# Briefing on banks' processes and consumer protections for scams

Report of the Finance and Expenditure Committee

August 2023

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Chairperson

# Briefing on banks' processes and consumer protection for scams

## Recommendation

The Finance and Expenditure Committee has considered a briefing on banks' processes and consumer protections for scams, and recommends to the Government that:

- New Zealand adopt a system similar to the UK's Confirmation of Payee scheme as part of the move to open banking
- the Government urge the New Zealand Bankers' Association to update its Code of Banking Practice[1] to offer further measures that help protect consumers from scams and fraudulent activity
- a voluntary compensation or reimbursement scheme be investigated for the New Zealand setting, similar to the one operating in the UK.

## Introduction

We initiated this briefing about bank processes and consumer protections against scams after following high-profile cases of scams in early 2022, which included digital and online scams, causing New Zealand victims to lose millions of dollars. We are concerned about the effects that scams are having on victims' lives and were keen to understand how banking processes could better protect consumers from scams.

To learn what work is being done in New Zealand to review scam regulations, and whether current approaches need updating, we invited the Banking Ombudsman, Nicola Sladden, to a hearing of evidence, and invited written evidence from the Council of Financial Regulators and the Ministry of Business, Innovation and Employment (MBIE). We also requested information from the Parliamentary Library about relevant approaches being undertaken in similar countries. This report briefly summarises the evidence we received on our briefing, as well as our recommendations.

## Scam activity in New Zealand is increasing

The Banking Ombudsman told us that it has seen an increase in complaints about scams, year after year. In 2015, the Banking Ombudsman Scheme received approximately 30 complaints about scams in each quarter. In the second quarter of 2022, the number of complaints rose to 157. According to the Banking Ombudsman, not only is the volume of complaints about scams rising, but scams are also becoming increasingly more sophisticated and are involving larger sums of money. The Banking Ombudsman said it is

[1] The Code of Banking Practice sets out principles of good banking practice for banks in New Zealand to adhere to, with the intent of ensuring that banks' customers have good experience when banking. You can learn more about the code on the New Zealand Banking Association's website.

therefore timely to review what protections New Zealand has in place to protect consumers against scams.

In its Cyber Security Insights report for the first quarter of 2023, CERT NZ (Computer Emergency Response Team New Zealand—a government-funded group focused on cyber-security and cyber-crime) reported that direct financial loss from cyber incidents had increased 66 percent in the first quarter of 2023 compared to the fourth quarter of 2022. While the total direct financial loss for the first quarter of 2023 was still lower than the totals for the third quarter of 2022 and the fourth quarter of 2021,[2] the rise is nonetheless concerning.

## Current protections against scams

The Banking Ombudsman informed us that banks in New Zealand have an obligation to "act with reasonable care and skill". As part of this, they must identify and act upon any warning signs or indicators of fraudulent activity that they witness. Banks in New Zealand have various measures in place to help prevent fraudulent activity and to mitigate security risks, including biometric log-ins, multi-step verification for high risk payments, and algorithms that can detect fraud.

While banks have some protections in place, scammers are still actively targeting New Zealanders. We heard that scams broadly fall within two categories: authorised payment scams and unauthorised payment scams. Banks respond differently to these two kinds of scams. We briefly outline their approaches below.

### Authorised payment scams

Authorised payment scams involve consumers making payments to bank accounts that they believe are legitimate, but actually belong to scammers. These can include scams based on romance, investment, and fake invoices. When consumers fall victim to this type of scam, banks in New Zealand do not typically have to reimburse consumers—even when consumers are tricked into paying money to the wrong recipient. However, if banks have not acted with reasonable care to identify possible indicators of fraud, they may be liable to reimburse consumers.

### Unauthorised payment scams

On the other hand, consumers may fall victim to unauthorised payment scams, which are characterised by a payment being made from a person's account without their knowledge or agreement. Examples of this type of scam include phishing attacks,[3] remote access scams, and identity theft. When consumers are affected by this type of scam, banks in New Zealand will typically have to reimburse their customers. However, certain exceptions may apply—for example, in cases where the consumer has been negligent, has failed to take reasonable steps to protect their banking information, or has failed to comply with their bank's terms and conditions.

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2 The CERT NZ report, Quarter One Cyber Security Insights 2023, is available here.

3 Phishing attackers steal consumers' data by acting as a trusted entity, tricking people into installing malware or revealing their sensitive information.

# Protecting against scams in the United Kingdom and Australia

Noting the general approaches that banks in New Zealand usually take in relation to scams, we wanted to learn what consumer protections against scams are offered in other similar countries.

## United Kingdom

### Open banking

Since 2018, after the release of a Competition and Markets Authority[4] report into the commercial banking market, the United Kingdom (UK) has been using open banking processes to strengthen protections for consumers in the banking sector. Open banking enables individuals and businesses to securely share their banking data with trusted third parties, who are then able to provide tailored applications and services to consumers. The practice can be used to prevent fraud, because it requires that:

- strong customer authentication must be used for every payment
- sensitive details are unable to be shared
- payment instructions are pre-populated, reducing room for human error
- open banking providers carry out due diligence with merchants.

### Confirmation of Payee scheme

We learned that, in comparison to New Zealand, the UK has more comprehensive scam protections for consumers. Large banks and financial service providers in the UK have implemented a Confirmation of Payee service, which aims to ensure that consumers are sending money to the right person. This is done by banks checking the name provided by the person making a payment against the actual name associated with the account they are paying money into. If the names do not match, or the information is not available for the recipient account, a notification is sent to the consumer. This allows the consumer to make a more informed decision about whether to proceed with the payment.

Lloyds Banking Group, a large UK bank, has said that the Confirmation of Payee system helped reduce bank transfer scams by 31 percent within the first couple of months of its introduction in 2020.

### Contingent Reimbursement Model Code

The UK also has a voluntary scheme that sets out minimum standards for consumer protections against authorised payment scams, under the Contingent Reimbursement Model Code. If customers have been the victim of an authorised payment scam, they are eligible for a reimbursement from their bank, unless the bank can establish that one of the exceptions set out under clause R2(1) of the code applies—for example, that a consumer has ignored either a formal warning from the bank or a negative confirmation of payee notification.[5]

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4 The United Kingdom's Competition and Markets Authority serves to promote competitive markets and manages unfair market behaviour.

5 You can read the Contingent Reimbursement Model Code on the Lending Standards Board website.

## Australia

### ePayments Code

Australia's regulatory framework for consumer protections against scams is similar to New Zealand's, as it only enables protection for victims of unauthorised payment scams. To offer this protection, Australia has a voluntary code of practice that applies to electronic payment transactions, called the "ePayments Code". The code sets out minimum requirements for refunding consumers when they have mistakenly paid the wrong account. It is intended as an additional layer to accompany other regulatory requirements applying to Australia's banks and non-bank financial institutions. Although it is voluntary, most banks, credit unions, and building societies in the country subscribe to it.

# Our recommendations

We think that banks' processes in New Zealand should be strengthened to protect consumers against scams. We note that open banking will be introduced in New Zealand,[6] and we expect that this will have a positive impact on consumer protections in similar ways to the UK experience. To this end, we recommend that:

- New Zealand adopt a system similar to the UK's Confirmation of Payee scheme as part of the move to open banking
- the Government urge the New Zealand Bankers' Association to update its Code of Banking Practice to offer further measures that help protect consumers from scams and fraudulent activity
- a voluntary compensation or reimbursement scheme be investigated for the New Zealand setting, similar to the one operating in the UK.

In addition to banks' consumer protection mechanisms, we also support the work done by CERT NZ to educate the public about the nature of cyber-crime risks. We encourage this work to continue in future.

We look forward to following the implementation of open banking and any updates that arise in the banking sector related to our recommendations.

6 RNZ, 'Open banking coming to NZ mid-2024' (30 May 2023). See also Payments NZ, 'Open banking implementation timeline set for largest banks' (30 May 2023).

# Appendix

## Committee procedure

We met between 4 May 2022 and 16 August 2023 to consider this briefing. We received written and oral evidence from the Banking Ombudsman Scheme, and written evidence from the Ministry of Business, Innovation and Employment and the Council of Financial Regulators (submitted by the Ministry of Business, Innovation and Employment). We received advice from the Parliamentary Library.

## Committee members

Ingrid Leary (Chairperson)
Andrew Bayly
Hon Dr David Clark
Anna Lorck
Dan Rosewarne
Damien Smith
Chlöe Swarbrick
Hon Phil Twyford
Simon Watts
Helen White
Nicola Willis

Sarah Pallett also participated in our consideration.

## Advice and evidence received

We received the following documents as advice and evidence for this briefing. They are available on the Parliament website, www.parliament.nz.

- Parliamentary Library (Banking scams consumer protections UK and Australia)
- Parliamentary Library (The United Kingdom's Open Banking Scheme)
- Banking Ombudsman
- Ministry of Business, Innovation and Employment
- Ministry of Business, Innovation and Employment on behalf of the Council of Financial Regulators.

A recording of our hearing can be accessed online at the following link:

- Hearing of evidence 22 June 2022.