David Thorburn / TSC interview 17 June 14

Comments from Nab Customer Support Group

1. David Thorburn states (on page 1) “The difference was simplicity essentially.” Simplicity for whom, the customer, the bank or both? Simplicity implies a simple, transparent, suitable product which is easy to understand.

Given NAB’s similar historical problems with loans sold to farmers in Australia, should this product not have had clearer guidance and explanation? Does the simplifying of documentation in this scenario not amount to duping the customer? “Sign at the bottom and we’ll fill in the details later?”.

2. David Thorburn states (on page 1) “It was modelled on a domestic mortgage product to try to make it more understandable”.

If it was “modelled on a domestic mortgage product” then precisely which domestic mortgage product sold by NAB (containing hedging products/derivatives and macro hedged) was it modelled on?

3. Andrew Tyrie asks (on pages 1 and 2) “Is not all logic pointing to exactly the opposite? Is not what you are offering something that is much more complex?” David Thorburn replies “It depends on the nature of the TBL. If I might explain, a TBL can mean many different things”.

But we are told that a TBL is a simple, transparent and easily understood product. It seems that it is now indeed many things, ever evolving, ever changing to suit the needs of the bank.

4. David Thorburn states (on page 2) “What the customer got in that case is guaranteed payments for the duration. It is certainty of payments for the duration of the loan regardless of what happens with interest rates over that time”.

In one case, when a customer asked whether there was an interest rate swap attached to his fixed rate TBL in 2013, his Business Relationship Manager at Yorkshire Bank answered: “You have a fixed rate loan offering guaranteed payments for the duration of your loan!”, omitting to mention swaps, derivatives or break fees. David Thorburn gave the TSC the same answer, almost word for word, as the customer received from his Business Relationship Manager in this example. The reality is that the bank did not provide certainty of fixed payments, as the payments ‘varied’ to increasing margins as a result of engineered defaults, ie loan to values changing etc. The “loan to values” changed because the bank persistently changed the basis of the valuations by providing different valuation parameters to their ‘valuers’ (valuation panel).

5. David Thorburn states (on page 2) “Almost without exception it would not have an individual hedge on the other side of these loans”.

If the Tailored Business Loans loans did not contain embedded swaps then why did NAB/Clydesdale/Yorkshire Bank ‘imply’ that there was a swap in their documentation provided to customers?

6. David Thorburn states (on pages 2 & 3) “The original concept of these products developed by our parent company was to give SMEs access to some of the hedging instruments - particularly to hedge against interest rate risks - that they did not previously have”.

But customers wanted a ‘fixed rate mortgage/loan’ not commercial spread bet contracts which added a contingent liability to businesses. Clearly there was a risk element, however unlikely that the occurrence of a catastrophic fall in interest rates was. A regulated IRHP would require this ‘risk’ to be clearly set out in documentation on which the customer could have sought advice. Regulated investment products require a customer ‘attitude to financial risk’ questionnaire / fact find to be completed. This was not done for NAB Fixed Rate Loan TBLs.

7. David Thorburn states (on page 3) “I have seen no evidence of people trying to involve regulatory involvement” and again (on page 4) “We have seen nothing that suggests that anyone had in mind in the design of these products avoiding regulatory oversight”.

The original ‘Explanation of break cost’ document produced in 2001 was modified at some point to produce a new version. The new version was amended by i)removing the detailed example, ii)removing an explicit paragraph adjacent and iii) changing the term “economic cost” to “break cost” throughout. This evidences an attempt to avoid regulation and assist in the selling process.

8. David Thorburn states (on page 3) “Clearly also it is a commercial endeavour. In selling these products there are profits and new customers. It was used to attract new customers to the organisation as well”.

These products in many cases were sold conditionally. Customers were given no option to remain on variable rate products. The bank knew in early 2008 which way interest rates were going medium term and they ‘advised’ customers to the contrary, or at the very least ‘failed’ to warn of the downside risk of a drop in interest rate vis a vis to the extent of loan break costs.

9. David Thorburn states (on page 4) “I cannot guarantee there is not an e-mail where someone said something but looking back in time I do not believe that was the motivation at all. Indeed our parent company sold these through a regulated sales force even though the product was not regulated. These people were CF30s under the FCA and previously the FSA”.

If the products were ‘simple’ and did not contain individual embedded swaps, derivatives etc, then why the need to involve a separate treasury advisor? Why the need to link the loan to the best rate offered at point of sale? Why the need for a treasury checklist? Why did customers not receive ‘copies’ of these documents? Where was the customer ‘Risk Analysis’?

10. David Thorburn states (on page 4) “Not at this point. We have seen nothing that suggests that anyone had in mind in the design of these products avoiding regulatory oversight. As I say, although it was not required, the sales force that sold them were voluntarily regulated”.

What were the commissions/fees paid for selling these products? Were they more or less the same as for the selling of an equivalent loan and IRHP? We have evidence of 5.5% of the loan.

11. David Thorburn states (on page 4) “In particular, for the more complex products, the fact that with the benefit of hindsight it was clear we were selling them to customers who did not always understand what they were getting into in a falling interest rate environment. That was a matter of great concern to us”.

But David Thorburn stated that TBLs were ‘simple’ products. Were some less simple than others? Exactly which element of the ‘less simple’ product (ie cap, collar etc) makes it disadvantageous to a customer?

12. David Thorburn states (on page 5) when asked by Andrew Tyrie if it is simpler to offer these products as Tailored Business Loans compared with offering them as a standalone products :- “Yes, I think it is a lot easier for the customer because they do not have to wade through an ISDA; they do not have to deal with the complexities of the standalone product.”

Is it not simpler to <u>NOT</u> tell the customer that the Bank will group the customer's loan together with other customer loans and then enter into an interest rate swap agreement with a third party to hedge the risk to the bank and make the bank more money? Is it not simpler <u>NOT</u> to explain the complexitys of trapping an SME customer into a pooled derivative? Is it not simpler <u>NOT</u> to explain the possible potential break fees to an SME customer? Is it not easier for the bank to sell these loans, without disclosing this information? But the impact of the products are precisely the same as standalone swaps, except that one is regulated and one is not. If the main TBL agreement is 'not in plain English' then how is the addition of another document, an ISDA, any different? Surely all documentation must be understandable.

13. David Thorburn states (on page 6) "There is no individual embedded swap in any of these loans. The swaps are aggregated by a parent company as part of the broader balance-sheet management activities and funding".

So most fixed rate loans, including TBLs were pooled together and then attached to a complex interest rate swap agreement, without informing the customer. Clearly these are not individual swaps, or standalone swaps, but they have exactly the same effect on the customer. It makes no difference whether the loan was hedged in a pool or hedged individually, the effect on both the customer and the bank is the same.

14. David Thorburn states (on page 7) "They were introduced in 2001 and as I mentioned earlier the wholesale division of our parent company was used to providing hedging instruments to corporate customers globally and felt at the time there was demand among the SMEs to access fixed-rate products and some of the other categories that we talked about earlier".

What part or feature of a fixed rate TBL / embedded swap was more useful or deemed to be more advantageous to SMEs compared with conventional fixed rate loans (ie ones which were not hedged to the extent that there could be substantial break costs)?

15. David Thorburn states (on page 7) "It devised a way of hedging its interest rate risk and then providing these individual loans to SMEs. It was a commercial endeavour".

What was the rationale for offering a single loan product 'with hedging' (or potentially significant break costs) as opposed to a standalone IRHP and associated loan? Is it not the case that NAB knew that within the term of the fixed rate loans being offered (typically 5 years to 20 years) that interest rates were likely to reduce and remain low for a prolonged period of time? When precisely did the banks form a view that interest rates were likely to fall after 2008?

16. David Thorburn states (on page 8) "It was an opportunity for a parent company with subsidiaries that did not have that degree of sophistication to make that available to its customer base and therefore our business grew in the UK on the back of that".

Was it not also an opportunity for the NAB to take advantage of customers with NO degree of sophistication?

17. David Thorburn states (on page 8) “It was quite a broad range. It was anybody who wished to borrow initially over half a million pounds and latterly it came down to about quarter of a million pounds. It was a very broad range of SMEs.”

So both sophisticated and unsophisticated?

18. David Thorburn states (on page 9) “There were a number of different components to the sales process. It would involve the relationship manager initially in discussion with the customer about lending opportunities”

Are these mainly lending opportunities for the customer or the bank? What would be the banks worst case scenario? Did the bank price the hedged element fairly? What was the cost/benefit to the bank as opposed to the customer?

19. David Thorburn states (on page 9) “.....talking about the various risks that the customer might face….”

Really? The Relationship Manager discussed the risks? Is this risk in general or investment risk? The job of explaining these non regulated products was supposed to be with the treasury rep, according to the bank, and not the relationship manager.

20. David Thorburn states (on page 9) “......including interest rate risks and introducing the concept of these products”.

So, in discussing interest rate risk, the relationship manager would also have discussed the potential impact of interest rates going down as well as up and the potential effect of breaking the loan?

21. David states (on page 9) “If the customer was interested in that, a representative from our parent company would come to a subsequent meeting, explain the range of products, explain the features of them and also issues such as break costs”.

Which products? What features? How were they explained?

22. David states (on page 9) ".....which again would include a separate flyer which set out the nature of the products and had an explanation of break costs".

This flyer to which is referred does not adequately explain loan break costs, that is, if it was ever distributed anyway.

23. David Thorburn states (on page 9) "The final stage in the process, if the customer signed the facility letter—sorry, there were two more stages. One is that on the way through, we would say to the customer that they should take independent advice before they entered into these products".

From whom? Independent financial advice or independent legal advice or both? If these products were not regulated and 'simple' with clear written estimates of break costs and commission/fees paid then the customer or his representatives could have given advice as to their suitability. It is a well known fact that very few lawyers, accountants, actuaries, financial advisors, barristers etc knew <u>before today</u> that these loans were macro hedged and not considered 'embedded interest rate swaps'.

24. David Thorburn states (on page 9) "Then finally before the transaction was committed, there would be a phone call to either the representative or another representative of our parent company who would remind them of the risks of the break costs before they committed to the transaction".

Do these telephone calls record detailed explanation of break costs? They did not. How could they serve to remind the customer of the "risks of the break costs"?

25. David Thorburn states (on page 9) (referring to the staff) "They were trained to sell this product range. They were regulated".

Regulated staff were being used to sell the product as the bank perceived the products to be regulated. If the bank perceived the products to be regulated, surely the FCA should do also. The reality is that they were trained to make sure that the customer adopted a fixed rate which earned the 5.5% instant commission for the bank.

26. David Thorburn states (on page 9) "...a strategy paper would then be prepared and submitted by the representative of our parent company, which set this out in more detail and gave a range of options but did not point to one. They gave a range of usually 3 options…."

The reality is that the variable rate option earned no commission for the treasury rep, but the fixed rate option earned an instant commission of 5.5% of the loan. Which one would the treasury rep advise the customer to adopt?

27. David Thorburn states (on page 10) “Yes that is particularly so because if you look at the full range of the Tailored Business Loans, a subset of them were things like structured collars or collars. They are complicated, and they are beyond the ability of the relationship manager”.

But David Thorburn said that Tailored Business Loans were ‘simple products’. Exactly which part of a collar or structured collar fundamentally differentiates these products from a standard fixed rate TBL or a normal loan with a standalone IRHP or makes it intrinsically more complex or difficult for the relationship manager to understand? It follows that if these products and their intrinsic IRHP features could not be understood by relationship managers, then how was the customer supposed to understand them also?

28. David Thorburn states (on page 10) “With the benefit of hindsight it was not good enough for structured collars, so we accept that fully”.

So if the process was not sufficiently robust for structured collars, again, what makes it sufficiently robust for fixed rate loans without collars?

“We regret that and have learned from that”.

Exactly what do you regret and what have you learned?

“But there was a really sincere attempt here to design a process with various break points”

What break points? Please elaborate?

“.....and a recommendation of independent advice so that the customer had time to assimilate it and would understand what they were getting into.”

What were customers getting into? According the the bank, were they not simple fixed rate loans?

29. David Thorburn states (on page 10) “My colleague, Ms Crosbie might like to come in because she is leading our work in the redressing programme, but some people have crossed

that line—we can see from the correspondence, our staff have done that—and where they do, that is unacceptable and we will remediate it”.

How did staff cross this line? Can David Thorburn give some examples?

30. Debbie Crosbie states (on page 10) “ To date we have received 550 complaints about the sales process and on most occasions, we believe when we examine the case file the sale was conducted in a manner that was I think entirely fine”.

Does Debbie Crosbie <u>think</u> that it was entirely fine or does she <u>know</u> that it was entirely fine? Can Debbie Crosbie identify the process and confirm from a random sample of cases that correct procedures have been followed to the letter?

31. David Thorburn states (on page 13) “...That is why we have a voluntary review of Tailored Business Loans….”

The reality is that the bank’s voluntary review has been a farce from the day it was set up, some time in October 2012, approaching 2 years ago. None of the 5 members of NCSG who were invited to have their loans included in the voluntary review have received any level of compensation or even reached the point of having detailed discussions. The voluntary review was set up in order to keep the FCA happy and to postpone / avoid any redress to affected customers. It was nothing more than a stalling tactic.

32. David Thorburn refers to a flyer (on page 17) that he says sets out the nature of the products.

The flyer does not explain that break costs are dependent upon the markets and could exceed 40% of the value of the loan. The reality is that the flyer was never distributed anyway and was produced “to tick a box”.

33. Debbie Crosbie states (on page 18) that “Davis has outlined that we are fully participating in the FCA review”.

The reality is that virtually all of the bank’s lending was done via TBLs on fixed rates. As TBLs on fixed rates fall outside the scope of the FCA review, consequently, the bank has so far avoided an effective redress scenario intended by the FCA review.

34. Debbie Crosbie states (on page 19) "...that the redress programme that we are running for fixed rates has been fully informed by any adjudications we have had from FOS and we have made sure that our processes line up with what FOS expects us to do.

This is incorrect. The bank has so far resisted the recommendations of the FOS in all decisions in respect of NCSG members.

35. David Thorburn (on page 20) in conversation with the chair tries to give the impression that decision making is generally made by Clydesdale Bank.

However, this would only be in respect of the future running of the bank and not in respect of the disposal of the CRE portfolio, which is entirely in the hands of NAB, given that NAB has taken financial responsibility for the CRE portfolio.

36. David Thorburn (on page 21) refers to the flyer being "in pretty plain English".

This might be the case, but it does not warn the customer about the potential magnitude of break costs. The flyer does not explain that break costs are dependent upon the markets and could exceed 40% of the value of the loan. But the reality is that the flyer was never distributed anyway and was produced "to tick a box".

37. David Thorburn (on page 22) states "There was a worked example in the documentation the customers were given that set out - a pretty straightforward example - a 10 year loan for £1 million and so on and gave an example of the break costs….."

David Thorburn may be referring to the original document produced in 2001 that was intended to be issued to each customer, but the reality was that no system was ever implemented to monitor or enforce the issue of it. This document was soon replaced by a second version which was the same as the original but i) omitted the example to which David Thorburn refers ii) omitted the paragraph adjacent to the example to which David Thorburn refers and ii) replaces the term "economic cost" with "break cost" thereby avoiding drawing customers' attention to "mark to market" break costs. If there is another flyer in existence, please could David Thorburn provide a copy?

38. David Thorburn states (on page 24) "There was also a worked example given in the flyer that was attached to the facility letter"

Please could David Thorburn provide a copy? Whether the flyer was being distributed generally or not, the contents are not legally binding due to the fact that it is not an integral part of the facility letter.

39. David Thorburn (on page 25) focuses on the failure of staff to warn customers of the possible magnitude of break costs, explaining that no one expected the base rate to fall to such a low level and remain low for so long.

But the bigger issue is that staff were steering all customers onto the fixed rates, driven by the commission reward. What does David Thorburn have to say about that? As no system was in place to prevent mis selling, and as staff were being rewarded by instant commissions of 5.5% of the loan for steering a customer into a fixed rate, it is absolutely certain that mis selling would be occurring.

40. David Thorburn states (on pages 25/26) that two thirds of the fixed rate TBLs have "done what the customers wanted them to do".

This is incorrect. Over 5 years, the exorbitant break costs have locked the customers into the TBLs whilst rates have been low. The fact that the fixed rate period has expired and that the loan is no longer subject to the fixed rate is irrelevant. The TBLs certainly did not do what the customers wanted them to do. The product did not work. If the product had worked, it would have allowed a customer to break without incurring a ruinous break cost.

41. David Thorburn states (on page 27) "Our parent company did the hedging and nothing has failed in respect of their own interest rate hedging".

The fact that the portfolio collapsed and had to be transferred to the parent company's books evidences that the hedging strategy was a total disaster.

42. Debbie Crosbie states (on page 28) "What we found—and today we are only part way through the complaints review—is the mis-selling that we see and the lack of understanding through the sales process that was evident in standalone review, <u>we do not see that mirrored</u>."

But the issue is that staff were steering all customers onto the fixed rates, driven by the commission reward. As no system was in place to prevent mis selling, and as staff were being rewarded by instant commissions of 5.5% of the loan for steering a customer into a fixed rate, it is absolutely certain that mis selling would occur in a scenario with no controls. How can Debbie Crosbie possibly make this statement?

43. George Mudie (on page 29) asks David Thorburn “Did you supply customers—Tailored Business Loan customers—with written figures for break costs at any time in the sale process?”David Thorburn replies “Yes we did”.

This is not true. As the conversation continues, George Mudie asks David Thorburn to be more specific. David Thorburn refers to a double sided flyer. Double sided flyers were not issued to customers. There was no system in place policing the issue of these flyers. These were not an integral part of the agreement and would not be legally enforceable.

44. David Thorburn (on page 33) states “The process was enhanced on the way through, so for most of the time there was that flyer. I cannot remember whether the contents of the flyer changed”.

This is not true. David Thorburn may be referring to an early document produced in 2001 that was intended to be issued to each customer but no system was in place to monitor or enforce the issue of it. This document was soon replaced by a second version which was the same as the original but i) omitted the example to which David Thorburn refers ii) omitted the paragraph adjacent to the example to which David Thorburn refers and ii) replaces the term “economic cost” with “break cost” thereby avoiding drawing the customers’ attention to “mark to market” break costs. If there is another flyer in existence, please could David Thorburn provide a copy?

45. In Debbie Crosbie’s exchange with Jesse Norman (pages 36 - 42), it transpires :-

i) 550 complaints received
ii) 8,372 fixed rate loans offered
iii) none have been upheld
iv) 330 are expected to receive redress (but no indication of what this is
v) 250 complaints reviewed to date
vi) 50 / 60 settlements agreed (but not implying that the complaint was upheld)
vii) 150 some form of redress will be due
viii) approx 67 FOS adjudications against the bank

46. Debbie Crosbie states (on page 39) “This review started <u>in earnest</u> in late January”.

However, the bank agreed to implement a voluntary review in October 2012 (15 months previous). Why was there such a long delay? Debbie Crosbie uses the expression “in earnest” simply because her conscience prevented her from saying “The review started in October 2012”. The reality is that there was no movement until late January 2014, despite the fact that the bank was giving the opposite impression to the FCA over these 15 months.

47. When asked by Jesse Norman (on page 40) “How much redress has been paid out to customers with a fixed-rate TBL, Debbie Crosbie replies “I think the number is quite low.”.

The reality is that the figure is so low that she is too embarrassed to state the figure. Someone in Debbie Crosbie’s position attending such a meeting should have this figure in her head or at the very least in notes at the meeting. The reality is that the figure is zero. She confirms to Jesse Norman that the figure is less than £10 million. Zero is less than £10 million.

48. David Thorburn states (on page 43) “The whole Tailored Business Loan range, most of the revenue, somewhere between 90%, 75%, in fact went to the parent.”

In effect, NAB was generating enormous profits at the expense of British jobs using Clydesdale and Yorkshire Banks as vehicles.

<u>NCSG Questions</u>

49. Customers who adopted TBLs after March 2009 (after the base rate had dropped to 0.5% and whose TBLs were fixed at low rates) were being quoted similar break costs to those who adopted TBLs at much higher rates pre Oct 2008. It is clear that there is malpractice here. Could this be investigated?

50. Why does the bank believe that using the current market value of a swap for the residual term of the TBL is a suitable methodology for the calculation of break costs when it does not in any way align to or reflect the true costs to the bank in the event of prepayment?

51. Why does the bank call a fixed rate TBL a 'hedged product' when it leaves the borrower with a fixed interest rate risk that is not hedged?

52. Does the bank, by using an imbalance of knowledge between that available to the borrower and that available to itself, agree that it contravened Section 140B of the Consumer Credit Act?

53. Customers’ files do not give an accurate depiction of what happened during the sales process. There should have been a clear fact find document, which documented what was said at the sales meeting, which was then signed by the customer. The reality is that the Business Relationship Manager and the Treasury Partner did not do this and simply said anything to achieve the sale. Could the TSC visit the bank and conduct a review of 10 customers’ files without giving any notice to the bank?

54. NCSG has 3 whistleblowers (ex bank staff) who are willing to give evidence to the TSC. One was the head of one of the bank's Financial Solutions Centres. Does the TSC wish to interview these people?

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