

# **Nab Customer Support Group**

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## 1. Introduction

A fixed rate loan comes with conditions, the main one being that the interest rate is fixed. However, if one of the conditions allows the bank to transfer an infinitely variable break cost from the unwinding of an interest rate swap, dependent upon markets at the time of breakage, then the agreement becomes a derivative, regardless of whether or not it is broken and the penalty applied. This fact is confirmed by our lawyers.

Derivatives are regulated under FSMA Act 2000 due to the following:-

1. the risks to the customer inherent in the agreement and the likelihood of the introducer failing to fully explain the full risks transparently.
2. the substantial commission paid to the introducer.

### Commissions

We have evidence that introducers were receiving instant commissions of 5.6% of the loan:-

<https://docs.google.com/viewer?url=http://www.nabcustomersupportgroup.org/img/upload/2584/documents/Internal%2520emails%2520Feb%252008.pdf>

### Terms & Conditions

The bank prescribes its right to transfer swap break costs to the customer in the carefully worded small print in its standard Terms & Conditions. See section 8.2(f):-

[http://nabcustomersupportgroup.org/img/upload/2584/documents/Terms%20\\_%20Conditions.pdf](http://nabcustomersupportgroup.org/img/upload/2584/documents/Terms%20_%20Conditions.pdf)

### COBS checklist

Bank staff were completing COBS complaint checklists in the selling of Tailored Business Loans in order to follow procedures put in place in the past. This evidences that the bank management understood that the selling of TBLs should be no different to the selling of derivatives in respect of COBS. Here is an example of one :-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/Compliance%20checklist.pdf>

Section 1, question 3 bullet point 1 asks if there is any doubt surrounding the client's understanding of the transaction. The bank staff have answered "YES". But the reality is that the bank has replaced the "YES/NO" with "YES" (see later sections) and that the exercise has become totally ineffective. The instruction at the end is clear. "DO NOT PROCEED".

The two main advantages to the introducer of embedding swaps into fixed rate loans instead of selling them directly as standalone agreements are :-

1. Embedding the swap avoids drawing to the customer's attention the existence of a swap, thereby avoiding raising concern over associated onerous conditions, including breakage penalties, which will have had the effect of dissuading the customer from proceeding with the transaction.
2. As a fixed rate business loan is unregulated by the Financial Conduct Authority, bank staff are able to sell the product free of COBS rules in the knowledge that they are free from onerous regulations.

## **2. Standalone v embedded**

The Financial Conduct Authority has implemented an independently invigilated review of the potential mis selling of standalone Interest Rate Hedging Products (IRHPs). The sale of these products are subject to regulation because they are derivatives. As a fixed rate loan embedding a derivative is in effect a derivative, the products should be subject to at least the same level of scrutiny as standalone IRHPs. However, given the absence of a standalone agreement, a fixed rate loan embedding a derivative is less likely to be identified by the customer or even an FCA regulated individual than in the case of a standalone IRHP. The mis selling of a standalone swap requires to be proved by investigating each case. However, the process of embedding a swap in a fixed rate loan constitutes an attempt to mis sell without the need to investigate the circumstances of the sales process. In effect all fixed rate loans embedding swaps have been mis sold.

### 3. Dangers of embedding derivatives

The danger of failing to control the embedding of derivatives into fixed rate loans is illustrated no better than by the mass mis selling of the product by Clydesdale and Yorkshire Banks, subsidiaries of National Australia Bank (NAB), to virtually every customer in its Commercial Real Estate portfolio. The portfolio totaled £6.2 billion in March 2012 and at that point consisted of approximately 4,135 SMEs with an average loan of £1.5 million. The uncontrolled mis selling caused by the enormous instant commissions locked virtually every SME in the portfolio into long term fixed rates set at pre 2009 levels, precipitating severe financial difficulties for the affected SMEs and the collapse of the portfolio. Upon realising that a toxic portfolio had been created, NAB transferred the portfolio to its own books, relieving the subsidiary banks of the burden of defaulting customers. The portfolio is currently undergoing break up and disposal, precipitating receiverships, bankruptcies and enormous damage to the UK economy, including an estimated 21,814 job losses. NAB has accounted for TBLs as derivatives in its Financial Statement for y/e March 2012 :-

Section 42 Page 143

The following link is the original link but the target document has been removed and its location now is unknown.

<https://docs.google.com/viewer?url=http://www.nab.com.au/content/dam/nab/about-us/shareholder-centre/reports-and-presentations/documents/annual-financial-report-2012.pdf>

#### Significant transfers into Level 3

As part of the restructure of the Group's UK operations, the Tailored Business Loan (TBL) product was discontinued in the UK, in April 2012. The TBLs are structured loans measured at fair value that contain embedded derivative features such as interest rate caps and/or collars or convertible fixed rate options, and as such are designated as part of the Group's fair value through profit or loss loan portfolio. The discontinuation of the TBL product in the UK has removed the ability to validate the inputs (e.g. prepayment assumptions) with market observable data, as there will be no newly originated loans of this type in this market. Therefore, as at 30 September 2012, \$6,631 million of TBL fair value loans in the UK have been transferred from Level 2 into Level 3 classification for the Group and nil for the Company.

Martin Wheatley of the FCA wrote letters to HM Treasury in February and May of 2013 explaining that if the issue was not addressed, there would be nothing to prevent banks from in future embedding derivatives into fixed rate loans instead of offering them directly to the customer.

## 4. The present FCA review on standalone IRHPs

I have simplified the FCA's review progress report for March as follows:-

<https://docs.google.com/viewer?url=http://www.nabcustomersupportgroup.org/img/upload/2584/documents/NCSSG%2520analysis%2520of%2520FCA%2520Review%2520progress.pdf>

1. Only 12% of the 29,563 swaps issued to SMEs (before the sophistication test was applied) have been accepted by affected SMEs, nearly two years after the announcement of the review. This is evidence of collusion between the FCA and the banks.
  
2. The FCA has produced figures measuring all results by number of SMEs (as opposed to aggregate loan value). This prevents us from assessing the effectiveness of the review, since banks will tend to settle smaller claims more readily than larger claims. The FCA should have produced the figures measured by BOTH the number of SMEs AND aggregate loan value. Failure to do this evidences collusion between the FCA and the banks.
  
3. I am hearing (not from a definite statement from the FCA but via feedback from other sources) that the 8% interest being offered may now be offered in lieu of any SMEs' claims in respect of consequential damages. This is unacceptable. If this is correct, then hundreds of businesses which have been destroyed by the swaps (representing larger than average claims) will not receive adequate damages. Again, this evidences collusion between the FCA and the banks.
  
4. In respect of the above point 3, this was not made clear by the FCA at the early stages and is now being heard increasingly through the grapevine. This evidences that the FCA have deliberately mislead SMEs. The decision not to announce the fact that interest was to replace consequential damages until nearly two years after the details of the review were initially released amounts to blatant deceit. Again, this evidences collusion between the FCA and the banks.
  
5. The FCA published on its website within the June 2012 announcement, advice to affected SMEs not to contact law firms or claims management companies in view of the fact that the FCA review would ensure that all affected SMEs would receive full damages without the need to resort to taking legal action. This has resulted in many affected businesses exceeding their legal claim prescription limits. This constitutes misrepresentation and again evidences collusion between the FCA and the banks.
  
6. The FCA review scheme has rejected 12,197 (or 41%) of swaps issued to SMEs (29,563) on the basis that they were either "sophisticated" (10,712), not mis sold (751) or decided that no redress was due (734). Breakdowns have not been given of these figures. In particular, we are not given the reasons for "sophistication". The FCA should have published the reasons for "sophistication" at the very beginning of the review and ensured that the banks adhered to these criteria. It transpires that it was left to the banks to decide whether the SME failed the "sophistication" test. This evidences collusion between the FCA and the banks.

## 5. NAB's voluntary review

<http://nabcustomersupportgroup.org/img/upload/2584/documents/Clydesdale%20Voluntary%20Review.pdf>

On 12<sup>th</sup> October 2012, NAB agreed with the FCA to implement a voluntary review, supposedly comparable to the FCA review into standalone IRHPs.

However, the review was set up to apply only to those TBL products listed in the appendix. The products listed in the appendix are obscure products issued to few customers. Only 10 out of 85 NCSG members who had TBLs (ie 12%) had these products and so only these were able to benefit from the review.

However, 18 months after the scheme was announced, none of the 10 members have had any meaningful contact from the bank, apart from an initial letter confirming that their products were being reviewed.

Our conclusion is that the scheme is simply a delaying tactic used by the bank to avoid or postpone a redress scenario that has misled the FCA into believing that the bank is working in co operation.

## **6. Professor Michael Dempster : Cambridge Systems Associates Ltd**

BA (Tor) MA (Oxon) MA (Cantab) MS PhD (CMU) Linceo FIMA Hon FIA

<http://www.cambridge-systems.com/aboutmahd.html>

Report :-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/NAB%20Customer%20Support%20Group%206.3.14.pdf>

## 7. An example of the mis calculation of a break cost

**BG Consulting Group :-** <http://www.bgconsulting.com/>

BG Consulting calculates £416,643:-

[http://nabcustomersupportgroup.org/img/upload/2584/documents/BG%20\\_Richard%20Fedrick\\_.pdf](http://nabcustomersupportgroup.org/img/upload/2584/documents/BG%20_Richard%20Fedrick_.pdf)

Bank calculates £783,383 :-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/2%20Oct%2009.pdf>

This break cost was given to the customer over the telephone. At the time of the charge, the account statements were being diverted to the account holding branch of the bank. Apart from the debit on the bank statement, the customer has never received written confirmation that a charge had been applied, let alone an explanation of how it was calculated.

## 8. NAB's explanation of break cost documents

When NAB developed the Tailored Business Loan, it produced a document warning of break costs for the purpose of satisfying FCA regulation. We have called this Version 1. This version was at some point replaced by a new version, which we have called Version 2.

Version 2 was the same as Version 1, but with the exception of the following:-

1. The detailed example had been removed
2. The paragraph adjacent to it had been removed
3. The word "economic cost" was replaced with the word "break cost" wherever it appeared.

Version 1 :-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/Break%20Cost%20Version%201.pdf>

Version 2 :-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/Break%20Cost%20Version%202.DOC>

A survey on our group members revealed the following :-

Received nothing	60%
Received Version 2	10%
Received Version 1	7%
Not applicable	10%
Did not respond	13%

Despite the issue of the above documents to a small percentage of affected customers, no adequate attempt was made by any of the bank staff to warn the customer of the possible magnitude of break cost. Most affected customers perceived that any break cost would be in the region of between 1% or 2% of the amount of the loan, consistent with those of domestic mortgages.

## 9. Nab Customer Support Group Membership

NCSG membership is made up as follows:-

NAB	Fixed rate	85
NAB	Standalone	1
NAB	Variable	11
HBOS	Fixed rate	2
RBS	Fixed rate	1
Lloyds	Fixed rate	1
Bank of Ireland	Fixed rate	1
Nat West	Fixed rate	1
Triodos	Fixed rate	1
		104

[http://nabcustomersupportgroup.org/img/upload/2584/documents/Public\\_copy.pdf](http://nabcustomersupportgroup.org/img/upload/2584/documents/Public_copy.pdf)

Before joining our group, all applicants must scan a copy of a letter from the bank proving that they have a fixed rate loan (or a variable rate loan with NAB) and their driving licence. We make no exceptions.

A new member is about to join us who has a substantial loan (approx £9m) with Nationwide.

## 10. Job losses

All new members are asked in our questionnaire to state how many job losses there have been as a result of adopting the product. As you can see from the group register (see section 9), a total of 450 job losses are reported by our 85 members with fixed rate loans with NAB.

I always ask members if they are prepared to testify as to the figures they have given in any future enquiry and so I conclude that the figure of 450 is reasonably accurate and has not been exaggerated.

If the CRE portfolio stood at £6.2 billion as at 31 March 2012 (as confirmed by the bank) and as our aggregate total loan for the 85 members with NAB fixed rate loans is £127,897,458, we calculate a total of 21,814 job losses (ie 450 divided by 127,897,458 multiplied by 6,200,000,000).

If the FCA has confirmed that 69,738 similar loans have been issued by all banks, then we calculate a total of 365,201 job losses (ie 450 divided by 85 times 69,738). Of course, we are assuming that the constituents of the 69,738 have been affected in the same way as the members of our group and it may turn out not to be the case, but it is a starting point.

## 11. Freedom of Information responses

The following FOI responses were obtained by NCSG :-

FCA 31<sup>st</sup> March 2014:-

[http://nabcustomersupportgroup.org/img/upload/2584/documents/FOI3266%20Internal%20review%20response%20\\_signed%20letter%20and%20annex\\_%2020140331.pdf](http://nabcustomersupportgroup.org/img/upload/2584/documents/FOI3266%20Internal%20review%20response%20_signed%20letter%20and%20annex_%2020140331.pdf)

This release confirms that 69,738 embedded swap loans were issued by all banks and that one bank was responsible for the issue of 35,000.

HM Treasury 16<sup>th</sup> April 2014:-

<http://nabcustomersupportgroup.org/img/upload/2584/documents/document2014-04-16-172952.pdf>

This release confirms that the British Banking Association has agreed with HM Treasury that banks will provide the same level of disclosure of features within embedded loans as for products that fall within scope. If HM Treasury has taken this view, then it is acknowledging wrongdoing in the past. This past wrongdoing must be addressed and affected businesses compensated.

## 12. What we need to do

1. Apply an immediate suspension of foreclosure activity on any business which has adopted a fixed rate loan embedding a derivative, pending investigation.
2. A directive issued by Treasury that any fixed rate business loan embedding a derivative should in future be treated as a derivative as defined by the FSMA Act 2000. Embedding a derivative is qualified by an unquantified break cost in the bank's standard Terms & Conditions.
3. A directive issued by Treasury that the legal claim prescription limitation is calculated from the date that the affected SME discovered that it had a valid mis selling claim against the bank (and not from the date that the loan funds were released). It would be unfair to use the date that the loan was released, as the evidence of wrongdoing was not readily understood by law firms, let alone affected SMEs, until recent times. There should be no age bar in any FCA invigilated review (unlike as in the standalone review). If there is proof of wrongdoing, the age of the wrongdoing is irrelevant. If a criminal can be convicted of wrongdoing without age restrictions, so too can a bank of financial wrongdoing.
4. An FCA invigilated review is set up to calculate compensation for affected SMEs. Any fixed rate loan embedding a derivative is automatically declared mis sold and so mis selling will not need to be established by the review, rendering it unnecessary to undertake a study into alleged mis selling (as was required in the standalone review). The purpose of the review is purely to calculate redress. Mis selling is established by the presence of an unquantified break cost present in the bank's standard Terms & Conditions.
5. A review should be directly supervised by a newly formed APPG under the leadership of John Thurso (ie not passed to the present APPG) and carried out in close consultation with Nab Customer Support Group.
6. A review should contain no "sophistication" test such as that applied to reviewees in the standalone IRHP review, given that FCA approved advisors would never have received training to make them aware of the existence of embedded swaps. We have talked to a number of such advisors and we conclude that no FCA training was ever given. Therefore, any FCA approved advisor who was consulted by a "sophisticated" SME (as defined by the FCA in the standalone review) would not have received this training and would therefore not be equipped to warn the customer of mark to market break costs. Any SME, whether a sole proprietor or a company, should qualify to participate, given the devious intention on the part of the bank in embedding the swaps.

7. NAB is using low valuations to prove default of customers' "Loan to Value covenants". This enables the bank to either vary its loan conditions (eg by increasing the interest rate) or instructing receivership. Valuations are carried out at the customers' expense and are instructed by the bank via telephone calls to valuation companies who are told that the valuations are required to be "very realistic". The valuation company, wanting to co operate with the bank and attract future business, invariably provides a low valuation which is often significantly lower than the free market value or the "red book" value. A "red book " valuation is precisely defined by the RICS and one of the conditions is that there must be no outside influence on either the buyer or the seller. The process of the bank instructing a fire sale valuation is in effect outside influence and will depress the valuation. The FCA must stop this abuse by forcing banks to use "red book valuations" closely invigilated by the FCA. A new system of invigilation should be implemented in order to ensure that banks do not abuse the valuation system.

John Glare  
Nab Customer Support Group  
21st April 2014