20 May 2015

Sent by Registered Mail: Article id: 516255973018

12 Highland Way

Highton, 3216

Attn: Mr Chris Dawson APM

Chief Executive Officer

Australian Crime Commission

GPO Box 1936

Canberra City

ACT 2601

Dear Mr Dawson

Re: Joint Investigation with UK Serious Fraud Office

I have been providing the **Australian Crime Commission** evidence of a major fraud that was initiated by well known white-collar criminals who were the subject of three major investigations by the former **National Crime Authority** that was replaced by the **Australian Crime Commission**.

The **National Australia Bank** has become privy to this fraud and has actively engaged in ongoing attempts to conceal this fraud from its victims {***Fraus est celare fraudem*** – it is fraud to conceal a fraud}.

Please find attached a copy of a letter that I have sent to Mr David Green CB QC who is the Director of the **Serious Fraud Office** in the United Kingdom in relation to another fraud that involves the **National Australian Bank**.

Given the similarity of these frauds and the fact that Senator Sam Dastyari, who chairs the Senate Economics Reference Committee, has already proposed an information sharing arrangement with the UK Treasury Select Committee, there is scope for a joint investigation involving both the Serious Fraud Office and the Australian Crime Commission.

The **Serious Fraud Office** investigated a fraud very similar to the fraud involving the pension fund once known as the Elders IXL Superannuation Fund.

There are legitimate concerns that Australian business borrowers could find themselves victims to a similar type of fraud that has ruined may small businessmen in the United Kingdom.

As I mention in my letter to the Director of the SFO I shall provide further evidence to both the **Serious Fraud Office** and the **Australian Crime Commission** in future correspondence in relation to both frauds.

Yours Sincerely

Phillip Sweeney

Cc Senator Sam Dastyari – Chair of the Senate Economics Reference Committee

Attachments:

Letter dated 20 May 2015 to Mr David Green CB QC – Director - **Serious Fraud Office**

Letter to dated 18 May to Mr Andrew Bailey – CEO ***Prudential Regulation Authority***

Under What Circumstances can a Bank Non-Fraudulently Determine and Impose a "Break Cost"?

18 May 2015

Sent by International Registered Post: Article id: RR143219595AU

12 Highland Way

Highton, 3216

Australia

Attn: Mr Andrew Bailey

CEO

Bank of England

Prudential Regulation Authority

20 Moorgate

London, EC2R 6DA

www.bankofengland.co.uk/pra

Dear Mr Bailey

Re: Proposed Demerger of Clydesdale Bank

I refer to my letter dated 8 May 2025 (copy attached). In this letter I brought to the attention of the Prudential Regulation Authority the need for much higher provisioning by the **National Australian Bank (NAB)** for current and future claims for "*misconduct*" by the subsidiary banks – Clydesdale Bank and Yorkshire Bank.

To date the **Prudential Regulation Authority (PRA)** has required that £1.7 billion ($3.2 billion) to be set aside to ensure that there is enough money to cover potential compensation to victims of the bank in Britain that are not covered by existing provisions.

The **Financial Conduct Authority** recently imposed a record £20 million fine on Clydesdale Bank for file tampering and misleading the **Financial Ombudsman Service**. This is a clear indicator that there are more examples of misconduct by this bank that have yet to be exposed to the public.

In the letter of 8 May 2015 I stated that I believed that the amount of £1.7 billion may not be adequate to cover compensation to the victims of the "***Tailored Business Loans***" that were marketed until recently by Clydesdale Bank and its subsidiary Yorkshire Bank and other possible scandals that have yet to be uncovered.

In support of that claim please find attached a document titled "***Under What Circumstances can a Bank Non-Fraudulently Determine and Impose a "Break Cost"?***

In my letter dated 8 May 2015 I claimed that the Clydesdale Bank and its subsidiary bank, Yorkshire Bank, engaged in false and misleading conduct in marketing a financial product that did not involve a *bona fide* ***Hedging Arrangement*** as claimed in the stipulations (terms) of the contract.

However in reality the misconduct was far more serious that "*false and misleading conduct*", the misconduct actually amounted to fraud.

The details of the fraud are covered in the attached document.

The Prudential Regulation Authority needs to inform the **National Australia Bank** that it needs to conduct another capital raising before the Bank of England and the Prudential Regulation Authority will approve the demerger and flotation on the Clydesdale Bank on the London Stock Exchange.

The Bank of England will not wish to be fielding complaints from UK investors who suddenly find their shares in "***Fraudulent Bank Co***" to be worthless.

Yours Sincerely

Phillip Sweeney

BSc/BE (Hons), MBA, Dip Sec Inst (Applied Finance)

{Supporter of the ***NAB Customer Support Group***}

Cc Chairman of PRA – Mr Mark Carney

CEO of the Financial Conduct Authority - Martin Wheatley

Attachments

Under What Circumstances can a Bank Non-Fraudulently Determine and Impose a "Break Cost"?

Copy of previous letter dated 8 May 2015

20 May 2015

12 Highland Way

Highton, 3216

Australia

Attn: Mr David Green CB QC

Director

Serious Fraud Office

2-4 Cockspur Street
London
SW1Y 5BS

confidential@sfo.gsi.gov.uk

Dear Mr Green

Re: Fraud and the Clydesdale Bank

I refer to the mandate of the Serious Fraud Office (SFO).

The **Serious Fraud Office** is an independent government department, operating under the superintendence of the Attorney General. Its purpose is to protect society by investigating and, if appropriate, prosecuting those who commit serious or complex fraud, bribery and corruption and pursuing them and others for the proceeds of their crime. It operates in line with its statutory purpose and policies.

I refer to the definition of fraud provided by the SFO.

What is fraud?

Fraud is a type of criminal activity, defined as:

'abuse of position, or false representation, or prejudicing someone's rights for personal gain'.

Put simply, fraud is an act of deception intended for personal gain or to cause a loss to another party.

The general criminal offence of fraud can include:

- deception whereby someone knowingly makes false representation
- or they fail to disclose information
- or they abuse a position.

Fraud can also be defined simply as: "***An intentional dishonest act or omission done with the purpose of deceiving***."

Fraud knows no boundaries and of course "***respectable***" people can be involved in fraud and a classic example is Bernard Madoff who was once a very respectable figure on Wall Street.

The guidelines provided by the **SFO** as to what type of case the **SFO** will pursue are as follows:

In deciding what cases to adopt, the Director will consider all the circumstances of the case including:

- the scale of loss (actual or potential);
- the impact of the case on the UK economy;
- the effect of the case on the UK's reputation as a safe place to do business;
- the factual or legal complexity and the wider public interest.

The Case at Hand

The case at hand has already been subject to inquiry by a Treasury select committee and wide publicity in the media, however to date this case has not been identified as a case of fraud due to false and misleading testimony given before the Treasury committee.

The case involves financial derivatives or more accurately purported financial derivatives which is an area not well understood by members of the public and most politicians.

The mis-selling of business loans to small and medium sized businesses and associated **Interest Rate Hedging Products** (IRHP) has been the subject of a number of investigations by the **Financial Conduct Authority (FCA)**, however the jurisdiction of the **FCA** is limited to only one of the types of IRHPs marketed to retail customers of banks operating thin the United Kingdom.

In cases where retail customers entered into a separate Interest Rate Swap (IRS) contract that was separate to their loan facility the separate IRS contract is subject to regulation by the **FCA** as a "*Contract for Difference*".

There is now a compensation program being administered by the **FCA** to provide compensation to retail customers who have suffered substantial losses by being improperly advised on the nature and risks of "***standalone IRHPs***".

However there is another class of IRHPs which are not subject to regulation by the **FCA** and this is a class of loans which have what has been referred to as "***embedded swaps***" associated with the loan facility.

These types of loans were marketed by the Clydesdale Bank and its subsidiary, the Yorkshire Bank, under the name of "***Tailored Business Loans*** (TBLs)".

In order to avoid regulatory scrutiny by the **FCA** (and the former **FSA**) these types of loans required that a separate Interest Rate Swap contract to be arranged by the bank with a THIRD PARTY who was not a retail customer and therefore not subject to regulation by the **FCA/FSA**.

The Loan Contract

In the case of a typical "***Tailored Business Loan***" there was a written "**Master Contract**" that was signed by the retail customer which provided a variable rate loan facility as the default loan facility plus three ***options*** to provide an associated "***Hedging Facility***".

If the retail customer did nothing else he or she would have a variable rate loan facility for a stipulated amount subject to a stipulated retail margin above LIBOR. A typical retail margin would be 1.25%.

However the bank would then contact the retail customer by phone {a "*trade call*"} and ask the retail customer if the customer wanted to exercise any of the three hedging options and the Relationship Manager would provide the customer with a quote for the higher margin associated with the selected hedging option.

If the retail customer selected a "***Fixed Rate Facility***", then a typical quote might be a retail margin of 2.25% which would be fixed to the current LIBOR rate for a stipulated period (say, 5, 10, 15, 20 or 25 years).

By accepting the bank's offer the retail customer gave his consent for the bank to act has his or her ***agent*** and to enter into an **Interest Rate Swap** contract with an un-associated THIRD PARTY . The loan contract included an indemnity clause so that in the event that the bank was forced to terminated the IRS contract before maturity, then the retail customer would pay for any costs incurred by the bank on behalf of the retail customer.

There is nothing wrong with such an arrangement and such an arrangement was the subject of a case where the **Bank of Scotland** had arranged an Interest Rate Swap with the **Bank of America** to hedge a loan facility provided to Dunedin Property Developments Pty Ltd. {Bank of Scotland v Dunedin Properties [1998] GWD 18-887, 1998 SCLR 531, 1998 SC 657, [1998] CSIH 118, [1998] ScotCS CSIH_118, 1999 SLT 470}.

In the case of a *bona fide* Interest Rate Swap (IRS) it is the non-defaulting counter-party who produces the claim for damages for breach of contract if the IRS contract is terminated before maturity.

One of the approved methods of producing a claim for damages is referred to as "***Market Quotation***", where the non-defaulting counter-party obtains four quotations from other market participants to replace the position that was subject to early termination.

The highest and lowest quotations are rejected and an average of the remaining two is used to determine the claim for damages for breach of contract.

Fiduciary Duty

When a retail customer arranges a loan with a bank both parties deal as "**principal to principal**" and no fiduciary duty arises. When a retail customer contracts directly with a bank to provide an Interest Rate Swap again the parties deal as "**principal to principal**" and no fiduciary duty arises.

However if a bank offers to act on the behalf of the customer and arrange a contract with an un-related THIRD PARTY, the bank in undertaking the role of an ***agent*** and the relationship of principal and agent is one of the established classes of commercial relationships were a fiduciary duty arises.

The defining characteristic of a fiduciary duty is the loyalty of the fiduciary to the principal (eg agent to the principal) and the "***No Conflict/No Profit Rule***" applies.

That is, in the case of an agent, the agent cannot make a profit at the expense of his principal unless his principal has given explicit authorisation for the agent to make a profit.

The Fraud

The fraud committed by Clydesdale Bank and its subsidiary bank , Yorkshire Bank, is an extremely easy fraud to prove.

Instead of entering into *bona fide* Interest Rate Swap contracts with THIRD PARTIES as these banks were contracted to do, no such contracts with identifiable THIRD PARTIES were entered into as had been the case with the **Bank of Scotland** and the **Bank of America** in the Dunedin Properties case.

Instead the Clydesdale Bank and the Yorkshire Bank acting as agents with respect to the purported hedging facility they had sold to their retail customers simply pocketed the monthly payments that were in excess of the interest payments required for a variable rate loan which was the default loan facility under the loan contract.

Therefore the bank was taking secret profits as an ***agent*** which had not been authorised by the agent's principals – the retail customers.

If there had been *bona fide* Interest Rate Swap contracts with identifiable THIRD PARTIES then if a retail customer sought to revert to the underlying variable rate loan facility, the bank would be forced to terminate the Interest Rate Swap contract before maturity and the non-defaulting counterparty would prepare a claim for damages for breach of contract.

The bank relying on its indemnity clause would then pass the claim for damages onto the retail customer for payment.

If the retail customer thought the claim for damages could not be justified or was excessive, the retail customer could dispute the claim in court, since damages are awarded by a court for compensation and not as punishment.

If a claim for damages is not reflective of actual losses incurred but is imposed as a penalty instead, a court will not uphold the claim, since penalties are unenforceable.

To compound the fraud, when customers sought to terminate the non-exiting Interest Rate Hedging Product, these banks simply fabricated bogus and fraudulent "***break costs***" and threatened to seek immediate payment of the fraudulent "***break cost***" unless the retail customer kept making monthly payments at three times the current variable interest rate.

In many cases the purported "***break costs***" were not even mathematically correct, which is further evidence of their fraudulent nature.

If customers refused to continue to make monthly repayments at three times the variable interest rate, the fraudulent "***break cost***" amount was simply added to their account with the bank and the bank then foreclosed if the retail customer was unable to make payment.

More details of this fraud are provided in the attached document that has been submitted to the **Prudential Regulation Authority (PRA)** and will be submitted to the **Financial Conduct Authority (FCA)**.

Financial Conduct Authority

As mentioned above, the **Financial Conduct Authority (FCA)** regulates "***standalone IRHPs***", and a compensation program has been established by the **FCA** for retail customers who were mis-sold these products.

Some retail customers who were sold loans with "***embedded swaps***" have lodged claims with the **Financial Ombudsman Service (FOS)** and in many cases the FOS has ruled in their favour on the basis that the retail customers were unable to make an informed decision when they accepted the offer of the purported "**embedded**" hedging facility.

On 14 April 2015 the **FCA** imposed a record fine of £20.7 Million on Clydesdale Bank for file tampering and concealing evidence from the **FOS** in relation to the PPI scandal.

http://www.fca.org.uk/news/clydesdale-bank-fined-for-serious-failings-in-ppi-complaint-handling

The **FCA** hit Merrill Lynch International with a £13.3million fine for reporting financial transactions either inaccurately or not at all.

The **FCA** hit the Royal Bank of Scotland with a £5.6 million fine for reporting failures in July 2013

The **FCA** has also imposed a fine of £1.7 billion on Deutsche Bank for its role in the LIBOR rigging scandal

Georgina Philippou, the acting director of enforcement and market oversight at the Financial Conduct Authority, said the UK's portion of the fine – £227m – was a record for Libor because the bank had been misleading the regulator. The manipulation took place to generate profits and was pervasive, the FCA said.

The same situation has arisen with respect to "***Tailored Business Loans***" where Clydesdale Bank has misled the **FOS** and the fraudulent conduct has been pervasive with over 8000 retail customers subject to fraudulent conduct so as to generate profits.

There was also false and misleading evidence provided by Bank Executives to the Treasury Select Committee on 17 June 2014.

http://www.parliamentlive.tv/Event/Index/d15a66bb-4617-4fdf-9aad-929c96f161a5.

The Australian Connection

The parent company of Clydesdale Bank and its subsidiary, Yorkshire Bank, is the **National Australia Bank (NAB).** The **NAB** has recently announced its intention to de-merge Clydesdale Bank in an attempt to "*ring-fence*" further misconduct claims.

However this de-merger is still subject to regulatory approval in the UK.

To date, the **Prudential Regulation Authority** (PRA) has required NAB to set aside an additional £1.7 billion to cover anticipated misconduct claims, however this amount is far too small to cover claims that will arise from this fraud.

The disgorgement of un-authorised profits from the agency relationship should amount to up to £3 billion before consequential damages have been included by the time this matter is resolved.

Many borrowers were forced to sell other assets to meet the fraudulent claims of the bank and others were forced into foreclosure incurring large losses due to this fraudulent conduct.

The victims of a pension fund fraud in Australian involving the **National Australia Bank** are also seeking justice and compensation.

This fraud was initiated by well known white-collar criminals who were the subject of three major investigations by the former **National Crime Authority (NCA)**. A key fraudulent document bears the signature of Ken Jarrett the former Finance Director of Elders IXL Ltd who served a term of imprisonment for dishonesty. Elders IXL Ltd was the former owner of Courage Breweries in the UK.

The fraud is very similar to the Robert Maxwell pensions fund fraud committed in the UK. However the Maxwell fraud was soon uncovered after the body of Robert Maxwell was found floating in the Atlantic Ocean. The **Serious Fraud Office** prosecuted Kevin and Ian Maxwell, the sons of Robert Maxwell for their role in the fraud.

There is also a related court case in the UK where an attempt to defraud the employees of Courage Breweries was prevented by the High Court of England and Wales

The **National Crime Authority (NCA)** was replaced by the **Australian Crime Commission (*ACC*)** and evidence is currently being provided to the ***ACC*** and some is available from the website of the ***ACC***.

Senator Sam Dastyari who is the Chair of the Senate Economics Reference Committee has been in discussion with Mr Andrew Tyrie who was the Chair of the House of Commons Treasury Committee in the last Parliament. Senator Dastyari proposed an information sharing arrangement between Australia and the UK.

Therefore there is scope for a joint investigation by the UK **Serious Fraud Office** and the **Australian Crime Commission** into the fraudulent conduct of **National Australia Bank** and its subsidiary companies.

Summary of NAB Frauds

The two frauds are summarised in the following table and does not include other cases of misconduct such as the "***Financial Planner Scandal***" in Australia and the "***PPI Scandal***" in the UK.

Summary of NAB Frauds

The Victims	Est. Victim Losses	Aspects of Fraud
United Kingdom		
Small and Medium Business Borrowers	**£3 Billion plus**	Breach of Fiduciary Duty Breach of Agency Contract Concealment of Documents Fraudulent *"Break Costs"*
Australia		
Widows and Retirees	**£500 million plus**	Breach of Fiduciary Duty Breach of Trust Concealment of Documents Fraudulent Documents

The record fine of £20.7 million by the **FCA** related only to the "***PPI Scandal***" but is indicative of the culture that was and is still prevalent with **NAB** and its subsidiary companies.

There are similarities in these frauds which both involve a Breach of Fiduciary Duty and the deliberate concealment of documents that would disclose the fraud to the victims.

In the pension fund fraud, fraudulent documents related to a trust established in 1913 were produced so as to deceive the victims, while in the fraud against the business borrowers in the UK, fraudulent "***break cost***" were fabricated to also deceive the victims.

The loss to victims in the UK is likely to be at least £3 billion, while loses to retirees and widows should be at least £500 million.

As mentioned above the **Serious Fraud Office** conducted an investigation into the Robert Maxwell Pension Fund Fraud which is very similar to the Australian pension fund fraud.

Jurisdiction of the Serious Fraud Office

If the Interest Rate Hedging Products (IRHP) had been "*standalone*" Interest Rate Swaps, the victims would now be part of a compensation program administered by the **FCA**.

However "***Tailored Business Loans***" were designed to avoid regulatory scrutiny and therefore the opportunity for fraud likewise became more likely, which in fact turned out to be the case.

The victims are now in a "***legal limbo land***" and for this reason it is important for the Director to consider all the circumstances of the case including:

- the scale of loss (actual or potential);
- the impact of the case on the UK economy;
- the effect of the case on the UK's reputation as a safe place to do business;
- the factual or legal complexity and the wider public interest.

The scale of the loss is substantial at around £3 billion by the time of resolution {*underestimated to date by the **PRA***} and the fraud has resulted in a substantial number of job losses and small businesses have been foreclosed on or had to scale down their activities just to survive.

The UK's reputation as a safe place to do business relies on people having complete confidence in the banking system and attempts to avoid regulatory oversight should not be tolerated.

The fraud itself which involved the fabrication of fraudulent "***break costs***" is not very complex however it has to be placed in the context of the financial derivatives market which is complex and not well understood by most people. It was this complex background that has meant that the fraud could be concealed by essentially bluff.

Reference is made to other investigations conducted by the **Serious Fraud Office** in **Appendix A**.

There are similarities with the **Bank of Credit and Commerce International** (**BCCI**) case where investigators in the US and the UK revealed that BCCI had been "*set up deliberately to avoid centralized regulatory review, and operated extensively in bank secrecy jurisdictions*".

Interest rate swap transactions were also used for fraudulent purposes in the Weavering Capital (UK) Ltd case.

The use of indemnities to conceal the real nature of financial transactions was also a feature in the Guinness case.

For these reasons, an investigation into the fraudulent conduct of Clydesdale Bank and its subsidiary, the Yorkshire Bank clearly falls within the remit of the **Serious Fraud Office.**

I shall provide further evidence to both the **Serious Fraud Office** and the **Australian Crime Commission** in future correspondence.

Yours Sincerely

Phillip Sweeney

BSc/BE (Hons), MBA, Dip Sec Inst (Applied Finance)

Cc Mr Chris Dawson CEO - ***Australian Crime Commission***

Attachments

Letter dated 18 May 2015 to Mr Andrew Bailey – CEO ***Prudential Regulation Authority***

Under What Circumstances can a Bank Non-Fraudulently Determine and Impose a "Break Cost"?

Letter dated 20 May 2015 to Mr Chris Dawson - CEO ***Australian Crime Commission***

Appendix A

SFO Case involving a Major Bank Fraud

Bank of Credit and Commerce International (BCCI)

The **Bank of Credit and Commerce International (BCCI)** was a major international bank with head offices in London and Karachi.

Investigators in the US and the UK revealed that BCCI had been "*set up deliberately to avoid centralized regulatory review, and operated extensively in bank secrecy jurisdictions*".

Its affairs were extraordinarily complex. Its officers were sophisticated international bankers whose apparent objective was to keep their affairs secret, to commit fraud on a massive scale, and to avoid detection.

The liquidators, Deloitte & Touche, filed a lawsuit against Price Waterhouse and Ernst & Young – the bank's auditors – which was settled for $175 million in 1998.

The British government set up an independent inquiry, chaired by Lord Justice Bingham, in 1992. Its House of Commons Paper, ***Inquiry into the Supervision of the Bank of Credit and Commerce International,*** was published in October of that year. Following the report, BCCI liquidators Deloitte Touche filed suit against the Bank of England for £850m, claiming that the Bank was guilty of misfeasance in public office. They claimed the Bank knowingly failed to protect depositors from the world's biggest bank fraud that led to the collapse of BCCI with debts of $16billion (£9billion).

The suit lasted 12 years. It ended in November 2005, when Deloitte withdrew its claims after England's High Court ruled that it was "no longer in the best interests of creditors" for the litigation to continue. Deloitte eventually paid the Bank of England £73m for its legal costs. According to news reports at the time, it was the most expensive case in British legal history.

{Note: The task of supervising the banking system was removed from the Bank of England in 1997 and transferred to the **Financial Services Authority** (FSA).}

Barclays Bank Investigation

On 15 August 2012 the Director of the SFO formally opened an investigation into certain commercial arrangements between Barclays Bank and Qatar Holdings in 2008.

A Trade Finance Fraud

Versailles plc - a trade finance fraud

Carlton Cushnie was getting noticed in the City as a seemingly successful trade finance businessman. The company, he created, Versailles plc, together with business partner Frederick Clough, grew rapidly and during 1999 its value trebled to £600 million.

Versailles, a FTSE 250 company was promoted as a short-term bridging finance service for cash poor, perhaps small, companies. This was to enable them to buy materials to produce goods for orders from larger, perhaps blue chip, companies, i.e. secure payers, or so Versailles claimed.

Investors, creditors and banks became attracted to providing finance to a seemingly highly profitable venture. But by the end of 1999 Versailles stock exchange listing was suspended. The Versailles bubbie had burst. Its shares had become virtually worthless.

The DTI, acting on a tip off had already discretely started to examine Versailles turnover calculations and in early 2000 an SFO investigation was launched. The culmination was that in 2004 Cushnie, convicted by a jury, was jailed for six years, as was Clough who admitted a number of offences. Confiscation orders were made amounting to £24 million.

FSO case involving An Interest Rate Swap Fraud

Weavering Capital UK

Weavering Capital (UK) Ltd went into administration in March 2009. The company was advisor to a Cayman Islands incorporated hedge fund called Weavering Macro Fixed Income Fund Ltd which had funds of US$639 million under management in 2008. The investigation concerns interest rate swap transactions between the fund and a related Weavering company in the British Virgin Islands which had the effect of inflating the net asset value of the fund.

FSO Case Involving Indemnities

The Guinness case

In 1986 Guinness was involved in one of the most notorious take-over battles seen in the City.

There were rumours that the Guinness plc bid in 1986 for The Distillers Company plc was tainted by an unlawful share support operation by them, which involved the company offering secret indemnities (from its own funds) against losses to "supporters" of the bid which resulted in a dramatic rise in the price of Guinness shares. Guinness chief executive Ernest Saunders denied any knowledge of it.

Following an examination of the bid by DTI inspectors, the SFO opened an investigation which resulted in Mr Saunders and three other defendants (Anthony Parnes, Gerald Ronson and Jack Lyons) being convicted in 1990. Ernest Saunders, who was the only defendant who opted to take the witness stand, appealed against his conviction because of evidence acquired by the DTI using compulsory powers was used against him. However his conviction stood.

Under What Circumstances can a Bank Non-Fraudulently Determine and Impose a "Break Cost" ?

The document has been prepared to advise the **Financial Conduct Authority (FCA)** and the **Prudential Regulation Authority (PRA)** of the fraud associated with some types of unregulated business loans with purported ***"Embedded Interest Rate Hedging Features"***

Summary

The Clydesdale Bank (and Yorkshire Bank) subsidiary companies of **Australia National Bank (NAB)** engaged in fraudulent conduct by failing to do what they were contractually committed to do so as to avoid regulation by the **FSA/FSA**.

If a standalone **Interest Rate Hedging Product (IRHP)** had been offered by these subsidiary companies of **NAB**, this financial product would have been subject to regulation by the **FSA/FCA** and retail customers would now be eligible for compensation as part of the redress program administered by the **FCA**.

To avoid regulation these subsidiary companies of **NAB** were required to enter into **Interest Rate Swaps (IRS)** and related "*Contracts for Difference*" with **THIRD PARTIES** who would bear the risk of interest rate fluctuations.

This contractual arrangement placed these subsidiary companies of **NAB** in the role of agents for the retail customers and thus a fiduciary relationship arose.

However instead of undertaking what the stipulations (terms) of the contract required these subsidiary companies to do, no **Interest Rate Swap (IRS)** contracts where entered into with identifiable THIRD PARTIES on behalf of the retail customers.

In breach of the well know duty of fiduciaries not to make an unauthorised profit from the agency arrangement, the subsidiary companies of **NAB** made excessive unauthorised profits when official interest rates fell to historical record lows in late 2008 and early 2009.

The banks retained amounts that should have been passed onto third parties if *bona fide* IRS contracts had been arranged with identifiable THIRD PARTIES which was a stipulation in the loan contracts.

If a *bona fide* IRS contract had been entered into it is the non-faulting counter-party who is able to lodge a legally valid claim for breach of contract which is commonly referred to as a "***break cost***".

However the subsidiary companies of the **NAB** did not enter into any *bona fide* IRS contracts with identifiable THIRD PARTIES and so no legally valid claims for breach of contract can be produced.

Instead, the subsidiary companies of **NAB** produced fraudulent *in terrorem* claims for breach of contract when no such contracts existed and the sole purpose of these *in terrorem* claims was to lock retail customers into high monthly repayments on their loan facilities when official interest rates has fallen to record historical lows.

These subsidiary companies of **NAB** who took on the role of agents must now disgorge all the authorised profits and pay damages for consequential losses suffered by may retail customers due to this fraudulent conduct.

Current provisions made by **NAB** under the direction of the **PRA** are insufficient to meet these claims that will arise due to the fraudulent conduct of **NAB** and its subsidiary banks.

Introduction

On the 1 April 2013 **the Financial Services Authority (FSA)** was renamed as the **Financial Conduct Authority (FCA).**

On 10 March 2015 the Treasury Select Committee published a report on the "***Conduct and Competition in SME Lending***"

The Committee classified the types of interest rate hedging products into two main categories:

(i) Standalone "*Interest Rate Hedging Products*" (IRHP), and
(ii) Loans with purported "*Embedded Interest Rate Hedging Features*"

Hedging products is the first category are classified as "***Contracts for Difference***" and are subject to regulation by the **FSA/FCA**, while loan products with purported "***embedded***" interest rate hedging features are not currently subject to regulation by the **FSA/FCA**.

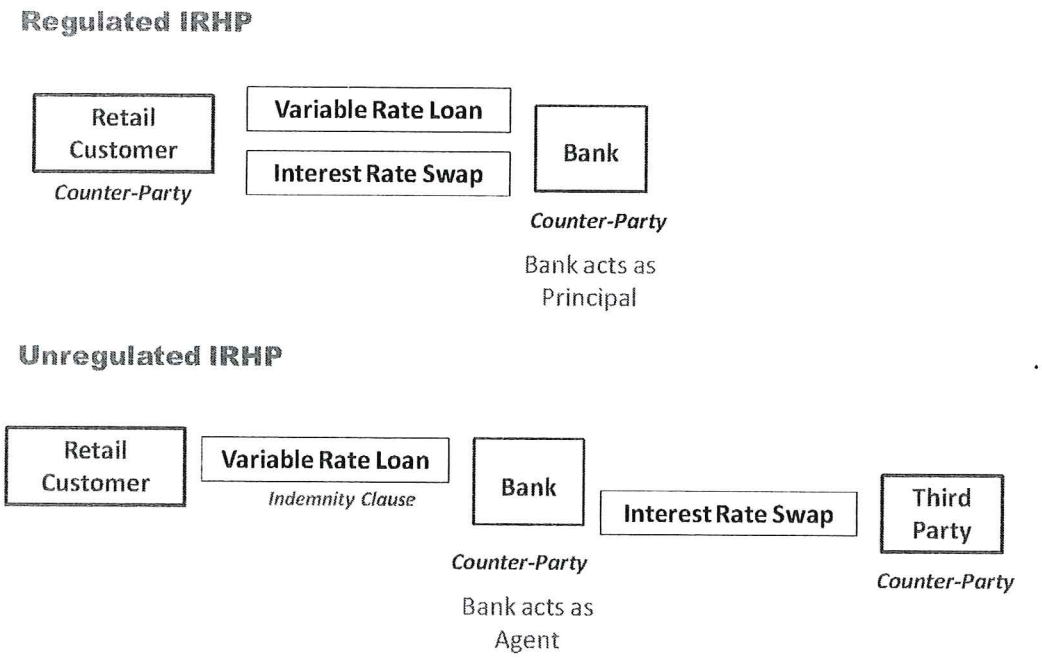
The terminology "*embedded swap*" or "*embedded interest rate hedging features*" is not particularly helpful in understanding the differences between these two types of "***Hedging Products***".

The following alternative descriptions are therefore proposed:

(i) **Two Party** Interest Rate Hedging Products, and
(ii) **Third Party** Interest Rate Hedging Products

These two types of Interest Rate Hedging Products are shown in the following diagram.

Two Types of Interest Rate Hedging Products



In the case of any financial arrangement that can be described as a "***hedging arrangement***" there must be at least two parties since hedging is a "***zero-sum-game***", involving the exchange of cash flows between at least two parties over an agreed period of time.

The two parties are known as "**counter-parties**" and in an ***Interest Rate Swap (IRS)*** one counter-party will be the "**floating rate payer**" and the other counter-party will be the "**fixed rate payer**".

In the case of a "**Regulated IRHP**" the bank acts as a **Principal** with respect to the retail customer when providing the Interest Rate Swap or other "*Contract for Difference*" and the retail customer is a counter-party to an IRS contract.

In the case of an "**Unregulated IRHP**" the bank acts as an **Agent** with respect to the retail customer when providing the Interest Rate Swap or other "*Contract for Difference*". The IRS contract is arranged with a **THIRD PARTY** who becomes the counter-party to the IRS contract and not the retail customer. The loan contract includes an **indemnity clause** to cover any losses that might be incurrent if the bank is forced to terminate the IRS contract before maturity.

In a *bona fide* IRS contract both counter-parties will agree to exchange cash flows over an agreed time period, where the direction and quantum of the cash flows will depend of the notional amount of the swap and the movement of interest rates as determined by an agreed benchmark such as LIBOR.

If one of the counter-parties terminates the IRS contract then the **non-defaulting counter-party** will have a claim for damages due to breach of contract.

In the case of a "**Regulated IRHP**" if the retail customer seeks to terminate the IRS contract before maturity, then the bank as the **non-defaulting counter-party** can legitimately determine a claim for damages for the breach of the IRS contract.

In the case of an "**Unregulated IRHP**" if the retail customer seeks to terminate the IRS contract before maturity, then the **THIRD PARTY** as the **non-defaulting counter-party** can legitimately determine a claim for damages for the breach of the IRS contract.

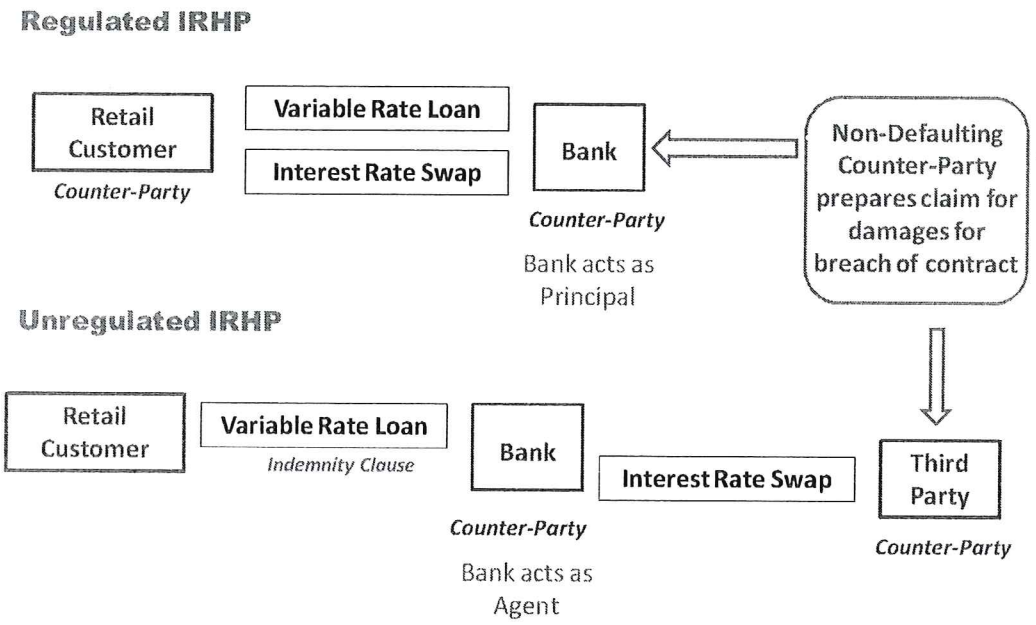
In the case of an "**Unregulated IRHP**" it is the bank who is the defaulting counter-party who is forced into default by the customer and the bank will seek to recover any damages claim made by the **THIRD PARTY** by way of an indemnity clause included in the "*terms and conditions*" of the loan contract.

Correctly identifying who is the **non-defaulting counter-party** in the event of the early termination of an Interest Rate Swap (IRS) contract of related "*Contract for Difference*" is critical in determining who is able to legally impose a "***break cost***" in the event of the early termination of an IRS contact.

If is the **non-defaulting counter-party** who has a legally valid claim for damages if interest rates have moved adversely to the defaulting counter-party.

This difference is illustrated in the following diagram.

Retail Customer Initiates Early Termination of IRHP



Claim for Damages for Breach of Contract

The Scottish Lord Jauncey of Tullichettle in the House of Lords in ***Ruxley Electronics & Construction Ltd v Forsyth*** [1995] 3 WLR 118, [1995] 3 All ER 268, [1996] AC 344, [1995] CLC 905, [1995] UKHL 8 stated:

> The general principles applicable to the measure of damages for breach of contract are not in doubt. In a very well-known passage Parke B in ***Robinson v Harman*** (1848) 1 Exch 850 at 855, [1843-60] All ER Rep 383 at 385 said:
>
> > 'The next question is: What damages is the plaintiff entitled to recover? The rule of the common law is that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.'

Damages for breach of contract are awarded by the court by way of compensation and not by way of punishment.

A claim that is excessive is not enforceable since the Court will rule the excessive claim to be a "***penalty***".

If an **Interest Rate Swap (IRS)** contract is terminated before maturity, it is the **non-defaulting counter-party** who prepares the claim for damages which the defaulting counter-part can challenge in the Court if the claim is deemed to be excessive and a penalty which is unenforceable.

In a highly liquid market such as the swap market, a typical approved method of determining the claim for damages is **"Market Quotation"** , where the non-defaulting counter-party obtains four market quotations to replace the swap position that has of will be terminated before maturity.

The highest and lowest quotations are rejected and the average of the remaining two is used as the basis for the claim for damages.

In a decision make by Tony Boorman, an ombudsman with the **Financial Ombudsman Service** in July 2013 concerning a loan with a ***"Two Party IRHP"*** {standalone IRS} with the "W Family", the ombudsman made mention of how the ***"break cost"*** would be determined.

The W Family run a small hotel business and in 2007 they decided to sell one of two hotels they ran and purchase a new slightly larger hotel.

Initially the loan was for £4.2m but decreasing to £2.2m once one of the old hotels had been sold.

The loan was approved on the basis of a variable rate interest loan at a margin of 1.25% over the bank's base rate repayable over a 14 year term.

A separate agreement was then made with the bank for a 15 year IRS (ie a standalone or **"Two Party"** IRHP).

In 2009 the bank advised that the break cost would be £542,000.

In 2011 the bank offered to re-finance with the break cost added to the principal of the new loan to meet the break cost quoted at £550,000.

On page 15 of his decision the ombudsman states:

> "But it is up to the non-defaulting party to calculate the "loss".

In this case since the IRS is a **"Two Party IRHP"** {ie a standalone IRS} the borrower is the ***"fixed rate payer"*** counter-party and the Bank is the ***"floating rate payer"*** and the bank has decided to take the risk of paying the borrower if interest rate rise, but to also take the benefit if interest rates fall.

The ombudsman continued:

> "And subject to "*showing such calculations in reasonable detail and including all relevant quotations.*"

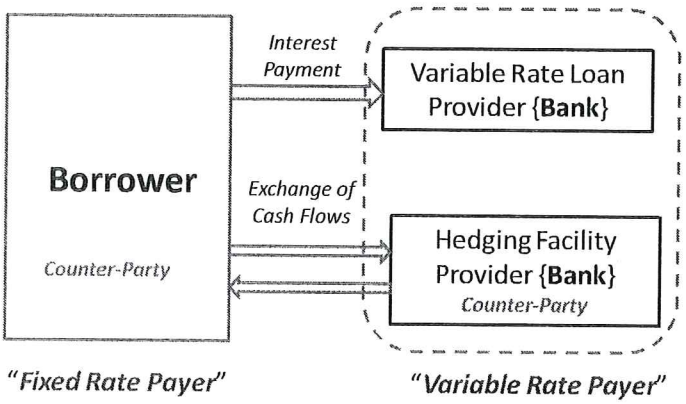
This refers to the method the bank would use to determine a claim for damages for the early termination of the **"Two Party IRHP"** and that would be to seek market quotations on the interest rate swap market to effectively replace the swap that was or would be terminated before maturity.

The contractual arrangement for the ***"Two Party IRHP"*** is shown on the following diagram.

Because the borrower is a party to the separate IRHP contract, which is classified as a ***"Contract for Difference"*** this contract is related by the **FCA** (and previously be the **FSA**).

Two Party IRHP

Separate Written Contracts – Same Provider



Standalone IRHP are regulated by FSA/FCA as *"Contracts for Difference"*

Case Law Example: ***Grants Estate v Royal Bank of Scotland*** *{Scots Law}*

If the borrower, who in this case in the "***Fixed Rate Payer***" in the Interest Rate Swap contract, terminates the IRS contract before maturity, then the bank as the **non-defaulting counter-party** can legally make a claim for damages for breach of contract (ie lodge a claim with the borrower which is otherwise known as a "***break cost***").

Third Party Interest Rate Hedging Products

In the case of "***Third Party Interest Rate Hedging Products***" , otherwise known as "***embedded swaps***", there is a different contract arrangement in the case of *bona fide* hedging facilities.

In the report by the House of Commons – Treasury Select Committee the following was stated at [119]:

Treasury - Eleventh Report
Conduct and competition in SME lending

"Over the course of the review of standalone IRHPs, the FCA identified, as a potential problem, loans with the features of interest rate hedging facilities written into the contract.[205] Martin Wheatley, Chief Executive of the FCA, wrote in a letter to the Financial Secretary of the Treasury:

> [...] the size of the issue is potentially significant. Data collected from Barclays, HSBC, Lloyds, National Australia Bank Group and RBS shows that more than **60,000** of fixed rate loans with mark to market break costs have been sold since 2001, significantly more than the **40,000** standalone IRHP's covered by our review.[206]"

The report continued at [121]:

"Clydesdale Bank plc, through both its own branches and through those under its trading name Yorkshire Bank, sold both standalone IRHPs and loans with embedded swaps. These loans were sold under its 'Tailored Business Loan' (TBL) brand. Clydesdale's target market for TBLs was "a very broad range of SMEs".[208] Clydesdale wrote that it sold 11,271 loans across all of its Tailored Business Loan variants between September 2002 and July 2012. This included both fixed-rate products and more complex arrangements. Between December 2001 and July 2012, the firm states that it provided 8,372 fixed-rate Tailored Business Loans to 6,153 customers.[209]"

Admission of Fraud

Now it is not very often you will find a bank executive admitting to fraud before a Treasury Committee, however at [123] the Treasury Committee states:

"Like standalone IHRPs, TBLs can incur break costs when a customer exits the loan early. Debbie Crosbie, Executive Director of National Australia Group Europe, Clydesdale Bank's parent company, explained how mark to market TBL break costs were calculated:

> [...] we look at [...] the difference between the interest rate that is prevailing at the moment and when the interest rate was set, and for the remaining period of time, the customer is charged the difference effectively of those interest rates.[213]

However what Debbie Crosbie should have stated before the Treasury Committee was:

> "A "Fixed Rate Facility" under the Tailored Business Loan program is provided by a different contract arrangement to a standalone IRHP which is subject to regulation by the FCA (and previously by the FSA). In our "*Terms and Conditions*" we confirm that the bank "*will enter into a hedging arrangement with a third party to hedge our risk to fluctuations in interest rates .*"
>
> In the event that a borrower seeks to terminate the "**Hedging Facility**" that has been arranged by the bank on their behalf, then the non-defaulting counter-party (ie the third party) will determine the claim for the early termination of the IRS contract and provide the bank with the documentation supporting the claim. The bank will then pass this documentation onto the borrower in accordance with the Indemnity Clause (Clause 8.2) which requires the borrower "*to pay us on demand an amount equal to any loss, cost or liability which we determine that we or any of our Affiliates suffer or incurs as a result of ..... (iii) the termination, closing out, cancellation or modification of any Hedging Arrangement..*"

Debbie Crosbie may have wish to have provided further clarification to the Treasury Committee by making reference to a related case that came before the Court of Sessions.

That case was ***Bank of Scotland v Dunedin Properties*** [1998] GWD 18-887, 1998 SCLR 531, 1998 SC 657, [1998] CSIH 118, [1998] ScotCS CSIH_118, 1999 SLT 470

In the case the **Bank of Scotland** arranged an **Interest Rate Swap** hedging facility with the **Bank of America** and when Dunedin Properties sought to terminate the IRS related to the variable rate loan facility provided by the **Bank of Scotland**, the **Bank of America** prepared a claim for damages for breach of contract due to the early termination of the **Interest Rate Swap** contract.

The Bank of Scotland then passed the claim for damages onto its customer, Dunedin Properties for payment.

Dunedin Properties did not dispute the quantum of the claim produced by **Bank of America**, but disputed their liability to pay the claim, given that they were not a direct party to the IRS contract.

Lords Kirkwood and Caplan indicated that they would have difficulty accepting that Dunedin Properties would be liable under another contract to which Dunedin was neither part nor aware of its precise content {**Appendix B**}.

However in relation to the facts of this case in which the loan facility had been specifically arranged following discussion with Dunedin Properties, the Court found in favour of the **Bank of Scotland**.

So clearly if the **Bank of Scotland** could arrange an interest rate Swap Hedging facility with a *bona fide* "**Third Party**", in this case the **Bank of America**, then why could not **Clydesdale Bank** (and its subsidiary **Yorkshire Bank**) do likewise?

Debbie Crosbie should have drawn the Treasury Committee's attention to **Condition 8.1** in the bank's "***Terms and Conditions***" which states:

> "8.1 **Acknowledgement**
>
> You acknowledge that in order to provide you with a Hedging Facility we or any of our Affiliates will have entered into an arrangement with a third party to hedge our risk to fluctuations in interest rates (a "***Hedging Arrangement***") .....

The Loan Facility Contract signed by borrowers included the following warning immediately above where they signed the contract:

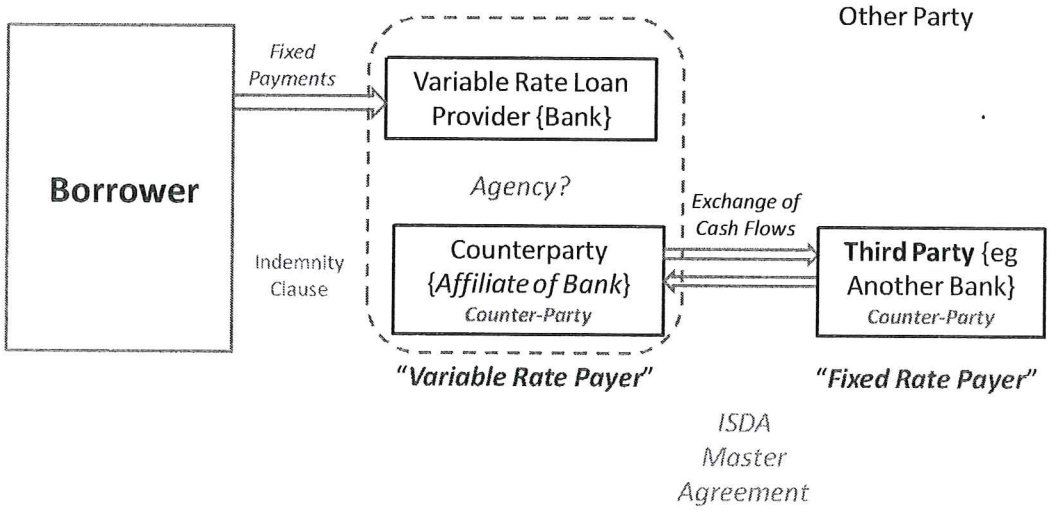
> **THIS IS AN IMPORTANT LEGAL DOCUMENT. ONCE YOU HAVE SIGNED IT YOU WILL BECOME LEGALLY BOUND BY ITS TERMS.**
>
> **IN PROVIDING FACILITIES WE DO NOT GIVE ANY INVESTMENT, FINANCIAL, TAXATION, LEGAL OR OTHER ADVICE. YOU MUST SATISFY YOURSELF THAT A FACILITY IS SUITABLE FOR YOUR CIRCUMSTANCES AND PURPOSES. YOU SHOULD NOT ENTER INTO ANY LOAN DOCUMENTS IF YOU DO NOT UNDERSTAND THE RISKS (INCLUDING THE CONDITIONS AND, IN PARTICULAR, CONDITION 8 RELATING TO BREAK COSTS). WE STRONGLY RECOMMEND THAT YOU TAKE INDEPENDENT LEGAL AND FINANCIAL ADVICE BEFORE YOU SIGN THIS DOCUMENT.**

Special attention was drawn to **Condition 8** which confirms that it is a stipulation of the contract that the bank will enter into an arrangement with a THIRD PARTY to hedge "***our risk***" to fluctuations in interest rates.

If Clydesdale Bank had done what is was contracted to do then the contractual arrangement would be as shown in the following diagram:

Third Party IRHP

One written Contract – Same Provider



Case Law Example: ***Bank of Scotland v Dunedin Properties*** *{Scots Law}*

If the borrower seeks to terminate the IRS associated with the borrower's variable rate loan facility, then it is the THIRD PARTY (eg the **Bank of American** in the Dunedin Properties case) that is the **non-defaulting counter-party** who produces the claim of damages for the breach of the IRS contract and NOT Clydesdale Bank.

Clydesdale Bank who has acted in the capacity as an **agent** for the borrower, then passes the claim onto the borrower for payment in accordance with **Condition 8.2**, the **Indemnity Condition**.

Also an agent is obliged to keep all records associated with the agency agreement and to produce these on demand to the agent's principal, in this case the retail customer.

Clydesdale Bank who is the defaulting counter-party is not in the position to produce a claim for damages, but what does Debbie Crosbie state in her testimony before the Treasury Committee?

> [...] we look at [...] the difference between the interest rate that is prevailing at the moment and when the interest rate was set, and for the remaining period of time, the customer is charged the difference effectively of those interest rates.[213]

This statement is a confirmation of fraud.

Clydesdale Bank never bothered to comply with its contractual obligations under **Condition 8.1**.

Clydesdale Bank did not ***"enter into an arrangement with a third party to hedge the bank's risk to fluctuations in interest rates"***.

Clydesdale Bank simply pocketed the additional margin charged to customers under the "**Fixed Rate Facility**" TBL and when interest rates fell to historical record lows, the bank then fraudulently produced purported "***break costs***" and imposed these on borrowers when there were non-existing IRS contracts with identifiable THIRD PARTIES who could have lawfully made a claim for damages for breach of contract.

Because Clydesdale Bank had never bothered to comply with its own "***Terms and Conditions***" so there were no valid IRS contracts that were terminated and which could have given rise to claims for breach of contract.

The purported "***break costs***" imposed on borrowers who had accepted the bank's offer of a "***Fixed Rate Facility***" to hedge the variable rate loan provided by the bank were simply **fraudulent.**

The only way that Clydesdale Bank could honestly and lawfully produce a claim for damages is if the bank had provided a "***Two Party***" IRHP (ie standalone IRHPs) which is subject to regulation by the **FCA** (and formerly by the **FSA**).

However it is accepted that the loan and hedging facilities provided under the "**Tailored Business Loan**" program were not "***Two Party***" IRHPs (ie standalone IRHPs).

In these hedging facilities were of this type they would have been subject to regulation by the **FSA/FCA** and borrowers would now be included in the compensation program currently administered by the **FCA**.

An Honest Admission by Clydesdale Bank

When interest rates fell it historical record lows in late 2008 and early 2009, the management of Clydesdale and Yorkshire Bank should have made an honest admission to the borrowers who had accepted the bank's offer of purported "***Hedging Facilities***" under the **Tailored Business Loan** (TBL) program.

The admission should have been along these lines:

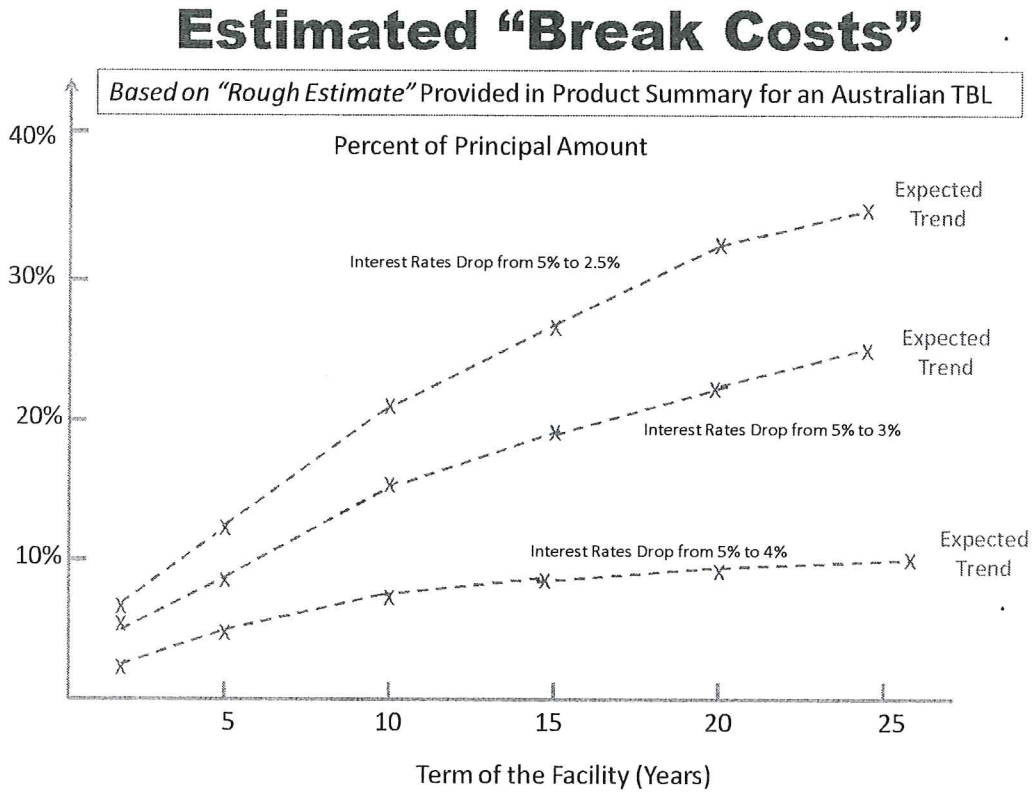
> "Retail customers who accepted a loan facility with a "***Hedging Facility***" were advised by the bank that the bank would enter into an arrangement with **a third party** so that the bank might hedge its **own risk** to fluctuations in interest rates. However no such arrangements with third parties were put in place and the bank simply pocketed the increased margin charged on the loan facilities that were purportedly hedged. This became increasingly profitable for the bank as official interest rates fell to record historical lows. Two of the overarching Principles for Business contained in the FSA Handbook **{Appendix C}** are:
>
> "No.1 - A *firm* must conduct its business with integrity, and
>
> No.6 – A *firm* must pay due regard to the interests of its *customers* and treat them fairly."
>
> On this basis the bank will be refunding all overcharged interest payments to customers who accepted the bank's offer of a "***Hedging Facility***" to manage the risk of fluctuations in interest rates in relation to the variable rate loan provided by the bank.

More Evidence of Fraud

Debbie Crosbie from Clydesdale Bank stated in her testimony before the Treasury Committee?

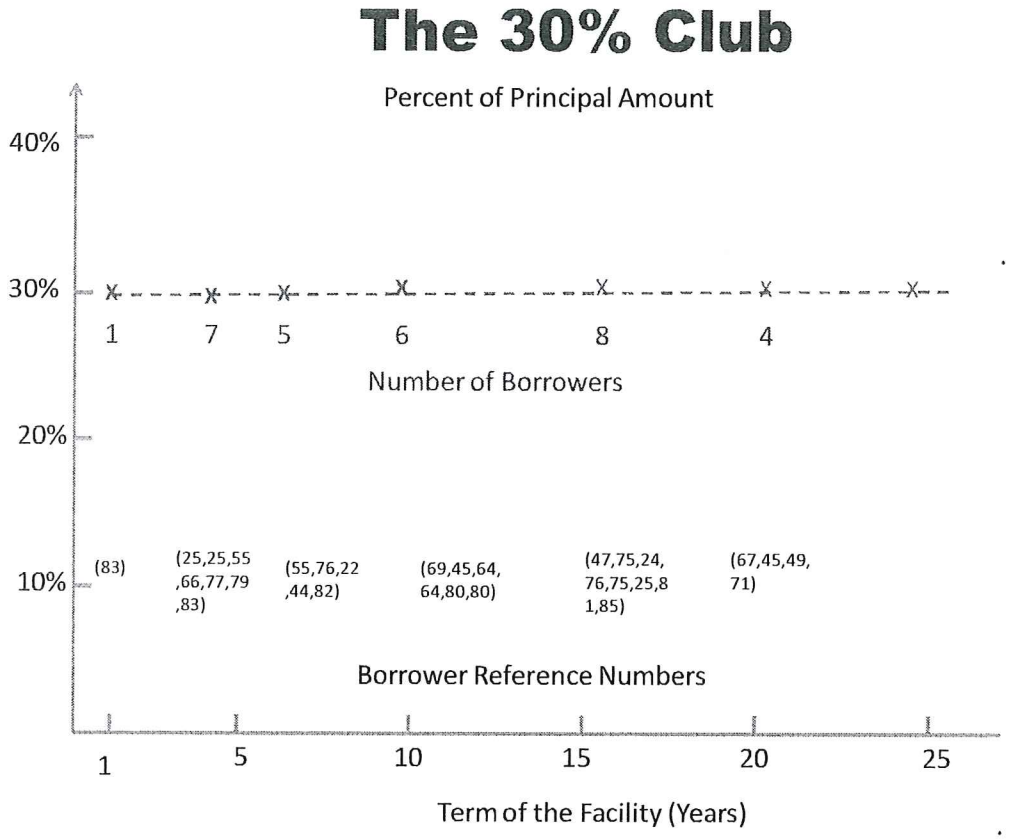
> [...] we look at [...] the difference between the interest rate that is prevailing at the moment and when the interest rate was set, and for the remaining period of time, the customer is charged the difference effectively of those interest rates.[213]

The parent company of Clydesdale Bank, the **National Australia Bank (NAB)**, markets a similar financial product to "**Tailored Business Loans**" in Australia, however the **NAB** provides its retail customers a means of estimating the quantum of a "**break cost**" that might become liable in the event of the early termination of the hedging facility and the following graph can be derived from the information provided by **NAB** to Australian retail customers.



As Debbie Crosbie testified the size of the "***break cost***" will increase with the size of the fall in interest rates as well as with the remaining period of time to the maturity of the Interest Rate Swap contract.

However when the size of the purported "***break costs***" imposed on 33 retail customers of Clydesdale Bank and Yorkshire Bank are plotted as a percentage of the loan principal, the amounts imposed by these banks all lie on a straight line at 30%.



If these banks had entered into a valid IRS contract with a THIRD PARTY as the banks were contracted to do so as to avoid being subject to regulation by the **FSA/FCA**, then the THIRD PARTIES involved should have been able to provide claims for actual or anticipated beaches of contract that would have plotted on a rising curve the longer the period left to maturity.

However since there were no such IRS contracts with THIRD PARTIES, in many cases Clydesdale Bank and Yorkshire Bank simply imposed an arbitrary and bogus "***break cost***" simply taken to be 30% of the loan principal.

This is a classic example of an *in terrorem* penalty that is imposed by one party to a contract to force the other party to complete the contract. Penalties will not be enforced by the courts.

The following is stated in the Treasury Committee report at [123]:

"This break cost calculation process for a TBL appears to be the same as for a standalone IRHP delivering the same hedging function. Mr Thorburn said:

> As long as it is for the same loan for the same duration broken at the same point in time and entered into at the same point in time [the break cost] should be the same.[214]"

However the evidence of actual "***break costs***" imposed by Clydesdale Bank (and Yorkshire Bank) do not support the contention of the former CEO of Clydesdale Bank.

The following is stated in the Treasury Committee report at [126]:

> "To protect themselves against the risk of providing a TBL's hedging function, banks need to hedge the risk themselves. The FCA said that "*the bank will have entered into a separate IRHP with a third party in order to manage its financial risk of entering into the loan*".[220] Mr Thorburn confirmed that this was the case for Clydesdale Bank.[221] Break costs therefore partially reflect the cost to the bank of their own underlying hedge."

However Clydesdale Bank (and Yorkshire Bank) have been unable to produce any evidence to support this representation made by the FCA, even though as an agent acting on behalf of the retail customer the banks have a duty of disclosure as a fiduciary if such a "*separate IRHP*" was in fact entered into on behalf of the retail customer.

The onus of establishing a right to be indemnified for an expense or liability rests with the agent {***Johnston v Kearley*** [1908] 2 KB 514 at 520, 524}.

Avoiding Regulation

The following is stated in the Treasury Committee report at [140]:

Indeed, Clydesdale told the Committee that avoiding regulation was one of the reasons they created TBLs. In particular, Clydesdale wished to avoid the complex documentation that the sale of regulated products required. In explaining the design of TBLs, Mr Thorburn said:

> The difference was simplicity essentially. A standalone interest rate hedging product will have a separate ISDA agreement quite separate to the loan. The documentation associated with it is really complex and really extensive. A tailored business loan provides potentially a similar outcome to an interest rate hedging product but without the complexity so the documentation is much, much simpler. It was modelled on a domestic mortgage product to try to make it more understandable. In a nutshell that is the difference between the two.[259]

Mr Thorburn also said:

> [...] because the standalone [IRHP] is a regulated product you are required to go through a certain process, uses the documentation, which is very complex. That was something we did not need to put our smaller business customers through. If they wanted a loan that was fixed for a period of time we didn't need to put them through all that.[260]

However in order to achieve such as outcome Clydesdale Bank (and Yorkshire Bank) required a THIRD PARTY to take on the risk of interest rate fluctuations and the contract documentation confirmed that the banks would in fact procure such a contract on behalf of the retail customer.

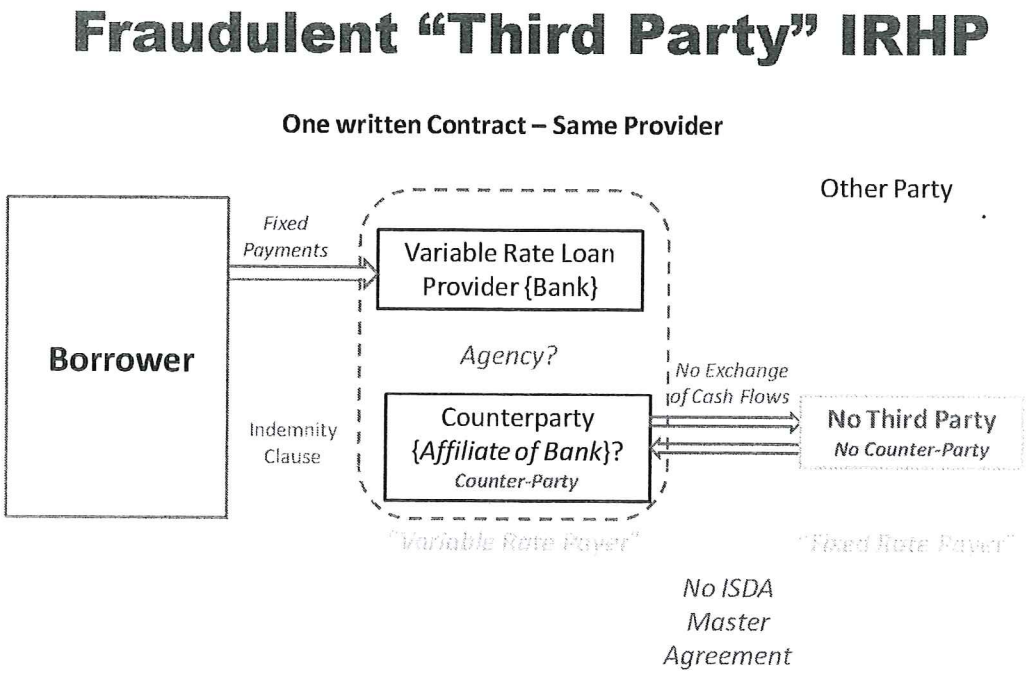
The THIRD PARTY and the bank would then be bound to the contractual obligations of a separate ISDA agreement and the bank acting as an for the retail customer would be indemnified under **Condition 8.2**.

The following is stated in the Treasury Committee report at [150]:

> "Clydesdale understood that TBLs were unregulated. It created TBLs to avoid requirements imposed by the regulator on the sale of a regulated product, IRHPs. It claims that this was to simplify the associated documentation, and to make the product easier for customers to understand. The use of TBLs has left regulators powerless to enforce compensation for customers to whom products were mis-sold, as they have done with IRHPs. **Clydesdale created a product that retained the risks and complexities of the regulated product, but had none of the safeguards."**

The Fraud

The fraud perpetrated by Clydesdale Bank and Yorkshire Bank is summarised on the following diagram:



If the bank has not done what is was contractually required to do so as to avoid being subject to regulation by the **FSA/FCA**, and that is to enter into an IRS contract with a *bona fide* THIRD PARTY, then there has been no breach of contract with the THIRD PARTY which could give rise to a *bona fide* claim for damages for a breach of that contract.

If Clydesdale Bank has suffered no loss, then any purported claim for damages produced by Clydesdale bank (or Yorkshire Bank) is simply a fraudulent claim with no substance in law.

In fact Clydesdale Bank (and Yorkshire Bank) made enormous profits as official interest rates fell to record historical lows when these banks produced fraudulent purported "***break costs***" quotations to lock retail borrowers into paying a fixed interest rate of typically 7% to 8% , when retail variable interest rates fell to around 2.5%.

That is, both banks profited by not doing what they were contractually required to do and that was to enter into a *bona fide* **Interest Rate Swap** (IRS) contract with an identifiable THIRD PARTY, just as the Bank of Scotland had done in the Dunedin Properties case.

Defence by the Banks?

Now Clydesdale Bank (and Yorkshire Bank) might claim that the loan book is hedged by the parent company, **National Australian Bank (NAB)** at an aggregate level. However this begs the question as to why **NAB** would hedge against a FALL in interest rates?

The yield curve inverted in 2005 signalling that the medium term trend in interest rate would more likely to be down and not up and the Bank of England started to reduce the official interest rate on 10 April 2008.

If the **NAB** had hedged against a fall in interest rates after 2005, this would be confirmation of total incompetence by **NAB**, since billions of pounds would have flowed to counter-parties as official interest rates fell to historic lows.

When a bank is hedging its loan book, the bank is protecting its own interests and the interest of the shareholders and not those of its retail customers.

The **NAB** and Clydesdale Bank made no loss since there were no *bona fide* THIRD PARTIES who could make a legally valid claim for damages for the early termination of IRS contracts since no such contracts exist.

If the bank is claiming losses were incurred by the bank due to the breakage of Interest Rate Swap contracts, then the onus is on the bank to produce documents and evidence to support such a claim.

Fiduciary Relationship

So as to avoid regulation by the **FSA/FCA** Clydesdale Bank did not offer an IRS Contract to its retail customers where the contractual relationship would be Principal-Principal. Instead the loan facility contract has a stipulation that the bank *"will enter into a hedging arrangement with a third party to hedge our risk to fluctuations in interest rates ."*

This implies that the bank will act as an **agent** for the retail customer and procure an IRS contract with an unrelated THIRD PARTY.

It is open to a court to find a relationship of agency, even in the face of a specific claim purporting to deny it {***Ex parte Delhasse*** 7 Ch D 511}.

The House of Lords in ***Garnac Grain Co Inc v HMF Faure & Fairclough Ltd*** [1968] AC 1130 ruled on page 1137:

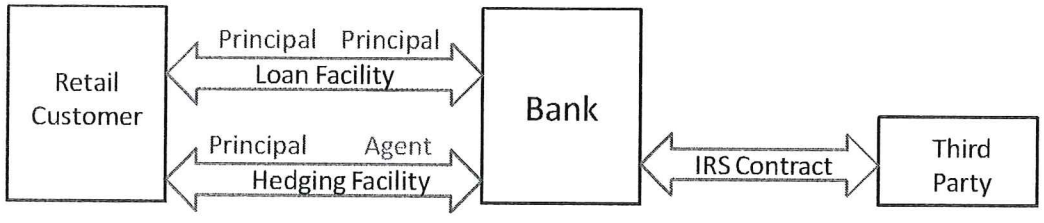
> "The relationship of principal and agent can only be established by the consent of the principal and the agent. They will be held to have consented if they have agreed to what amounts in law to such as relationship, even if they have professed to disclaim it, as in *Ex parte Delhasse* 7 Ch D 511. But the consent must have been given by each of them, either expressly or by implication from their words and conduct.

Lindgren J in the Federal Court of Australia in ***NMFM Property Pty Ltd v Citibank Ltd (No 10)*** [2000] FCA 1558; (2001) 186 ALR 442 stated at [629]:

> "While it is the law, not the parties, that ultimately determines whether their relationship falls within a certain legal category, this does not mean that the parties' express agreement and their use or non-use of agency terminology are irrelevant."

The expressed agreement between a retail customer and Clydesdale Bank or Yorkshire Bank included the express requirement that the bank would enter into a IRS contract with a **third party** on behalf of the retail customer and that the bank would be indemnified for all expenses and liabilities properly incurred under this arrangement by the retail customer. This has all the hallmarks of an agency relationship even if not specifically expressed as such in the contract documentation.

Agency Relationship



An Agent must Account to his Principal

With respect to the variable rate loan contract the relationship with the retail customer is one of Principal to Principal, however in relation to the ***"Hedging Facility"*** which is offered as one of Three OPTIONS in the main or head contract the bank proposes to act as an agent and procure an IRS contract with an unrelated THIRD PARTY.

A definition of agency is as follows:

> "Agency is a fiduciary relationship which exists between two parties, one of whom expressly or implied consents that they should act of his behalf so as to affect his relationship with third parties, and the other of who similarly consents so to act or so acts. The one on whose behalf the act or acts are to be done is called the principal. The one who is to act is called the agent. Any party other than the principal and the agent may be referred to as a third party"

One the inherent duties of any agent is to account to his principal and this requires that the agent produce records of any contracts or dealing with a third party to his principal {***Grey v Haig*** (1855) 20 Beav 219; 52 ER 587; ***Lord Chedworth v Edwards*** (1802) 8 Ves 46; 32 ER 268, ***Pearse v Green*** (1819) 1 Jac & W 135; 37 ER 327}.

All books and documents in the possession of the agent that relate to the business conducted on behalf of the principal must on demand be produced to the principal, or to a person named by the principal {***Bevan v Webb*** [1901] 2 Ch 59; ***Barkley v Barkley Brown*** [2009] NSWSC 76}.

The agent's duty to provide the records effected pursuant to the agency, and this to the principal's right of inspection, subsist notwithstanding the termination of the agency agreement and irrespective of the grounds for such termination {***Yasuda Fire & Marine Insurance Co of Europe Ltd v Orion Marine Insurance Underwriting Agency Ltd*** [1995] QB 174; [1995] 3 All ER 211; [1995] 2 WLR 49, ***Fairstar Heavy Transport NV v Adkins*** [2014] FSR 8; EWCA Civ 886}.

At the termination of the agency agreement, if the agreement does not allocate ownership of documents by express provision all documents brought into existence by the agent while engaged by the agent's principal are the principal's documents and the principal can require the agent to deliver them up {***Leicester County Council v Michael Faraday and Partners Ltd*** [1941] 2 KB 205 at 216; [1941] 2 All ER 483; ***Zeus Chemical Products Pty Ltd v Jaybee Design & Marketing Pty Ltd*** (1998) 41 IPR 491}.

The duty to account is imposed by law in consequence of the existence of the agency relationship and is not founded on the existence of a contract of agency {**Appendix D**}.

Therefore if Clydesdale Bank (and the Yorkshire Bank) had entered into any *bona fide* IRS contract with an identifiable **third party**, then the banks have a duty to produce the contract documentation and records of any cash flows between the third party and the bank at the request of the retail customer {***Eisenger v Lyneham*** [1952] St R Qd 232}, including computer records. This is, in any event, part of the agent's duty to account.

An agent only has a right to be indemnified for authorised transactions within the express, implied or usual authority of the agent {***Barron v Fitzgerald*** (1840) Bing NS 201}.

An agent at general law is not entitled to an indemnity for expenses or liabilities incurred as a result of the agent's own negligence, default, insolvency or breach of duty {***Lewis v Samuel*** (1846) 8 QB 685; 115 ER 1031; ***Duncan v Hill*** (1873) LR 8 Ex 242; ***New Zealand Farmers' Co-operative Distribution Company Ltd***

v National Mortgage and Agency Company of New Zealand Ltd [1961] NZLR 969 at 971; ***Hurst v Bryk*** [2000] 2 All ER 193 at 205}

An agent who engages in a fraudulent scheme to defraud their principal forfeits the agent's right to an indemnity in respect of any transaction that forms part of the fraud {***Solloway v McLaughlin*** [1938] AC 247 at 257}, since it would be contrary to public policy to allow an indemnity in respect of an agent's own dishonesty.

The onus of establishing a right to be indemnified for an expense or liability rests with the agent {***Johnston v Kearley*** [1908] 2 KB 514 at 520, 524}.

In ***Johnston v Kearley,*** Fletcher Moulton LJ stated on page 524:

> " The onus is, of course, upon the plaintiff, and to establish his claim to an indemnity he must shew two things – first, that the alleged contracts were in fact made by him on behalf of the defendant; and secondly, that those contracts were within the scope of his authority."

Therefore if Clydesdale Bank (or Yorkshire Bank) is seeking an indemnity from retail customers for a purported damages for a breach of contract, the first step is to produce evident that confirms that *bona fide* IRS contracts with *bona fide* THIRD PARTIES were in fact made by the bank or one of the bank's affiliates on behalf of each retail customer who accepted the bank's offer of a variable rate loan with and associated "***hedging facility***".

An agent can take on a role as a trustee, especially where money is entrusted to the agent and the intentions of the parties are not clearly expressed: J.D. Heydon and M.J. Leeming, *Jacobs Law of Trusts in Australia*, 7th Edition, 2005, at [211] and ***Walker v Corboy*** (1990) 19 NSWLR 382 at 386, 389 & 397. {***Parker v Higgins*** [2012] NSWSC 1516} .

Therefore when a retail customer makes a monthly payment to the bank some of which is to pay for the interest on a variable rate loan and some is to pay for the IRHP, it could be held that the amount in excess of the amount for the payment of the interest on the variable rate loan is held on trust by the bank until such time as it is paid over to the third party providing the **Interest Rate Swap** or related *Contract for Difference*.

Again a trustee, as a fiduciary, is also under a duty to account to the principal.

Disgorgement of Unauthorised Profits

A defining feature of a fiduciary relationship is the duty of loyalty and a fiduciary cannot earn a profit from the relationship unless explicitly authorised to do so.

All moneys received on the principal's behalf must be paid over or accounted for to the principal upon request { ***Harsant v Blaine Macdonald & Co*** (1887) 56 LJQB 511, CA, ***Campbell v Kitchen & Sons Ltd*** (1910) 12 CLR 515; 18 ALR 0; [1910 HCA 23.}

Instead of complying with the obligations imposed by the "*terms and conditions*" and arranging an IRS contract with a *bona fide* THIRD PARTY, Clydesdale Bank (and Yorkshire Bank) diverted the

additional payments made by retail customers above the normal retail margin for a variable rate loan to the banks' own use without the authorisation of their principal (ie the retail customer).

Therefore both banks must account to their retail customers for these unauthorised profits and return these profits accruing since late 2008 to these retail customers.

On a typical loan facility for £1,000,000 assuming a variable interest rate margin of 1.25% overpayments on a purported "***Fixed Rate Facility***" with an fixed retail rate of 7.25% currently amount to approximately £335,000 or 33.5% of the principal of the loan, dating back to 1 January 2009.

With a loan book of around £10 billion in "***Tailored Business Loans***" therefore unauthorised profits amount to at least £3 billion before taking into account consequential claims for damages for fraud in cases where retail borrowers were forced into receivership or forced to sell other assets and incur Capital Gains Tax liabilities.

Claims for consequential damages could easily double the £ 3 billion, however the **PRA** has only directed that the **NAB** should set aside £1.7 billion to cover all claims for "***misconduct***".

Summary

The Clydesdale Bank (and Yorkshire Bank) subsidiary companies of **Australia National Bank (NAB)** engaged in fraudulent conduct by failing to do what they were contractually committed to do so as to avoid regulation by the **FSA/FSA**.

If a standalone **Interest Rate Hedging Product (IRHP)** had been offered by these subsidiary companies of **NAB**, this financial product would have been subject to regulation by the **FSA/FCA** and retail customers would now be eligible for compensation as part of the redress program administered by the **FCA**.

To avoid regulation these subsidiary companies of **NAB** were required to enter into **Interest Rate Swaps (IRS)** and related "*Contracts for Difference*" with **THIRD PARTIES** who would bear the risk of interest rate fluctuations.

This contractual arrangement placed these subsidiary companies of NAB in the role of agents for the retail customers and thus a fiduciary relationship arose.

However instead of undertaking what the stipulations (terms) of the contract required these subsidiary companies to do, no **Interest Rate Swap (IRS)** contracts where entered into with identifiable THIRD PARTIES on behalf of the retail customers.

In breach of the well know duty of fiduciaries not to make an unauthorised profit from the agency arrangement, the subsidiary companies of **NAB** made excessive unauthorised profits when official interest rates fell to historical record lows in late 2008 and early 2009.

The banks retained amounts that should have been passed onto third parties if *bona fide* IRS contracts had been arranged with identifiable THIRD PARTIES which was a stipulation in the loan contracts.

If a *bona fide* IRS contract had been entered into it is the non-faulting counter-party who is able to lodge a legally valid claim for breach of contract which is commonly referred to as a "***break cost***".

However the subsidiary companies of the **NAB** did not enter into any *bona fide* IRS contracts with identifiable THIRD PARTIES and so no legally valid claims for breach of contract can be produced.

Instead, the subsidiary companies of **NAB** produced fraudulent *in terrorem* claims for breach of contract when no such contracts existed and the sole purpose of these *in terrorem* claims was to lock retail customers into high monthly repayments on their loan facilities when official interest rates has fallen to record historical lows.

These subsidiary companies of **NAB** who took on the role of agents must now disgorge all the authorised profits and pay damages for consequential losses suffered by may retail customers due to this fraudulent conduct.

Current provisions made by **NAB** under the direction of the **PRA** are insufficient to meet these claims that will arise due to the fraudulent conduct of **NAB** and its subsidiary banks.

The **PRA** should defer the proposed demerger of Clydesdale Bank (and Yorkshire Bank) until there is a better assessment of claims due to fraud by these banks.

Key Points

- NAB sought to avoid regulatory oversight of its hedged interest rate products.
- To avoid regulatory oversight required a THIRD PARTY to be the counterparty to an Interest Rate Swap contract instead of the retail customer.
- The loan facility contract signed by the retail customer provided an authority for NAB to act as an agent for the retail customer and to enter into an Interest Rate Swap contract with a third party.
- This arrangement would protect both the retail customer and the bank from an increase in interest rates
- However even though entering into an Interest Rate Swap contract was a stipulation of the loan facility contract, the NAB breach this stipulation and failed to enter into any *bona fide* Interest Rate Swap contracts with any *bona fide* third parties.
- Instead the subsidiary banks of NAB breached their fiduciary duty as agents and made unauthorised profits by pocketing the monthly payments made by retail customers in excess of LIBOR plus the variable rate retail margin.
- The purported "***break costs***" imposed by the subsidiary banks on retail customers were and are completely fraudulent with no legal substance
- Genuine claims for damages for breach of contract (ie "***break cost***") can only be produced by the non-defaulting counter-party, which are non-existent in the case of "***Tailored Business Loans***"
- These subsidiary banks must not disgorge these unauthorised profits as well as paying damages for consequential losses
- The £1.7 billion the PRA has directed **NAB** to set aside to meet claims for "*misconduct*" is far too low when these subsidiary banks have engaged in fraudulent conduct.
- The **PRA** should now instruct **NAB** to conduct additional capital raisings to cover much higher claims due to the fraudulent conduct of the subsidiary banks, before approving the demerger of these subsidiary banks.

Appendix A

The following definition of a "***interest rate swap***" was provided by the FCA in its submission to the Court of Appeal In the case of ***Green and Rowley v Royal Bank of Scotland*** with the **Financial Conduct Authority (FCA)** being an Intervener.

This description relates to the case of a separate IRHP contract where that the payments made to the bank by the small business are fixed and the small business then able to "*net off*" the cash flows the small business receives under the separate IRHP contract.

Schedule C:

General descriptions of the following IRHPs: (i) interest rate swaps, (ii) interest rate caps, (iii) "simple" interest rate collars and (iv) "structured" interest rate collars.

Interest rate swap

1. An interest rate swap is an agreement between two parties whereby one type of interest payment is swapped for another, such as exchanging a fixed interest rate payment for a floating payment, based on a notional amount.

2. For example, a small business may enter an interest rate swap contract with its bank to 'swap' a floating rate payment for a fixed interest rate payment on a notional value of £1.5 million. Thus, the small business may pay the bank a fixed amount (e.g. 5% or £75,000) and receive from the bank a floating rate (e.g. LIBOR). In practice, this means that if the floating interest rate payment increases because LIBOR rises, the small business receives an amount above that due under the fixed payment. Conversely, if the floating interest rate payment decreases as a result of LIBOR falling, the small business continues to pay the fixed amount, but receives less in return.

3. If there is a separate variable rate loan agreement between the bank and the small business that matches the £1.5 million notional value of the swap the product can thus be used to 'fix' the interest payments on the loan, netting off the payment due under the variable rate loan and the cashflows due under the swap, remains the same at each repayment date.

Appendix B

Scottish Law Commission

promoting law reform

Review of Contract Law

Discussion Paper on Interpretation of Contract

February 2011

Bank of Scotland v Dunedin Property Investment Co Ltd

5.2 The leading modern case on how to interpret contracts in Scotland is usually taken to be *Bank of Scotland v Dunedin Property Investment Co Ltd*,[10] starting with the words used but avoiding interpretations in conflict with business reality or producing an absurd result. In that process the court is entitled to be placed in the same position as the parties were themselves at the time the contract was concluded, "not in order to provide a gloss on the terms of the contract, but rather to establish the parties' knowledge of the circumstances with reference to which they used the words in the contract".[11] The facts of the case were that the Bank (BoS) and Dunedin entered into a loan stock deed, in which a clause provided that Dunedin had a right, on giving six months' notice, to purchase the stock, but "subject to Bank of Scotland being fully reimbursed for all costs, charges and expenses incurred by it in connection with the stock". The loan was for the duration of ten years, at a fixed rate of interest. In order to hedge itself against interest rate fluctuations in the market, BoS entered into a further 'swaps' contract with another bank. Some years into the loan, Dunedin gave BoS notice under the contract that they wished to purchase the debenture stock and so terminate the fixed term loan early. BoS then sought repayment of the breakage charge which it was obliged to pay to the other bank for prematurely terminating the swaps agreement, on the basis that that payment was a cost incurred "in connection with" the stock in terms of the contract. Reversing the Lord Ordinary, the First Division held that the phrase "in connection with" did not limit recoverable costs to such matters as drafting, registration or purely administrative charges, and that BoS could therefore claim the amount of the breakage charge (some £923,253) from Dunedin.

5.3 There were some significant differences in the approaches of the judges of the First Division to the BoS claim. Rather than taking Lord Hoffmann's approach to interpretation, Lord President Rodger found it:

> "helpful to start where Lord Mustill began when interpreting the reinsurance contracts in *Charter Reinsurance Co Ltd v Fagan*[12] at p 384B-C: 'I believe that most expressions do have a natural meaning, in the sense of their primary meaning in ordinary speech. Certainly, there are occasions where direct recourse to such a meaning is inappropriate. Thus, the word may come from a specialist vocabulary and have no significance in ordinary speech. Or it may have one meaning in common speech and another in a specialist vocabulary; and the content may show that the author of the document in which it appears intended it to be understood in the latter sense. Subject to this, however, the inquiry will start, and usually finish, by

---

Supreme Court: see [2010] UKSC 47, para 26 per Lord Rodger ("it is appropriate to treat the lease as a commercial agreement which is to be construed accordingly") and para 45 (Lord Clarke). Lord Hope clearly sees the lease concerned as a commercial contract.
[10] 1998 SC 657 (hereafter "***BoS v Dunedin***").
[11] Ibid at 665 per LP Rodger.
[12] [1997] AC 313.

> asking what is the ordinary meaning of the words used.' I begin therefore, not by enquiring into the state of knowledge of the parties to the contract, but by asking myself what is the ordinary meaning of the words 'in connection with' in Condition 3."[13]

Having reached a particular understanding of the words in issue on the basis that in their ordinary meaning the words "in connection with", "while imposing a certain restriction on the costs which fall within the condition, none the less brought in costs over a wide area",[14] the Lord President then confirmed this interpretation by reference to the commercial background to the contract, including the parties' knowledge that BoS would have to engage in a further hedging transaction with a third party to minimise its risk and that charges would be incurred in the event of early termination of the hedging arrangement.[15]

5.4 Lords Kirkwood and Caplan, on the other hand, both indicated that they would have had great difficulty in reaching the Lord President's conclusion on the wording of the contract alone, since the liability which BoS in effect wished to pass on to Dunedin arose under another contract which BoS had not been required to enter under the Dunedin deal, and to which Dunedin was neither party nor aware of its precise content.[16] Each judge referred approvingly to Lord Hoffmann's approach and found it more helpful to bring in the surrounding circumstances from the start of the interpretative exercise.[17] Lord Caplan said:

> "Formal language is less important than an attempt to extract from the language what parties must in all the circumstances have intended. I am certainly not suggesting that plain words should be ignored but equally it is not useful or sensible to struggle with contorted semantic exercises if it is perfectly obvious what reasonable and informed business people must have meant if they were hoping to achieve a workable and intelligent result."[18]

This did not, however, lead to, or indeed require, any re-working or adjustment of the words used in the contract under consideration; the question was interpreting how these words applied to the dispute between the parties.

Appendix C

Principles of Business from FSA Handbook

The Principles

1 Integrity	A *firm* must conduct its business with integrity.
2 Skill, care and diligence	A *firm* must conduct its business with due skill, care and diligence.
3 Management and control	A *firm* must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A *firm* must maintain adequate financial resources.
5 Market conduct	A *firm* must observe proper standards of market conduct.
6 Customers' interests	A *firm* must pay due regard to the interests of its *customers* and treat them fairly.
7 Communications with clients	A *firm* must pay due regard to the information needs of its *clients*, and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A *firm* must manage conflicts of interest fairly, both between itself and its *customers* and between a *customer* and another *client*.
9 Customers: relationships of trust	A *firm* must take reasonable care to ensure the suitability of its advice and discretionary decisions for any *customer* who is entitled to rely upon its judgment.
10 Clients' assets	A *firm* must arrange adequate protection for *clients*' assets when it is responsible for them.
11 Relations with regulators	A *firm* must deal with its regulators in an open and cooperative way, and must disclose to the *appropriate regulator* appropriately anything relating to the *firm* of which that regulator would reasonably expect notice.

Appendix D

Ward J in the New South Wales Supreme Court stated in ***Barkley v Barkley Brown*** [2009] NSWSC 76 at [100-103}

Liability of Agent to Account

100 As her agent (and absent any attenuation by Mrs Farrell of such a duty) the first duty of Mrs **Barkley** -Brown was to keep and, at least when requested, communicate a clear account of the moneys passing through her hands. That duty was described in the following terms in ***Pearse v Green*** [1819] EngR 773; (1819) 1 Jac & W 135 at 140; [1819] EngR 773; 37 ER 327:

> "It is the first duty of an accounting party, whether an agent, a trustee, a receiver, or an executor, for in this respect, as was remarked by the *Lord Chancellor* in *Lord Hardwicke v Vernon* (14 Ves. 500 And see *White v Lincoln*, [1803] EngR 541; 8 Ves. 363) they all stand in the same situation, to be constantly ready with his accounts.

101 An agent who fails to render an account when called upon to do so will be in breach of that duty. The obligation to provide an account (again, absent express agreement to the contrary) survives the termination of the agency - ***Yasuda Ltd v Orion Underwriting Limited*** [1995] QB 174 for the reasons give by Colman J at 185-186. In that cause it was said that:

There is no suggestion in any authority - decided case or textbook - that, if there is merely a gratuitous agency, there is no duty to provide records or accounts.

Because the agent's duty to provide records of transactions to the principal is founded on the entitlement of the principal to the records of what *has been* done in his name, termination of the agent's authority to enter into further transactions should have no bearing on the continuance of the duty to provide pre-existing records pertaining to the period when transactions were authorised. Accordingly, in the absence of express agreement to the contrary, the agent's duty to provide to his principal the records of transactions effected pursuant to the agency must subsist notwithstanding termination of the agent's authority. That, as I have held, is a duty that is imposed by law in consequence of the existence of the agency relationship and is not founded on the existence of a contract of agency.

102 From ***Lord Chedworth v Edwards*** (1802) 8 Ves Jun 46; 32 ER 68 it can been seen that the failure of the principal to ask for an account, even over a long period, does not diminish the duty of the agent to keep proper accounts.

103 Therefore, it seems clear that, as Mrs Farrell's agent (to whom use and eventual custody and sole control of the bank passbook was entrusted), Mrs **Barkley** -Brown had a duty to keep proper records so that she could, if called upon, account for all funds withdrawn by her from Mrs Farrell's bank account. She could have been called upon to give that account at any time by Mrs Farrell and, after her death, by her executors."

In ***Yasuda Fire & Marine Insurance Co of Europe Ltd v Orion Marine Insurance Underwriting Agency Ltd*** [1995] QB 174 Colman J stated on page 185:

The nature of the defendant's mandate was such that, subject to express qualifications by the terms of any agency agreement, they were to keep and provide records of all transactions into which they had entered on behalf of the plaintiff including those which were in the process of being run-off: see **Halsbury's Laws of England**, 4th ed vol. 1 (1973). P. 466, para 780, **Bowstead on Agency**, 15th ed. (1985), pp 191-193, art 51, ***Pearce v Green*** (1819) 1 Jac & W 135 and Gray v Haig (1855) 20 Beav 219. The nature of the duty to keep and provide records in such a case would, by necessary imputation, involve full disclosure of records of all transaction and the current state of premium, outstanding claims.

That obligation to provide accurate account in the fullest sense arises by reason of the fact the agent has been entrusted with the authority to bind the principal to transactions with third parties and the principal is entitled to know what his personal contractual rights and duties are in relation to those third parties as well as what he is entitled to receive by way of payment from the agent. He is entitled to be provided with those records because they have been created for preserving information as to the very transactions which the agent was authorised by him to enter into. Being the participant in the transaction, the principal is entitled to records of them.

Although in modern commercial transactions agencies are almost invariably founded upon contract between principal and agent, there is no necessity for such a contract to exist. It is sufficient if there is consent by the principal to the exercise by the agent of authority and consent by the principal to the exercise by the agent of authority and consent by the agent to his exercising such authority on behalf of the principal. See ***Garnac Grain Co Inc v HMF Faure & Fairclough Ltd*** [1968] AC 1130,1137 , per Lord Pearson.....

Because the agent's duty to provide records of transaction to the principal is founded on the entitlement of the principal to the records of what has been done in his name, termination of

the agent's authority to enter into further transactions should have no bearing on the continuance of the duty to provide pre-existing records pertaining to the period when transactions were authorised....

That, as I have held, is a duty that is imposed by law in consequence of the existence of the agency relationship and is not founded on the existence of a contract of agency.