that you would not reduce the fees to less than they were in the previous period. That is taking a bald point. You would leave the fees as they were in the previous year or quarter as the case might be. You would know the people who should be charged a little more than indicated in the report and that would be based on the level of correspondence you had to do in relation to them or the fact that they were in and out to you all the time.*

oooOooo

> *On the fee, it was target driven. There is no doubt in my mind on that …*

oooOooo

*Inspector:* *Was it a guesstimate based on documentation on what you thought the time may have been or was it a guesstimate of what the account might bear without raising a query?*

*Manager:* *It was a guesstimate, it's probably a combination of those.*

oooOooo

> *I would say that in some instances people were possibly overcharged and in other instances undercharged.*

***Internal Audit Reports***

Findings noted in branch audit reports between 1992 and 1996, at the dates set out below, are consistent with the evidence set out above:

<u>March 1992:</u> *It was noted that where fees were increased that an explanation was not annotated and confirmed by the Manager/Deputy Manager as required.*

<u>May 1992:</u> *Where increases to fees are made an explanation should be recorded beside the entry on the fees to be applied report. Branch should ensure that increases can be justified if queried by customers.*

<u>June 1992:</u> *When fees were increased/decreased there was* (sic) *often inadequate explanations annotated to the fees to be applied report.*

<u>September 1992:</u> *It was noted that a reason was not annotated on the fees to be applied report when fees were decreased or increased.*

<u>February 1993:</u> *From examination of the fees to be applied reports many instances were noted where customers* (sic) *fees were increased by substantial amounts and there was often inadequate explanations annotated on the report.*

<u>April 1993:</u> *It was noted that the reason why fees were increased was not noted on the fees to be applied report.*

<u>May 1993:</u> *It was noted that the reason why fees were increased or reduced was not annotated on the fees to be applied report as required.*

<u>June 1993:</u> *A number of instances were* (sic) *noted where fees calculated by the computer system were amended but no explanation was given.*

<u>July 1993:</u> *When fees are increased/reduced the fees to be applied report was not annotated with a suitable explanation.*

<u>July 1993:</u> *Many instances were noted where the fee as calculated by Livelink was increased/reduced but the report was not annotated with a suitable explanation.*

<u>August 1993:</u> *Many instances were noted where fees were increased or reduced below the figure calculated by Livelink and a suitable explanation was not annotated on the fees to be applied report.*

<u>September 1993:</u> *The fees to be applied report is not annotated as required when fees are increased/reduced below the figure calculated by Livelink.*

*October 1993:* *It was noted that the fees to be applied report was not annotated with a meaningful explanation or signed by an authorised official beside the relevant entry, when fees were adjusted.*

*October 1993:*
- *Numerous instances were noted where customers* (sic) *fees were substantially increased without legitimate cause or reason.*
- *The fees to be applied report is not annotated with a meaningful explanation and signed by an authorised official beside the relevant entry when fees are increased or reduced below the figure calculated by Livelink.*

*November 1993:* *It was noted that the Fees to be Applied Report was not annotated with a meaningful explanation beside the relevant entry when fees were increased or decreased below the figure calculated by Livelink.*

*December 1993; January 1994; May 1994:* *Numerous instances were noted where customers* (sic) *fees were substantially increased and a meaningful explanation was not annotated beside the relevant entry.*

*January 1994; February 1994; March 1994; November 1994; February 1995:* *Numerous instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.*

*April 1994:* *Numerous instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.*

*July 1995:* *Many instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.*

*July 1994; December 1994; January 1995; February 1995; May 1995; June 1995; July 1995:* *Instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.*

*July 1994:* *A few instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.*

*September 1994:* *Many instances were noted where customers* (sic) *fees were substantially increased and a legitimate reason was not recorded on the Fees to be Applied Report.*

*November 1994:* *On a number of occasions fees as calculated by Livelink were increased and a suitable explanation was not recorded on the fees to be applied report.*

*February 1995:* *A number of instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.*

*June 1995; March 1996:* *Instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.*

Findings noted in internal audit reports referred to below are consistent with the oral evidence received to the effect that there was no system in the branches for recording management time:

August 1995: *Following an examination of the Fees to be Applied reports and Costing reports produced this year to date, it is noted that approximately £20k is charged to customers each quarter in respect of management time (this is in addition to normal fees). There is no system at Branch to record details of management time.*

September 1995: *It is noted that administration charges represents* (sic) *approximately 25% of total fees charged each quarter. There is presently no system at Branch to record details of administration charges.*

November 1995: *It is noted that there is no system at Branch to record details of administration charges.*

February 1996: *Administration charges represent approximately 5% of total fees charged each quarter. There is presently no system at Branch to record details of administration charges.*

March 1996: *Account administration charges represent approximately 20% of total fees charged each quarter. There is presently no structured system at Branch to record details of administration time.*

April 1996: *From an examination of two recent Fees to be Applied Reports, it is noted that account administration time charges represents* (sic) *only approximately 8% of total fees charged each quarter. Furthermore, there is no system at Branch to record details of account administration time.*

April 1996: *From an examination of two most recent Fees to be Applied reports, it is noted that account administration charges represents* (sic) *only approximately 4% of total fees charged each quarter. Furthermore, there is currently no system at Branch to record details of account administration time.*

May 1996: *From an examination of two recent Fees to be Applied reports, it is noted that account administration time charges represents 1% to 2% of total fees charged each quarter. There is currently no structured system at Branch to record details of account administration time.*

**Pre-notification of Fees**

In 1996, as a result of an initiative taken by the Director of Consumer Affairs, a system of pre-notification of fees was introduced by the five main banks, including National Irish Bank. Special Circular S10/96 dated 1 March 1996, the title of which was "Recording of Account Administration Time" summarised the background as follows:

> *Currently, it is still the practise* (sic) *of some Banks, including National Irish Bank, to apply fees to a customer's account and leave it up to the customer to*

*discover the extent of the bank's deductions on receipt of their statement. Information on the makeup of this charge is not provided to the customer unless it is subsequently requested. Whilst it has been normal practice for Banks to act in this way, lately there has been growing pressure on Banks, particularly from the Director of Consumer Affairs, to provide customers with an itemised breakdown of their charges before they are applied to the account.*

*In a press release on 'Bank Charges' made during 1995, the Director of Consumer Affairs referred to the provisions of the pending Consumer Credit Bill and declared:*

***"All of the five main Banks will have introduced a system of pre-notification of their main transaction charges before the end of 1996 …… The effect of pre-notification will be to give customers details of charges two weeks before they are debited to accounts. Customers will then have an opportunity of querying these charges before they are actually debited."***

*It should be noted that the requirements of pre-notification will not be included in formal legislation provided that the Banks' "voluntary" actions are approved by the Director of Consumer Affairs.*

*Within National Irish Bank, software is currently being developed which will allow the Bank to meet these requirements. It is expected that this software will be implemented at the beginning of May with the first pre-notification Fee Advices being produced at the end of the charging period in August.*

The circular went on to state that the charge which was previously referred to as a management time or administration charge had now been replaced with the designation "account administration".

The requirement for the pre notification of fees necessitated keeping a record of account administration and a key feature of the revised system provided for the input at branch level on an ongoing basis of time spent on account administration, so that such charges would henceforth be automatically included in the calculation of the fee at the end of the charging period. New forms, which required that details of time taken and the nature of the work done be recorded and input daily, weekly or monthly to the computer system, were introduced in the circular, to take effect from the May/August charging period of 1996.

The content of the Fees to be Applied Report was amended to include all activity items, including details of all account administration time inputs – date, time spent and work category.

It was explicitly stated that the only amendments which ought to be necessary on review of the Fees to be Applied Report would be those resulting from current period input errors which had not already been corrected. Fee amendment procedures were set down, and a fee amendment form, requiring that the basis of the alteration be recorded, was prescribed.

Managers interviewed were comfortable with the post-1996 system, albeit that there appeared to have been some "teething troubles" attending its introduction. Their comments included:

> *It's a proper system now.*

oooOooo

> *Well, I am not sure of the date [of introduction of the new system in 1996], but even in the early stage of that system it is difficult to, you know, people weren't familiar with the system, they weren't documented. We are documenting it 90% correctly now, but in the early stage at the introduction of the system, again you would have had an element of the crude mechanism.*

oooOooo

> *Since '98* (sic) - *I can't remember exactly what time in '98 but during '98, that system was discontinued and everything was, we had to do administration sheets …*

oooOooo

*Inspector:* *The situation now is there would be no manual intervention at the quarter end?*

*Manager:* *No, except … if there was a blatant error.*

**Delay in Implementing new Time Recording System**

***Fee Income Theme Audit***

This audit was carried out in October 1996, and was the subject of a report to Bank management in November 1996. The audit represented the first formal review of the fee income area following introduction of the revised system for recording account administration time on a contemporaneous basis. The stated principal objective was to ensure that fee income was being properly collected.

The majority of findings relate to areas where the Bank may have been failing to record, and therefore to recover, charges, but the report also records deficiencies in completion, coding, input and checking of account administration forms in the branches visited. It would appear that at the outset of the pre-notification period, the newly introduced system for recording account administration time was not fully operational and that to an extent the practice of unsupported amendment of the Fees to be Applied Report persisted.

As is indicated in the second interview extract quoted above, managers interviewed acknowledged that the new system took some time to become fully operational.

***Internal Audit Reports***

Internal audit reports from branch visits about this time also indicate some delay in adoption of the revised procedures:

August 1996:

> *By enquiry, it was established that the completion and input of account administration input forms in respect of quarter end August did not commence until early July. This has necessitated the manual input of a considerable amount of account administration time at quarter end for which details are not fully documented.*

October 1996:

> *By enquiry, it was established that account administration input forms were not completed and input on all occasions in respect of the first half of the quarter ended August 1996. This necessitated the input of a considerable amount of account administration time (65 hours approximately) at August quarter end under category 99 (general) for which details are not fully documented. It was further noted that category 99 (general) represents almost 40% of total administration time charges for this quarter.*

December 1996:

- *An examination of the most recent Fees to be Applied reports indicates that account administration input forms are not being completed on all occasions by staff dealing with customer queries, lending, counter activity etc. An examination of the reports revealed the following:*
  - *(a) Over 95% of the account administration time charges for the quarter ending August 1996 were input in bulk at the end of the quarter for which details were not fully documented.*
  - *(b) Only two hours of account administration time were input for the full quarter ending November 1996 (some charges are levied at time of transaction/task).*

- *By enquiry, it was established that in some cases account administration time charges and in one case activity charges are applied to accounts at the time of the transaction/task and are therefore not pre-notified.*

***Review of November 1997 Fees to be Applied Reports***

Review on behalf of the Inspectors of a sample of Fees to be Applied Reports for the quarter ended November 1997 revealed that at that date, extensive manual adjustments were still being effected at quarter end in a number of branches.

## ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE

### No Action Taken prior to 1996

While Internal Audit had regularly reported that "*customer fees were substantially increased and a meaningful explanation was not annotated beside the relevant entry*", as appears from the branch audit reports referred to above, the Inspectors have not found any evidence that these reports resulted in any move by the Bank to examine how fees were being charged.

In fact, prior to the introduction of the Customer Action Pad in July 1992, there appears to have been no appreciation at any level within the Bank that it was improper or inappropriate that customers be charged for services on a time-related basis while there was no system in operation for recording such time. Indeed, as is clear from the memorandum which accompanied it, the Customer Action Pad was not introduced with the intention of remedying a deficiency in control systems, but in an effort to ensure that a greater proportion of manager and staff time was charged to customers. As already stated, the introduction of the Pad did not bring about any improvement in how management time was charged. Managers found the system cumbersome and unworkable.

No effective action was taken until an upgrade of the computerised system for customer charges was introduced in April 1996 in anticipation of the requirement of the Director of Consumer Affairs (referred to at pages 155 and 156) to prenotify customer charges.

## ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS

### Interviews with Bank Staff

As already indicated in Part 6, the initial action taken by the Bank was to have internal audit staff interview 210 Bank personnel. 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.

As already noted, 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*

As described in Part 6, 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.

### *Work Done*

As already outlined in Part 6, 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 fee area, following review of available branch audit reports, the Bank decided to concentrate on the branch referred to in the RTE report, that at College Green, Dublin. The Fees to be Applied Report was not available for the November 1989 charge period, the subject of the allegations of unjustified fee increase, and so the next charge period was chosen. Arthur Andersen ("AA") was therefore engaged to investigate "*whether fees have been debited to customer current accounts at the College Green branch of the Bank without any contractual, statutory or other valid basis and, if so, the extent thereof for the February 1990 quarter end posting date*."

Following classification of a total of 896 manual amendments to the Fees to be Applied Report in the quarter, AA reviewed Fee Amendment Sheets, Costing Sheets and Customer files; the documentation provided unambiguous support for a specific amendment in two instances only.

***Work carried out by Bank investigation team – College Green branch***

Bank staff carried out an account by account review for each College Green, Dublin, branch customer identified by AA as having a fee amendment greater than IR£3.00 in the quarter – 549 in all. By applying standard times for management activities identifiable from examination of the account to a cost per hour, a calculation of management time cost was compared to the fee uplift.

The outcome of this exercise is summarised in the Unauthorised Interest & Fee Amendments report as follows:

| | No. | IR£ |
|---|---|---|
| Fee amendments | 885 | 11,294 |
| Examined | 549 | 10,651 |
| Justified | 439 | 9,958 |

The Report notes, and Bank management have emphasised the point to the Inspectors, that the list of activities warranting a management charge indicates that only a small proportion would be identifiable from a review of transactions on the account.

The Bank concluded that the results of this work represented a "*high level of satisfaction with … fee charging practices at the time of the allegations*". The Bank further decided to use a matrix based on the level of fee uplift identified at this branch as a key indicator in evaluating the level of fee adjustment effected at other branches during the period investigated.

***Work carried out by Bank investigation team – other branches***

Bank staff carried out additional work on fee amendments using the same approach as that adopted for the College Green, Dublin, branch, under a number of headings:

- A sample of twelve branches was selected for detailed review of some 50 amendments for one quarter. The Report states that the sample was biased towards branches and time periods which had been found to include unjustified interest amendments. The Bank concluded that the results of this examination were satisfactory for all branches except Cork and Carndonagh branches.

- Review of other branches where the managers of these two branches had worked resulted in a similar "unsatisfactory" conclusion being reached in respect of Waterford branch.

- A matrix of "reasonable" fee uplifts, by account type and account activity level, was developed based on the results of the review at College Green, Dublin branch. This matrix was then applied across all customer fee enquiries for one quarter. Enquiries failing this test were subjected to a detailed account review for the quarter in question to establish whether adequate justification for the fee uplift existed. The Bank concluded from this work that fee refunds were not warranted at branches other than those identified above – Cork, Carndonagh and Waterford.

- A minimum of ten amendments over two quarters was examined at all other branches; no further instances of unjustified fee charging were identified from this work.

***Conclusions***

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

> *The fee charging process in place at the time of the allegation involved a series of three reports and required manual intervention for the application of management time charges. The approach taken in College Green branch, namely making manual amendments to the Fees to be Applied Report, was typical across the network.*
>
> *While many of the activities which would warrant management time charges are invisible to a retrospective account review, the results of the work carried out in College Green gave a high level of satisfaction with their fee charging practices at the time of the allegations.*
>
> *Work carried out across the remainder of the network confirms that there was no widespread abuse of fee charging practices. However Cork, Carndonagh and Waterford branches have been identified as having low justification levels for fee uplifts applied during certain time periods. Whilst the full quantification of the position in Waterford has not yet been completed, it is anticipated that the total amount of fees that will be refunded will be approximately £200k before indexation.*
>
> *System developments in the periods since the allegations were made have resulted in improvements in the capture of administration and management time and, as a follow on, in enhanced transparency to the customer.*
>
> *The introduction of detailed pre-notification of fees in August 1996 gives a high level of comfort with the integrity of current fee charging practice.*

Arising from the work described above, fee refunds were made to customers of the three above-named branches only.

The Bank has advised the Inspectors that it has now made inflation-adjusted refunds totalling approximately IR£960,000 in respect of unjustified fee adjustments. (This total includes refunds in respect of some charges made in 1987).

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

As there was no system in operation in the Bank for recording administration and management time between 1988 and April 1996, and in light of the internal audit reports and the consistency of the evidence the Inspectors have received from branch managers, the Inspectors reject the conclusions of the Unauthorised Interest & Fee Amendments Report that there was no widespread abuse of fee charging practices and that fee refunds to customers should be confined to three branches only.

**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 informed the Inspectors that approximately 1,481 fee-related queries were received, through the helpline and otherwise.

The Bank's approach to the resolution of these queries and to responses to customers placed considerable reliance on the work described in the Unauthorised Interest & Fee Amendments Report and the conclusions reached from that work, as summarised at pages 160 to 162 above. This resulted in many replies to customers being based on work done at branch level rather than on review of their accounts. Customers whose individual accounts did not reach an acceptable threshold in course of the work underlying the Unauthorised Interest & Fee Amendments Report, or whose accounts contained unresolved issues, were given assurances based on the view taken of the relevant branch, notwithstanding the results of work on their accounts.

**Further Work proposed by the Bank**

Following, *inter alia*, discussions with the Inspectors, the Bank informed the Inspectors that it would undertake a fee review which would examine in detail the areas described in a paper entitled "Fees Review 2001" which was furnished to the Inspectors on 8 August 2001. This paper is reproduced as Appendix 17.

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 on the Inspectors' provisional findings when received.

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.*

As already stated (see page 137) the Bank anticipates that this programme will result in additional fees and interest refund payments to customers of Euro10.6 million.

## INSPECTORS' CONCLUSIONS

**The Inspectors find:**

1. Between 1988 and April 1996 there was no system in operation at the branches for the contemporaneous recording of administration and management time.

2. The manner in which branch managers purported to charge fees for administration and management time during this period was in the opinion of the Inspectors improper, resulting in some customers being overcharged, across the branch network.

3. While the new system for recording and charging account administration time introduced in March 1996 was to take effect from the May/August charging period of 1996, this system did not become fully operational in the branches on schedule, and extensive manual adjustments were still being effected in a number of branches in November 1997.

4. Customers at branches other than those at Carndonagh, Cork and Waterford were overcharged and have not been refunded.