ombudsman
news
essential reading for financial firms and consumer advisers

Financial Ombudsman Service

settling financial disputes, without taking sides

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Walter Merricks
chief ombudsman

who do they think we are?

Meetings with a number of journalists last month had me scratching my head over the radically different ways the ombudsman service can be perceived within the communities we serve. On the one side, journalists from publications aimed at independent financial advisers wanted to know how I could defend an organisation that was virtually taking the bread out of advisers' mouths, '*destroying the livelihoods*' of small firms and regularly '*breaching their human rights*'. A few days later, meeting personal finance journalists – I was asked why we don't use our clout to condemn more publicly the '*disgracefully unjust*' behaviour of firms both large and small towards consumers.

You could say that we must have got things about right if an equal amount of dissatisfaction is coming from two different points of view. But I'm not so sure. In our publicity we stress our independence and impartiality. We say we are neither a champion for consumers nor an apologist for the industry. Unfortunately, it's a little easier to state what we are *not*, rather than what we are – largely because ombudsmen haven't been around for all that long.

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We try to level the playing field for consumers so that the outcome of disputes is determined by the merits of their case, rather than by which party has access to the greater expertise or resources. Our service is free to consumers and they bear no legal risk if we do not uphold their complaint. These features of our scheme are certainly designed to give consumers a helping hand, and can lead some consumers to think that we ought to be doing more, upholding complaints just because we might feel sorry for them. These features can also lead firms to conclude that we are constitutionally biased in favour of consumers.

So treading a path between consumer and industry perceptions is not easy. There is no agreed model or benchmark of how an organisation like ours should position itself. Since – in making decisions – we perform a semi-judicial function, one option would be to operate with a more distant style, rather like the judges, simply letting our authority speak for itself. In that case we would not have any external liaison functions, technical advice phone lines or publications, and I wouldn't be talking to journalists at all. Another option would be to operate more centre-stage, attracting a higher profile, with more distinctly-angled messages of advice for firms and consumers. But that would duplicate – and could even be seen as competing with – the role of the regulator.

By now you will be wondering how we cope with such a permanent identity crisis. The answer is simple – by getting on with the job. Most of the time, just dealing with the pressures of our workload is quite enough to be getting on with. And as time goes by, and consumers and firms get more used to what an ombudsman service is and does, we'll stop worrying. In the meantime I'll keep scratching my head.

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banking update – cheque clearing problems

In issue 34 of *ombudsman news* (January 2004) we gave a basic explanation of the cheque clearance system, and outlined some of the difficulties that can arise when customers ask their bank or building society whether a cheque paid into their account has 'cleared'.

What customers often mean when they ask if a cheque has cleared ('is there any danger of the cheque still coming back unpaid?') can differ substantially from what the cashier thinks they are asking ('will you let me draw money on the cheque?'). This misunderstanding can create problems, especially if a customer intends to do something irrevocable – such as paying out money, or releasing goods – on the basis of what the cashier says.

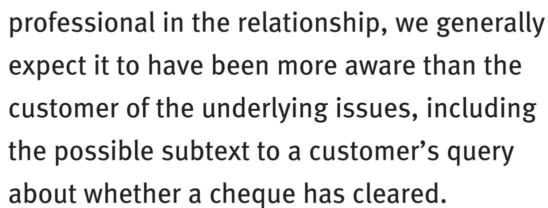
The situation has been highlighted recently by the small number of cases we are starting to see involving an increasingly common cheque 'scam'. The customer advertises something for sale (typically a car) and then receives an e-mail from a fraudster, posing as a buyer. The fraudster arranges to send a cheque for the cost of the item, together with an extra amount which the customer is asked to pass on to a third party (usually by money courier or direct transfer). Often the fraudster says this extra amount is to cover 'shipping costs'. The cheque that the customer receives is generally drawn on a business, such as an insurance company.

... we have to decide what the customer probably asked, and what the cashier probably said.

Before passing on the money to the third party, the customer will normally check with their bank or building society to see whether the cheque has cleared. The point at which the customer makes this enquiry will usually coincide with the point at which their bank or building society will allow money to be drawn against the cheque. The customer will not usually realise that – at that stage – there is still no certainty the cheque will actually be paid by the bank on which it was drawn.

Once the customer has sent the surplus money to the third party, the fraudster will ask for the rest of the money back – saying they have had second thoughts about the purchase. By this point, the cheque that the customer paid in will normally have been returned unpaid. The customer will then discover that the transaction had never been genuine and that the cheque they were sent had originally been stolen. Even though the customer does not return any more money – they are already out-of-pocket by the amount they have sent to the third party.

A dispute often then arises between bank and customer about what the branch did (or did not) say about the risk that the cheque would not be paid. When unresolved disputes are referred to us, we have to decide what the customer probably asked, and what the cashier probably said. As the bank or building society is the banking



professional in the relationship, we generally expect it to have been more aware than the customer of the underlying issues, including the possible subtext to a customer's query about whether a cheque has cleared.

Sometimes we think it should have been evident, from what the customer asked, that they needed to know for sure if there was any chance of the cheque not being paid. If the bank or building society then failed to address that point, we may find in the customer's favour. In such cases the bank or building society will have to bear the loss.

If the customer's questions were less clear, we take account of what the bank or building society knew about the cheque transaction. If it had been told of the circumstances in which the customer obtained the cheque, then (given the widespread knowledge within the industry about this type of scam) we might expect it to have warned the customer – even if the customer's enquiries about the cheque were of a more general nature.

In some – less usual – cases, the circumstances under which the customer obtained the cheque were so obviously fraudulent that we decide the customer could not reasonably have been unaware of this. In these cases, we may say the customer should bear the loss.

The facts and circumstances are different in each case, even though the scam itself is usually carried out in a similar way. As always, we reach a decision on the basis of what happened in each individual case. If there is a dispute about the facts, our decision is based on what we think is most likely to have happened.

... our decision is based on what we think is most likely to have happened.

case studies
banking update – cheque clearing problems

53/1
bank confirms to customer that cheque has '*cleared*' – should it then have debited customer's account when cheque was returned unpaid?

Mr H was sent a cheque for £4,400 (drawn on an insurance company) for a car he was selling over the internet. The price of the car was only £500 but the 'buyer' asked Mr H to transfer the remainder of the money to a third party living abroad.

When Mr H paid the cheque into his bank he obtained a receipt, on which the cashier had noted the day on which the '*funds will be available*'. Mr H later told us he had contacted the bank on that date for confirmation that the cheque had '*cleared*'.

Mr H then withdrew £3,900 from his account and transferred it to the third party. It was only when the cheque for £4,400 was subsequently returned to his bank – unpaid – that Mr H realised he had been duped. He complained to the bank, saying it was at fault for telling him the cheque had cleared and it was safe for him to draw on it.

When the bank refused to uphold his complaint, Mr H came to us.

complaint rejected

We did not accept Mr H's assertion that the wording of the receipt was an assurance that it would be '*safe*' for him to draw on the cheque on the given date. The terms and conditions of Mr H's account made it very clear that, even though he had been told he could draw against a cheque paid into his account, the cheque could still be debited to his account if it was later returned unpaid.

We were not persuaded, either, by Mr H's insistence that the bank's response to his subsequent telephone enquiry constituted an assurance about the fate of the cheque. He admitted he had not explained the circumstances to the cashier but had simply asked if the cheque had cleared. We sympathised with Mr H's plight, but we could not uphold his complaint.

... he had not explained the circumstances but simply asked if the cheque had cleared.

53/2

bank confirms to customer that cheque has cleared – whether it should then have debited customer's account when cheque was returned unpaid

Mr E advertised a motorcycle for sale at £3,000. An overseas 'buyer' responded and sent Mr E a cheque for £6,000, asking him to pass on the extra £3,000 to a third party. The 'buyer' said the extra money '*represented shipping costs*'.

Mr E paid the cheque into his bank. But before drawing out and dispatching the 'shipping costs', he made two separate enquiries about whether the cheque had cleared. Reassured by the firm's response to his second enquiry, Mr E sent the money.

Not long afterwards, the cheque was returned unpaid and Mr E realised he had been duped. He complained to the firm, saying it should not have debited his account by the amount of the returned cheque. However, the firm refused to uphold his complaint, so he came to us.

... when the cheque was returned unpaid he realised he had been duped.

complaint upheld

We examined transcripts of the telephone conversations Mr E had with his bank before he drew on the cheque. The first conversation – held not long after the cheque had been paid in – was general in nature and gave no specific information about the cheque in question.

But the second conversation was different. We felt the bank had failed to pick up on clear signs that Mr E was not just asking if he could draw on the cheque. He was really asking if there was any danger of the cheque being returned unpaid. In the context of what Mr E was asking, we felt it reasonable for him to have construed the bank's assurances that the cheque had cleared as meaning it was safe for him to draw on the cheque and send off the shipping costs.

Mr E could see, with the benefit of hindsight, that there were some unusual aspects to this transaction. But we did not consider that his dealings with the 'buyer' were such that he should have been aware he was dealing with a fraudster. We upheld his complaint and said the bank should cover the £3,000 loss.

53/3

on mistaken assumption that a payment was made by CHAPS – not by cheque – customers say bank should not have debited account when cheque was returned unpaid

Mr and Mrs L ran a small business and received an order for goods worth £6,700. This was a much larger order than they were used to handling, so they asked their bank about the safest way to obtain payment for the goods. The bank advised them that an electronic transfer of funds by the 'CHAPS' system would be safest because - once made - the payment could not be cancelled.

Mr and Mrs L asked their 'buyer' to make the payment by CHAPS. They told us that they later checked the balance of their account online, and found it showed a '*cleared balance*' that included the £6,700 they had been expecting.

Before allowing the 'buyer' to pick up the goods, Mr and Mrs L called the bank to check that it was indeed true that CHAPS payments could not be taken back once made. The bank confirmed this was the case.

A few weeks later, Mr and Mrs L discovered that their account had been debited by £6,700. The 'buyer' had paid with a stolen cheque – not by CHAPS – and the cheque had been returned unpaid.

... we could not fairly find that the bank should bear their loss

complaint rejected
We checked out the information that customers were given when looking at their account balance online. This stated that the 'cleared balance' was subject to adjustment if any items were subsequently returned unpaid.

We accepted that Mr and Mrs L had received two assurances from the bank that CHAPS payments could not later be withdrawn. That information was correct. Unfortunately, even by their own account Mr and Mrs L had not asked about any specific transaction – they had simply asked a general question about CHAPS payments. The bank did not know the couple were intending to release goods on the basis of what it told them, and in the mistaken assumption that they had received a CHAPS payment.

So although we sympathised with Mr and Mrs L, we could not fairly find that the bank should bear their loss from the stolen cheque.

insurance at the click of a button

Increasingly, people are buying insurance over the telephone or through the internet. So in a growing proportion of the insurance complaints we see, the sale was carried out by these 'instant' means.

Buying insurance at the click of a button may be quick and easy – but what if things go wrong? Does investigating a complaint create particular difficulties without the clear paper trail that more 'traditional' insurance sales generate?

Peter Hinchliffe lead ombudsman

We asked Peter Hinchliffe – the lead ombudsman for insurance – what the implications are for insurers and intermediaries.

Does the Financial Ombudsman Service have problems with online or other non-traditional methods of applying for insurance?

No, as long as care is taken during the sales process. We know that using the telephone or internet is convenient for firms and for consumers. It's economic and time-efficient for both sides – so we certainly wouldn't want to discourage it.

But it's important to be aware that the easier and quicker the process, the greater the potential for misunderstanding or errors. People may be led to believe they can go online and buy insurance more or less at the click of a few buttons.

But problems can occur – for insurers as well as for consumers – if the arrangements they are entering into are not fully understood.

The application itself can be crucial to the whole policy, so it's in everyone's interest to ensure appropriate safeguards are built in. If the consumer fails to realise the importance of disclosing relevant information at this stage and (perhaps feeling rushed) gives approximate or inaccurate answers – then a subsequent claim may be refused on grounds of 'non-disclosure'.

So consumers should be given sufficient opportunity to understand the insurance arrangements they are entering into. And there should be a permanent record of the sale.

Is that why so many firms still send out the completed form for signature?

Yes, they are simply following good practice. When investigating complaints involving 'non-traditional' applications for insurance, we don't *need* to see a signed form. But it's important that there is some permanent record of the agreement that was entered into, and of the information the consumer was given about their situation.

Getting a signature on an application form is a good way of capturing this information and establishing its importance, because consumers still see signing a piece of paper as significant. Allowing consumers to check the details means they can appreciate the implications of their application – and it helps avoid problems at a later date.

Is it important for firms to retain a record of the application once the policy is in place?

Yes. Keeping information from the time of the sale is really important. The record will be referred to later if the firm refuses a claim or if the consumer complains that the policy was not suitable. Problems can quickly arise if the consumer gives a convincing explanation of what was said or done and the firm disagrees but has no records to back up its view.

The risk of not keeping a record of the application frequently lies with the firm. This obligation cannot be passed on to the policyholder, especially when the firm hasn't given the policyholder a second chance to check the information.

So firms *should* send out a paper copy for the consumer's signature after the event?

Not necessarily. Although there is some legal doubt here, we take the view that the permanent record does not need to be on paper. It could be held as a telephone recording or a saved web page. The important thing is that it is made at the time of the sale, is not open to alteration and is kept in a secure manner.

Are there any particular guidelines that firms or intermediaries should follow when selling insurance online or over the phone?

The intermediary or firm needs to ensure that all the same requirements which apply to a traditional sale process are satisfied and that the process, while quick, is still comprehensive. They should be aware of the potential for confusion when applications are made over the phone or online. So they should look at the process from the policyholder's perspective, and consider whether – if a dispute arose – a policyholder might justifiably say that the firm gave confusing or inadequate information.

If the application was not completed by the policyholder but by an intermediary acting on their behalf, the margin for error and dissatisfaction is much greater. But if the policyholder has not seen a policy summary or had the opportunity to understand all the policy content, then this is true whether the transaction took place online, over the phone or on paper. It's certainly not a technology-specific issue. The clarity of the information provided, the quality of the records, and the consumer's ability to understand the transaction will always be what matters.

So could someone actually buy insurance by text message?

Well, I wouldn't advise it, but it's certainly possible! We have heard of plans to sell travel insurance in this manner. The issue for the intermediary or insurer to consider is whether they can satisfy the requirements of good practice and the Insurance Conduct of Business Rules (ICOB) in selling this way, and to accept that their ability to rely on exclusions or consumer non-disclosure may be compromised by an inadequate sales process.

Can insurers still raise concerns about a policyholder's non-disclosure if the sale was made online or over the phone?

Yes, of course. The only difference for the firm to bear in mind is that we might be more easily persuaded that there is an innocent reason for a failure to disclose information where someone who answers a question incorrectly did not see the question for long, did not write the answer down themselves, and did not get the chance to re-read or sign the policy documents.

We will apply the same criteria and the same standards as we would with a traditional application, where the individual had been asked to complete a form, check it for accuracy and then sign it.

So in conclusion, would you say that buying insurance online raises different concerns to those that arise when buying anything else online?

People are generally well aware nowadays of the security and payment issues for most online transactions. But the possibility of mis-selling is more of a concern when dealing with complex, regulated products like financial services than it is with items like CDs or books – or even with electronic items that may prove faulty when they are delivered to the customer.

With insurance – the fact that the insurer may refuse to meet a claim on the basis of information that the policyholder did (or didn't) give in their application raises particular problems – we are applying 18th century law to 21st century technology. That's why, as I've outlined, firms need to be sure they've built appropriate safeguards into their sales processes, and are able to produce reliable, contemporaneous records. ❖

your complaint and the ombudsman

ordering supplies of our consumer leaflet

your complaint and the ombudsman **is the leaflet that (under the FSA rules) firms are required to give consumers at the appropriate stage in the complaints procedure.**

Firms can obtain supplies by sending us a completed order form (available on the publications pages of our website www.financial-ombudsman.org.uk) with a cheque for the correct amount. The leaflets cost £5 per pack of 25, including postage and packing.

Leaflets are free to public libraries and consumer advice agencies, such as trading standards departments and citizens advice bureaux – who should email aniko.rostagni@financial-ombudsman.org.uk

future funding of the ombudsman service

The Financial Services Authority (FSA) and the Financial Ombudsman Service recently published a joint discussion paper, outlining possible options for the future funding of the ombudsman service's compulsory jurisdiction.

The way in which the costs of the ombudsman service are divided among financial firms is a subject close to the heart of many in the industry. More than 70% of the ombudsman service's funding currently comes from the fees we charge firms for considering complaints made against them. The remaining funding comes from annual fees (levies) payable by all firms, calculated according to their role in the different industry sectors they are involved in.

Two years ago – in recognition of the fact that 95% of firms have fewer than three disputes referred to the ombudsman each year – we introduced an arrangement whereby we do not charge firms for the first two complaints made against them in a year. This arrangement has been warmly welcomed, especially by smaller firms. We now look forward to hearing more ideas and feedback on other possible funding options – as part of broader debate on how firms should pay for the ombudsman service.

The options for future funding that are set out in the discussion paper include:

- continuing the existing arrangements whereby the ombudsman service is financed by a combination of a case fee and a levy;
- raising all the funding by annual fees only, with no case fees, or alternatively by case fees only; *or*
- adopting a new approach which would combine a small flat-rate annual fee for all firms, and a case fee. The paper discusses a number of possible combinations of the flat-rate fee, the case fee and the number of cases a firm is allowed each year before the ombudsman service begins to charge case fees.

After evaluating responses to the discussion paper, the FSA and the ombudsman service will publish a consultative paper in autumn 2006 – about any changes to the future funding arrangements (and transitional arrangements if required). The discussion paper, *Financial Ombudsman Service compulsory jurisdiction: funding review*, is available on the FSA website (www.fsa.gov.uk). There is a link to it from the news page of our website (www.financial-ombudsman.org.uk).

ask ombudsman news

informal guidance needed ...

Q The few complaints my firm has had until now have been very minor matters that we were able to sort out very quickly and entirely to the customer's satisfaction. But we've now got a very tricky situation on our hands. We don't think we're to blame at all but the customer is adamant that we're in the wrong.

I remember reading or hearing somewhere that you can advise firms on the handling of complaints before they reach the stage where the customer refers them to the ombudsman service. Is this true?

A Yes. As well as resolving disputes, we do a lot of complaints prevention work with firms. Drawing on our experience of resolving hundreds of thousands of complaints, we can provide practical guidance. We will tell you whether we think you or your customer are on the right lines. In this way we can help firms nip potential problems in the bud – before they turn into full-blown disputes.

Firms can contact our technical advice desk for help or informal guidance at any time. You don't need to wait until a customer has made an official complaint to your firm before you get in touch with us. The sooner you contact us to talk through what looks like a tricky situation, the easier it often is to sort out the problem informally at an early stage – saving time, money and effort all round.

You can call the **technical advice desk** on 020 7964 1400 or email technical.advice@financial-ombudsman.org.uk

You may also find it helpful to look at our website (www.financial-ombudsman.org.uk) where you'll find a wide range of information, including the answers to many frequently-asked questions.

keeping it confidential ...

Q I am sending you the information you asked for in connection with a complaint made against me by one of our clients. But I am concerned that some of it is quite personal. Can I rely on the ombudsman service treating the information in confidence, or will you automatically pass on everything I say to the client concerned?

A We will have regard for your rights of privacy, and we do not automatically copy all the information we have on a case to both parties in the dispute. But in general, you should assume that we may disclose to the customer any information you send us about the complaint. And we will certainly need to summarise information that is central to our decision, as well as disclosing other information where we think it appropriate.

If you believe some of the information you send us should be kept confidential between you and the ombudsman service, you should mark that information clearly and tell us why you think we should not pass it on to the customer. We will consider your request – but we may not agree to it, unless there is a strong case for confidentiality, such as security reasons.

We take the same approach with information the customer gives us. By signing our complaint form, customers authorise us to exchange information with you about their complaint.

We have statutory power to require information from you – and this overrides any duty of confidentiality you may have to a third party.

ombudsman news gives general information on the position at the date of publication. It is not a definitive statement of the law, our approach or our procedure. The illustrative case studies are based broadly on real-life cases, but are not precedents. Individual cases are decided on their own facts.