NATIONAL AUSTRALIA BANK LTD
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON DC 20549

FORM 6-K

REPORT OF FOREIGN ISSUER

Pursuant to Rule 13a-16 or 15d-16 of

the Securities Exchange Act of 1934

For the month of March 2004

National Australia Bank Limited

ACN 004 044 937

(Registrant s Name)

Level 24

500 Bourke Street

MELBOURNE VICTORIA 3000

AUSTRALIA

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F ý Form 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No ý

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82 -

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This Report on Form 6-K shall be deemed to be incorporated by reference in the prospectus included in the Registration Statement on Form F-3 (No. 333-6632) of National Australia Bank Limited and to be part thereof from the date on which this Report, is filed, to the extent not superseded by documents or reports subsequently filed or furnished.

Group Corporate Affairs

National Australia
Bank Limited
ABN 12004044937

500 Bourke Street
Melbourne
Victoria 3000
Australia

ASX Announcement

Melbourne, 12 March 2004

Board changes at the National

The National s Chairman, Mr Graham Kraehe, today announced changes to Board Committees and the appointment of a Senior Independent Director.

Mr Kraehe said the changes followed a review of Board structures and membership since he was appointed Chairman.

Directors have decided that Mr Peter Duncan should replace me as Chairman of the Board Risk Committee and that Mr John Thorn should replace Mrs Catherine Walter as Chairman of the Audit Committee, he said.

Mr Duncan, who has been on the Board for two years, has extensive international experience in finance and general management. Mr Thorn, who was appointed to the Board six months ago, has significant international accounting, auditing and management experience.

Mrs Walter, who has been on the Board for eight years, and a member of the Audit Committee for the last six years, the last three as Chairman, will leave the Audit Committee.

In due course, new Directors with banking experience will also be appointed to the Audit Committee and the Risk Committee.

Mr Kraehe said Dr Ken Moss, who has been on the Board for four years, had also been appointed as the Senior Independent Director in line with the best practice corporate governance model in the United Kingdom.

He said that the Board would also enhance existing governance processes including the annual review of Board performance and the review of individual Directors prior to their standing for re-election at Annual General Meetings.

For further information:

Brandon Phillips

Corporate Relations Manager

Group Corporate Affairs

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National s response to foreign currency options trading losses

The National s Chairman, Mr Graham Kraehe, and Chief Executive, Mr John Stewart, today announced a four point action plan to fully address all of the issues associated with recent foreign currency options trading losses.

The action plan follows a thorough and impartial review by PricewaterhouseCoopers over the last two months involving interviews with over 45 employees and third parties and research into several thousand e-mails, numerous reports and a database of 10,000 transactions. A copy of the full PwC report is attached.

The Board has also received advice from Deloitte about potential conflicts facing PwC as a result of past and current relationships in areas relevant to the review, and probity and governance advice from Blake Dawson Waldron. A copy of the advice from Deloitte and Blake Dawson Waldron is attached. The PwC report and Deloitte and Blake Dawson Waldron advice should be read together.

Mr Kraehe said: The Board is confident that a full and fair assessment of all issues has been undertaken and that appropriate remedial actions are being taken to address all of the issues raised in the PwC report and to prevent them from recurring.

Key points

Key points in the PwC report include:

the final loss arising from foreign currency options trading announced on 27 January is $360 million

the losses arising from the foreign currency options trading increased significantly between September 2003 and January 2004

four traders on the foreign currency options desk exploited loopholes and weaknesses in systems and processes to hide trading losses and protect bonuses

the trader s activities were contrary to the National s strategy of building customer-focused business the foreign currency options trading losses were reported to management by several junior employees

no customers were directly or indirectly affected by the foreign currency options trading losses

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in the Markets Division there was:

inadequate management supervision,

significant gaps in back office monitoring functions,

escalation processes that did not work properly,

weaknesses in control procedures,

failure of risk management systems; and

an absence of appropriate financial controls

there is not a suitable compliance culture within this area of the National and a tendency to suppress bad news rather than be open and transparent about problems; and

warning signals, both inside the National and from regulators and other market participants, were not properly acted upon.

1. Board changes

Mr Kraehe said Directors had accepted the proposition in the PwC report that the Board is ultimately responsible for the culture and the reputation of the National, and any losses suffered by shareholders.

The former Chairman, Mr Charles Allen, and former Chief Executive, Mr Frank Cicutto, resigned earlier this year because they felt that was in the best interests of the National and its shareholders, he said.

However, the Board accepts that further action is required. I have already announced that we are seeking two additional Directors with banking experience, one from Australia and one from the United Kingdom. This process is well advanced.

We have also made a separate announcement today concerning changes in the Chairmanship of Board Committees and the appointment of a Senior Independent Director in accordance with international best practice in corporate governance.

2. Management changes

Mr Stewart said that management changes were also appropriate.

Primary responsibility for the unauthorised trading rests with four members of the foreign currency options desk and they have been summarily dismissed from the National, he said. The four traders that have been dismissed are: Mr Luke Duffy, Mr David Bullen, Mr Gianni Gray and Mr Vince Ficarra. The Head of Foreign Exchange in the Markets Division, Mr Gary Dillon, who was the direct supervisor of the four traders, will also be dismissed.

Mr Stewart said the events surrounding the foreign currency options trading losses are being investigated by the Australian Prudential Regulation Authority (APRA), the Australian Companies & Securities Commission (ASIC) and the Australian Federal Police (AFP). Overseas authorities are also reviewing the events and the National s responses.

These agencies will determine whether any civil or criminal actions will be taken against individuals as a result of the foreign currency options trading losses, he said.

The National will continue to fully co-operate with the authorities in their investigations.

Mr Stewart said a number of other employees within the National would also be transferred or counselled as a result of the events surrounding the unauthorised foreign currency options trading.

Mr Stewart said the National had decided to review the employment of certain individuals: Those who will be leaving the National include; the Executive General Manager of Corporate & Institutional Banking, Mr Ian Scholes, the Head of Markets Division, Mr Ron Erdos, and the Executive General Manager of Risk Management, Mr Chris Lewis. Experienced managers have been appointed to these positions on a short term basis until the National completes appropriate recruitment processes.

3. Risk and control frameworks

Mr Stewart said the management team are continuing to implement remedial actions to close gaps and loopholes identified in the PwC report that were exploited by the traders or contributed to long standing breaches of policies and limits.

We will refine our risk management framework to get a more appropriate balance between management and policing functions, he said. We have already reviewed value at risk limits and reduced our risk exposure.

Weaknesses in control procedures identified by PwC have been or will be rectified without delay. This includes analysis of daily trading profits and accounts, reporting of all large and unusual transactions, investigation of all off-market rates on high risk transactions, critical review of revaluation rates sourced from third parties and a stronger back office function that properly checks all transactions.

It is totally unacceptable that employees of the National breach policies and control limits. From now on, there will be a zero tolerance policy towards unauthorised limit breaches at the National.

Mr Stewart said the management team would also review responsibilities between business units to ensure that there would be clear reporting lines and accountabilities between Risk Management, Operations and Finance functions within the National.

These and other specific issues identified in the PwC report will be addressed quickly and I will report to the Board regularly on our progress in tackling these long standing problems at the National.

4. Culture

Mr Stewart said he was concerned about references in the PwC report to staff that adopt arrogant or aggressive attitudes towards others, or who abrogate responsibility and focus on suppressing bad news rather than engaging in full and frank dialogue.

We will continue cultural change programs within the National such as Revitalisation and Making a Difference that promote positive and transparent behaviours, he said. We will ensure that these programs are actively adopted in the Markets Division of the National.

I am pleased that whistleblowers had uncovered the losses from foreign currency options trading and the National would continue to encourage and protect whistleblowers: We need more brave people that are prepared to confront bad behaviours, he said.

Mr Stewart said the management team would also review its recruitment processes, the annual appraisal processes and incentive structures to avoid inappropriate behaviours in future at the National.

For further information:

Brandon Phillips

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Investigation into foreign exchange losses at the National Australia Bank

12 March 2004

Mr David Krasnostein

Chief Legal Counsel

National Australia Bank Limited

Level 24

500 Bourke Street

Melbourne Vic 3000

12 March 2004

Dear Mr Krasnostein

Report on investigation into foreign currency losses

Please find attached PwC s report resulting from our investigation into foreign exchange losses at the National Australia Bank.

Your faithfully

PricewaterhouseCoopers

Craig D Hamer Partner	P G Rivett Partner

About this report and our investigation

This report presents the findings of the PricewaterhouseCoopers investigation of the $360 million foreign exchange losses (the losses) incurred by National Australia Bank (the National), which were announced to the market in January 2004.

The scope of our investigation

PricewaterhouseCoopers (PwC) was appointed by the National s Chief Executive Officer which was ratified by the Principal Board. PwC provided status updates to the National s Principal Board Risk Committee. The terms of reference were to:

investigate the sequence of events and trading activities that led to the losses

prepare an analysis of the losses and how they occurred, with an initial focus on foreign currency option transactions entered into on or after 1 October 2003

identify key policies, procedures, systems and control failures within the foreign currency options trading business responsible for the losses

investigate whether any customer of the National or other third party incurred a direct or indirect loss as a result of the events.

During our investigation we provided periodic updates to the National s Chief General Counsel, the Chief Executive Officer, the Chairman of the Board and the Principal Board Risk Committee. We also liaised closely with APRA and from time to time with Australian Federal Police and ASIC.

We were not asked to establish the amount of the losses. This task was conducted by management and audited by KPMG. We were asked by management to perform a limited review to ensure the procedures used by management were reasonable.

Our investigation was confined to foreign currency option transactions as described above. We did not review the transactions of any other desks within the National s trading activities.

Our investigation

The findings of our investigation are based on facts and, where appropriate, our opinion. We used a number of different methods to obtain the evidence supporting the facts, including:

- analysis of trading records
- forensic acquisition and analysis of electronic data
- analysis of other records, including minutes, internal and external audit reports and communications with regulators
- interviews with staff, directors and third parties
- analysis of telephone recordings.

Our investigation involved conducting formal, recorded meetings with over 45 National staff, some of the National s directors and former directors. We conducted many more informal interviews with National staff and third parties, and reviewed several thousand emails, numerous reports and a database of some 10,000 transactions. In addition, we accessed and analysed the National s tapes that contained recorded telephone conversations of the foreign currency options traders in the dealing room.

Given the limited time in which we were required to complete our investigation, we made judgements as to how to focus our attention and allocate our resources among a number of issues.

The people we interviewed were not under oath or legal compulsion, and we made judgements as to their credibility and the weight that should be assigned to their views and recollections. We have not sought to verify our findings with any of those interviewed, and instead have relied upon the evidence. However, we have confirmed with key people that we have been provided with all relevant reports and information relating to the trading losses.

Due to the sensitivity of the matters in this report and the timeframe of its production, we have not disclosed the content with anybody other than the Principal Board, the National s Chief General Counsel, a partner and staff at one of the firms acting as the National s external legal advisors, the probity and governance advisers to the National (Blake Dawson Waldron) and Deloitte, APRA, and the National s General Manager Corporate Strategy and Investments.

Disclosure statement

PwC is not currently nor has ever been the National s external auditor.

Summarised below are services PwC provides to the National that are relevant to this investigation, together with information on financial interests and business relationships between members of PwC s investigation team and the National.

I PricewaterhouseCoopers

a) PwC s assignments in relation to Corporate & Institutional Banking (CIB), Risk Management, Internal Audit and relevant financial controls

These include:

- a review of CIB s overall IT security framework
- advice on Basel II, IFRS and regulatory compliance
- due diligence in connection with acquisitions
- assistance in the development of financial risk model policies, whistleblower protection policies and a compliance framework for the Super 12 project.

b) PwC resources provided to Internal Audit for work in CIB

- In February 2003 PwC was selected as a preferred (but not exclusive) third party provider of resources to the National s Internal Audit function.
- Internal Audit resources provided to CIB in the 16 months to 31 January 2004 represent approximately 3% of total Internal Audit work in CIB.
- PwC personnel worked under the direction and control of a nominated Internal Audit manager of the National. Contractually, PwC did not determine scope or quality control, or review the final conclusions reached on work completed.
- A PwC partner was seconded to the National between December 2001 and May 2002 as acting Head of Technology Internal Audit for the National.
- Jim Power, a PwC partner, acted as Head of Internal Audit for CIB from 13 February 2002 to the end of October 2002.
- A PwC resource was provided for two weeks in September 2002 to assist in the review of some aspects of the IT control environment supporting Horizon, the currency options trading system.
- During 2002 and 2003, work performed included approximately 40 days of internal audit work in the area of foreign exchange trading. The work involved supervised execution of specific audit steps determined by the National.

II Investigation team Financial interests, business relationships, personal relationships

PwC personnel engaged on this assignment have confirmed that:

They have no material direct or indirect financial interest in the National.

They do not have any relationships with the National other than arm s length mortgages, personal loans and credit cards, and investments by the National offered at normal market terms and conditions.

They do not hold ordinary shares in the National that are material to their net worth.

One of the partners leading the investigation, Craig Hamer, is PwC s relationship partner for the National. His principal responsibility in this role is to ensure the overall quality of professional services provided to the National.

III Other matters

John Thorn, a former senior partner of PwC who retired on 30 September 2003, was appointed to the Principal Board of the National, in October 2003. He was appointed to the Principal Board Audit Committee on 16 October 2003.

Geoff Tomlinson, a director on the Principal Board of the National is patron of the PwC Corporate Accountability Council which hosts informal and occasional PwC round table discussions with PwC and non-executive directors of other organisations on topical matters such as corporate governance, accountability and reporting. He receives no remuneration from PwC. Mr Tomlinson was previously a consultant to PwC. His consultancy concluded in June 2002.

Michael Sharpe, a former senior partner of Coopers & Lybrand who retired on 31 March 1998, is a director of National Australia Trustees Limited, a wholly owned subsidiary of the National. He was appointed in 1996.

Independent review of PwC s relationship with the National

The National engaged Blake Dawson Waldron to consider and advise on matters disclosed above. Further, the National engaged another professional firm (Deloitte) to consider and advise the National on matters set out in I above. Blake Dawson Waldron and Deloitte have provided their opinions to the National.

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Third parties

Customers

Appendix A Terms used in currency options trading

Executive summary

This is a summary of PricewaterhouseCoopers investigation into the A$360 million foreign exchange loss (the losses) incurred by the National, announced to the market in January 2004.

Amount of the losses: The losses were calculated by the National and announced during January 2004. The final figure was A$360 million.

Traders involved: The National staff involved in the currency options trading that led to the losses were Luke Duffy, Gianni Gray, David Bullen and Vince Ficarra. We refer to them as the Traders. They were supervised by Gary Dillon, Joint Head of Global Foreign Exchange.

How the losses occurred: The Traders activities were contrary to the National s strategy. The risk exposure of the currency options desk to the US dollar increased significantly in late 2003. This exposure resulted in significant losses when the US dollar fell by some ten cents against the Australian dollar.

Analysis of the losses: At 30 September 2001 the value of the currency options portfolio was overstated by approximately A$4 million. At 30 September 2002, the overstatement was approximately A$8 million. In both cases the overstatement was concealed by false transactions.

During the financial year to 30 September 2003, the currency options Traders regularly under and over reported profits, concealing the desk s true performance.

During September 2003 new transactions greatly increased the National s exposure to the weakening US dollar. The Traders incurred losses of A$35 million in September 2003, again concealing these losses by false transactions. This enabled them to achieve an apparent annual profit of A$37 million, overstating the cumulative position by approximately A$42 million.

During October, November and December 2003 the Traders continued to exceed risk limits and falsify the true position. Growing exposures, combined with the falling US dollar, increased the 31 December overstatement of the value of the currency options portfolio to A$92 million.

Note: In Appendix A we have described some of the technical terms used in the Executive Summary

By the 12th of January 2004, false transactions with a reported value of A$185 million were included in Horizon (the currency options trading and processing system), and on 13 January 2004 the National made the first announcement of the losses, then estimated at A$180 million. By the 27th of January 2004, after adjusting for a revaluation of the portfolio, total losses of A$360 million were announced.

How the losses were concealed: The practice of concealing losses by the Traders started in September 2001, and potentially earlier. Initially, by using incorrect dealing rates for genuine transactions, the Traders shifted profits and losses from one day to another. They called this smoothing . Later they processed false spot foreign exchange and false currency option transactions to conceal trading losses.

Note: In Appendix A we have described the foreign currency terms used in the Executive Summary

The Traders entered false transactions in Horizon just before the end-of-day close, at about 8:00am the next morning. Entries in Horizon were the basis for profits and losses included in the general ledger from which financial reports are prepared. The Operations Division started the process of checking transactions at about 9:00am each day. Sometime between 8:00am and 9:00am, referred to as the one-hour window , the Traders were able to amend the incorrect deal rates and reverse the false transactions in Horizon to prevent their detection by the checking process. We understand that the Traders discovered this window accidentally during 2000.

In October 2003, the Traders identified that the back office had stopped checking internal option transactions. This provided them with the third method of concealment entering undetected, one-sided internal currency option transactions.

As a consequence of meeting profit targets in 2003, the Traders received bonuses ranging from A$120,000 to A$265,000. Some of the Traders also received bonuses for 2001 and 2002.

The impact on risk: As the currency options desk s losses increased from 1 September 2003, exposures grew larger and riskier. Although the Traders partly obscured the position by the false option transactions, many limit breaches were identified, reported and approved.

VaR limits were breached throughout 2003 and approved by Mr Dillon. Other option risk limit breaches such as vega were routinely approved by Mr Dillon. The number of breaches grew significantly in late 2003 and in January 2004.

Who discovered the losses and how: In early January 2004, a currency options desk employee raised concerns about substantial losses included in the currency options portfolio, with another currency options desk employee. Others, including an analyst attached to the desk, then inquired further over the next few days and discussed the losses with Mr Dillon. Senior management was informed on 12 January 2004 and the National suspended the Traders on 13 January 2004.

What went wrong: Our investigation revealed critical weakness in three areas in relation to the losses:

Integrity of people

Risk and control framework

Governance and culture

Integrity of people

The Traders initially misstated profits and losses by smoothing , but this developed into using false transactions to conceal significant losses. They did not behave honestly and we can only assume that they believed they would earn enough profit in the future to recover the concealed losses.

Risk and control framework

Our report details our findings on the National s risk and control framework under the four themes outlined below:

Lack of adequate supervision the Traders took large, complex and risky positions, while supervision was limited to headline profit and loss monitoring. Through concealment of the losses, CIB management derived misplaced confidence that risks were tolerable. Multiple risk limit breaches and other warnings were not treated seriously, and no effective steps were taken to restrain the Traders.

Warnings from the market about large or unusual currency transactions drew an aggressive response from representatives of the National and the concerns were passed off without proper investigation. In January 2003 letters from APRA received by the Chairman and the EGM Risk Management, did not prompt an adequate response from the National.

Risk management failed there were flaws in the design, implementation and execution of risk management. Market Risk & Prudential Control (MR&PC) knew about and reported but failed to escalate persistent risk limit breaches effectively.

Absence of financial controls our investigation identified insufficient procedures to identify, investigate and explain unusual or suspicious transactions. Normal month-end processes lacked adequate cut-off procedures and did not restate results to adjust for cancelled or amended transactions.

Gaps in back office procedures the back office failed to detect false transactions. This failure was caused in part by the one-hour window between close of day for reporting purposes and back office checking, which enabled the Traders to falsify the true position of the desk. From October 2003, junior back office staff discontinued checking internal currency option transactions. As a result, the Traders were able to process false one-sided internal options transactions without being detected.

Governance and culture

Our investigation of the currency options business gave us wide access to the National s risk and governance processes including the role and actions of the Board and its committees. As a result, we formed a view about aspects of the National s governance and culture, as outlined below:

Board oversight the Principal Board received risk management information that was incorrect, incomplete or insufficiently detailed to alert them to limit breaches or other matters related to the currency options desk s operations.

Principal Board Audit Committee (PBAC) reviewed a number of reports from a range of internal and external parties that did not alert them directly to any issues in respect of currency options. After reading the supporting papers, probing of management may have revealed the seriousness of some of the control breakdowns.

Principal Board Risk Committee (PBRC) the first meeting of the PBRC in November 2003 was not informed of the currency options desk s risk limit breaches, but was reassured that the Markets Division as a whole was well within VaR limits.

Group Executive Forum, Group Risk Forum and Central Risk Management Committee there was no evidence of escalation of issues relating to the currency options desk to these groups.

CIB management was aware of significant limit breaches and failed to investigate and take action. CIB management had little confidence in the VaR numbers due to systems and data issues, and effectively ignored VaR and other limit breaches. There was no sense of urgency in resolving the VaR calculation issues which had been a problem for a period of two or more years.

Risk management MR&PC raised warnings about the currency options desk s limit breaches and other exceptions. These warnings were not escalated to the CEO or the Board.

Internal Audit reported on significant currency options issues, but failed to follow up and ensure that appropriate controls and procedure changes had been implemented.

The National s culture there was an excessive focus on process, documentation and procedure manuals rather than on understanding the substance of issues, taking responsibility and resolving matters. In addition, there was an arrogance in dealing with warning signs (ie APRA letters, market comments etc). Our investigation revealed that management had a tendency to pass on , rather than assume, responsibility. Similarly, issues were not escalated to the Board and its committees and bad news was suppressed.

Our investigations indicate that the culture fostered the environment that provided the opportunity for the Traders to incur losses, conceal them and

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escape detection despite ample warning signs. This enabled them to operate unchecked and flout the rules and standards of the National. Ultimately, the Board and the CEO must accept responsibility for the "tone at the top" and the culture that exists in certain parts of the National.

1 **Background to the losses**

In January 2004 the National made the following three public announcements relating to losses from the foreign exchange options transactions:

13 January 2004 - an initial announcement of losses from unauthorised foreign currency trading activities estimated at A$180 million.

19 January 2004 - an update of the losses was revised to A$185 million but with a statement that they were not expected to exceed A$600 million.

27 January 2004 - an announcement that the total losses were A$360 million.

The total amount of losses ultimately announced by the National on 27 January 2004 included the impact of false transactions as well as a further amount of A$175 million arising from a revised revaluation of the trading book at 19 January 2004.

The foreign exchange losses arose within the National s currency options business which is part of the Markets Division of Corporate and Institutional Banking (CIB). The currency options business consists of a centralised global trading desk, responsible for managing a portfolio of customer contracts as well as trading in currency options contracts in the interbank markets. They also trade actively in spot foreign exchange. The Markets Division of CIB employs some 550 people. The currency options business used a purpose built system called Horizon to record, value and process the transactions.

More details are provided on the National s currency options business in Section 4 - The currency options business.

2 How the losses occurred and were concealed

KEY POINTS

The losses occurred principally because of an increase in risk-taking in the currency options portfolio, combined with adverse currency movements (particularly in the last four months of calendar year 2003 and early 2004).

The overstatements of the currency options portfolio value at 30 September 2003 and 31 December 2003 were A$42 million and A$92 million respectively. The continued weakening in the US dollar led to an escalation of these losses in early January 2004 to A$185 million. A revaluation of the portfolio increased the losses to A$360 million.

Four currency options traders Luke Duffy, Gianni Gray, David Bullen and Vince Ficarra (the Traders) were aware that significant trading losses had been incurred and concealed at 30 September 2003 and subsequently.

The practice of smoothing profits and concealing losses had been undertaken by the Traders for over two years, and possibly since 1998.

The Traders concealed losses by entering various types of false transactions into the trading system, Horizon. Various methods were used which exploited gaps in controls. The key methods were:

- incorrectly recording genuine transactions
- entering false transactions
- using incorrect revaluation rates.

The size of the positions was partially masked by false transactions but limits were still breached continuously.

One of the motivations of the Traders appears to have been the desire to achieve budgeted profits and receive bonus payments.

The foreign exchange losses were revealed by a whistleblower on 9 January 2004 and brought to senior management attention on 12 January 2004.

In this section we describe the sequence of events leading to the occurrence and concealment of the foreign exchange losses. We present our findings under the following headings:

- How the losses occurred
- Analysis of the losses
- Who was involved
- How the losses were concealed
- The impact on risk
- Who discovered the losses

How the losses occurred

The current currency options team commenced trading for the National in 1998 with three dealers, increasing to four in 2000. The team s mandate was to grow both customer business and proprietary trading income. In recent years the strategy for the Markets Division of CIB had been to increase the percentage of customer-based revenue.

Contrary to the strategy, in 2003, risk-based proprietary trading(1) activity grew significantly. So too did the size of the book. At the time of our investigation, the National s currency options business consisted of a large and complex portfolio of spot foreign exchange and currency options transactions(2). At 30 September 2003 the notional principal of the currency options book was some A$253 billion. Dealing decisions in the last quarter of 2003 resulted in a large long US dollar position against a range of other currencies. Major losses were incurred when there was a ten cent fall in the value of the US dollar against the Australian dollar.

Analysis of the losses

Set out below is a brief chronological analysis of when the losses occurred. This analysis is based on an examination of the trading and other records and

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(1) Proprietary trading means taking risk positions on behalf of the bank, unrelated to customer business.

(2) Spot foreign exchange is the purchase or sale of one currency for another where a rate is agreed between two counterparties today for physical delivery in two business days. Currency options confer the right but not the obligation to exchange currencies at a pre-determined rate and are bought and sold for a consideration known as an option premium.

interviews with dealers shows the extent to which there were discrepancies between the actual results of the desk and the profits reported in the monthly management accounts. In accordance with our terms of reference, the investigation focused primarily on the period from 30 September 2003. However, in order to understand when the loss concealment began we have reviewed transactions at various points in time back to October 2001.

Financial year to 30 September 2001

Our investigation identified that as at 30 September 2001 the value of the currency options book was overstated by approximately A$4 million. This overstatement was concealed by four incorrectly recorded spot foreign exchange transactions.

Financial year to 30 September 2002

Similarly, at 30 September 2002, the value of the currency options book was overstated by approximately A$8 million. This overstatement was concealed by one incorrectly recorded spot foreign exchange transaction.

Financial year to 30 September 2003

In October 2002 the currency options desk made profits of A$8.9 million; however, the management accounts reported a profit of only A$974,000. Accordingly, by 1 November 2002, the loss of A$7.97 million misstated in the 30 September 2002 statutory accounts had been eliminated.

During November and December 2002 the results of the desk were correctly reported in the monthly management accounts, and our investigation did not identify any false transactions at 31 December 2002.

Table 2.1 shows the extent to which the results of the desk were falsely reported in each of the months between October 2002 and August 2003. By the end of August 2003 the cumulative overstatement of the value of the portfolio was A$5.5 million. The false reporting was made possible by incorrectly recorded spot foreign exchange transactions, and involved misstating both profits and losses. This is explained later in this section.

Table 2.1: **Comparison of actual and reported results of currency options trading from 1 October 2002 to 31 August 2003**

	Monthly actual profit / (loss) A$ 000	Monthly reported profits A$ 000	(Under) / Overstatement of reported profits A$ 000	Cumulative overstatement of portfolio value at each date A$ 000
2002				
At 30 September				7,972
October	8,946	974	(7972)	0
November	3,365	3,365		0
December	2,837	2,837		0
2003				
January	2,792	3,678	886	886
February	2,559	2,650	91	977
March	2,774	1,797	(977)	0
April	(10)	2,567	2,577	2,577
May	(1,292)	4,372	5,664	8,241
June	3,390	4,558	1,168	9,409
July	12,556	7,165	(5,391)	4,018
August	(169)	1,323	1,492	5,510

Activity in September 2003

As at 1 September 2003, the currency options desk had a net long(3) spot-equivalent(4) position of US$8 million, made up of a short US$210 million spot-equivalent options position and a long US$218 million spot position against major traded currencies. If a trading book is long in one currency it is equally short in other currencies. The long net US dollar position was against short positions in a range of currencies including the Australian dollar. In net terms the currency options desk was exposed to a weakening US dollar/strengthening Australian dollar.

During September, new trades, and the revaluation effect of exchange rate movements on existing options, caused the net long position of US$8 million to increase to US$271 million. A major decline in the value of the US dollar (by four US cents versus the Australian dollar) resulted in a loss of A$34.8 million but the Traders reported a profit of A$1.8 million.

In September 2003, the currency options desk incurred losses of approximately A$1.5 million on eight separate days. On each of three days (19, 22 and 26 September) losses of over A$5 million were incurred. This level

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(3) Long means the desk has bought more than it has sold; short represents having sold more than it has purchased.

(4) The spot equivalent translates an option transaction into a comparable spot position (in terms of exposure to exchange rate movements) and facilitates an analysis of a portfolio comprising both options and spot transactions.

of loss was significantly in excess of the daily A$3.25 million VaR(5) limit for the desk.

The losses, together with the underlying risk positions, were concealed by the Traders, who entered false transactions into the Horizon trading system. This is explained in greater detail later in this section.

Although these false transactions enabled the currency options desk to apparently achieve an annual profit of A$37 million, the value of the options portfolio was overstated at 30 September 2003 by A$42 million as follows:

	A$ million
Total overstatement at 31 August 2003	5.5
False reported profit for September 2003	1.8
Actual losses for September 2003	34.8
Total overstatement at 30 September 2003	42.1

Period from 1 October 2003

During October the currency options desk reduced the long US dollar position from US$271 million to US$211 million and, despite a further weakening of the dollar, earned a profit of A$13.4 million. However, there is evidence that the reported profits might have been misstated by up to A$10 million due to incorrect revaluation rates being used. Even so, the Traders used false transactions to report profits of only A$5.7 million.

In November, the long US dollar position increased to US$363 million. A profit of A$4 million was made, but a profit of A$7.4 million was reported. Again the Traders processed false transactions to achieve this result.

During December, further trading and the revaluation effects caused the spot-equivalent position to increase to US$1,548 million. Not only was this significantly over approved limits, but it also reflected a completely unhedged position, with both the options and spot positions being long US dollars.

As a result of this large long US dollar position and the fall in the US dollar of approximately three cents in the month, the currency options desk incurred losses of A$49 million in December. These losses were concealed by false options transactions such that a profit of A$5.3 million was reported. At the

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(5) VaR = Value at Risk a statistical measure of potential future loss based on current exposures and market volatilities, and calculated for a given level of confidence. VaR is the industry standard measure of market risk.

end of December the currency options portfolio value was overstated by A$91.8 million (see Table 2.2).

Table 2.2: Comparison of actual and reported results of currency options trading from 1 September 2003

	Monthly actual profits / (loss) A$ 000	Monthly reported profits A$ 000	(Under) / overstatement of reported profits A$ 000	Cumulative overstatement of portfolio value at each date A$ 000
Prior to 1 September 2003				5,510
September	(34,780)	1,761	36,541	42,051
October	13,871	5,774	(8,097)	33,954
November	3,993	7,421	3,428	37,382
December	(49,106)	5,272	54,378	91,760

The following charts illustrate the increase in exposure to the US dollar in the period between 1 October 2003 and 31 December 2003 (Figure 2.1), the actual spot Australian dollar to US dollar rates (Figure 2.2), and the cumulative, actual and reported results for the period from 1 October 2002 to 31 December 2003 (Figure 2.3).

Figure 2.1: US$ equivalent exposures of the currency options desk from 1 October 2003 to 31 December 2003

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Figure 2.2: Australian dollar v US dollar daily spot exchange rates
1 October 2003 31 December 2003

Figure 2.3: Cumulative actual and reported results of the currency options desk from
1 October 2002 to 31 December 2003

As noted above, at 31 December 2003 the currency options desk had unrecorded losses of A$92 million and a large long US dollar position. By 9 January 2004 the US dollar had declined by a further 2.5 cents against the Australian dollar, and further losses of A$85 million were incurred. Of this, A$30 million was incurred by Friday 2 January and a further A$39 million over the weekend to Monday 5 January.

By 12 January 2004, false transactions with a reported value of A$185 million were included in the Horizon system.

On 13 January 2004 the National made an initial announcement of unauthorised foreign exchange losses, estimated at that time as A$180 million. Subsequent announcements on 19 January and 27 January increased the amount of the foreign exchange losses to A$360 million, including losses arising on the revaluation of the portfolio.

A chronology of the misstatement of the portfolio valuation is set out in Table 2.3.

The losses announced on 27 January 2004 were made up of:

	A$ million
Unrecorded losses at 31 December 2003	92
Further losses to 12 January 2004	93
Revaluation of portfolio	175
	360

Table 2.3: Chronology of misstatement of portfolio valuation

Key dates	**Impact on portfolio valuation**	
30 September 2001	portfolio value overstated by	A$4.16 million
30 September 2002	portfolio value overstated by	A$7.97 million
31 October 2002	misstatement eliminated	
30 November 2002	results correctly reported	
31 December 2002	results correctly reported	
January August 2003	profits and losses misreported	
31 August 2003	portfolio value overstated by	A$5.5 million
September December 2003	US dollar falls	
30 September 2003	portfolio value overstated by	A$42 million
31 December 2003	portfolio value overstated by	A$91.7 million
12 January 2004	portfolio value overstated by	A$185 million
19 January 2004	portfolio value overstated by	A$360 million

2 How the losses occurred and were concealed 75

Who was involved

The National staff who were involved in the currency options trading that led to the above losses were Luke Duffy, Gianni Gray, David Bullen and Vince Ficarra (the Traders). The Traders were supervised by Gary Dillon, Joint Head of Global Foreign Exchange.

How the losses were concealed

The above analysis of losses, supported by interviews of the Traders(6), shows that the practice of concealing losses (in some cases profits) and the Traders true positions started sometime before October 2001.

Initially, incorrect dealing rates were entered into Horizon by the Traders in order to shift profits and losses from one day (or period) to another. This practice was referred to by the Traders as smoothing and appears to have been accepted practice by the currency options Traders. Subsequently, two other principal methods of concealment were employed by the Traders: processing false spot foreign exchange and false option transactions.

Examination of Horizon and our interviews with the Traders indicate that the incorrect deal rates and false transactions were primarily processed by one Trader. The Traders shared their Horizon system passwords with each other, so it is not possible to be certain whether the entering of the incorrect deal rates and false transactions into Horizon was restricted to one or more of the Traders.

To process and conceal the false transactions in the Horizon system, the Traders exploited weaknesses in the end-of-day procedures. The Horizon end-of-day was generally run at approximately 8:00am the following morning to allow transactions executed in the New York time zone to be captured. The Traders entered false transactions into Horizon just before the end-of-day close. The profits and losses arising from Horizon were posted to the general ledger and used to prepare management reports and ultimately the National s financial statements. There was a difference of approximately one hour

(6) Except for Mr Ficarra, all the Traders answered questions at formal taped interviews. We have reviewed a formal written statement from Mr Ficarra.

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between this end-of-day close in Horizon and the start of the procedures whereby Operations produced the reports that enabled them to carry out checks on transactions. During this period, referred to by some as the one-hour window , the Traders had time to amend any incorrect details and thereby bypass the deal checking process carried out by Operations.

This process had to be redone each day the dealers wanted to process false trades.

We understand that the Traders discovered the window , which is illustrated in Figure 2.4, by accident some time in 2000.

Figure 2.4: Horizon processing timeline (the one-hour window)

Two of the methods of concealment relied on exploiting the time delay between end-of-day close-off of the Horizon system (which provided the general ledger with profit and loss amounts), and the instigation of the deal validation process in back office which utilised data from a second system (which received data feeds from Horizon). The third method capitalised on the fact that, from October 2003, the back office ceased checking internal transactions. This enabled the Traders to enter one-sided internal option transactions at off-market rates, thereby masking the true exposures and concealing losses.

Each of these methods is described below.

Incorrect recording of deal rates on genuine spot foreign exchange transactions

The initial method the Traders used to conceal losses appears to have been entering genuine spot foreign exchange transactions into Horizon, with deliberately incorrect transaction rates, just before end-of-day (approximately 8:00am Melbourne time). The incorrect rates were designed to generate false profits (and occasionally losses).

Within the one-hour window , amendments were then made to the transactions in Horizon to reflect the correct rates.

The profits or losses recorded in the general ledger were incorrect because they were based on incorrect transaction rates used in the end-of-day revaluation process. The concealment was possible because:

the transaction rates in Horizon were corrected by the Traders in the one-hour window

the general ledger was not re-stated as a result of the amendments made by the Traders.

Table 2.4: Examples of amended deal rates

			Rate
Trade no:1057021-1			
Initial	AUD 1,000,000	USD 7,500	0.0075
Correct	AUD 1,000,000	USD 607,500	0.6075
Trade no:1047603-1			
Initial	JPY 2,945,000,000	USD 20,000,000	147.25
Correct	JPY 2,433,600,000	USD 20,000,000	121.65

Entering false one-sided spot transactions

The second method involved creating false one-sided internal spot foreign exchange transactions. These transactions typically recorded a profit in the currency options book but as they were one-sided, did not record a corresponding loss in another book, desk or business unit. Before 8:00am (Melbourne time), a one-sided internal spot foreign exchange transaction was entered in Horizon with no equal and offsetting transaction elsewhere within the National. The transaction rates were off-market, giving rise to an immediate profit from the end-of-day revaluation process. This profit was included in the general ledger as part of the normal processing.

Within the one-hour window the one-sided spot transaction was cancelled or surrendered . Surrendering is a function of the Horizon system that leaves the transaction record in place, but reverses the accounting entries and suppresses it for certain reports. The surrendered transactions do not appear in reports detailing unmatched or one-sided internal transactions. In addition, the back office did not validate or match surrendered internal transactions. Further, there was no cash settlement at maturity (two days later for spot trades), when other back office checks would have detected it as false.

The Traders discussed false spot transactions during several recorded telephone calls from mid September 2003(7), which we have matched to entries made in Horizon. For example, in one telephone conversation on 25 September 2003, two of the Traders discussed the value of the false transactions that were required to hide the losses in various portfolios. Some of the rates used were significantly off-market. A number of these values can be matched exactly to internal transactions entered into Horizon shortly before end-of-day on 25 September, that are then surrendered immediately after the end-of-day process is complete. Table 2.6 sets out the transactions that were entered into Horizon following that conversation and subsequently surrendered following the closure of Horizon for end-of-day processing.

Table 2.5: Surrendered false one-sided internal spot transactions 25 September 2003

Trade no	False profit generated	Currency	Time created	8am Horizon close off Time surrendered
1075875	5,700,000	AUD	7.12 am	8.02 am
1075876	3,400,000	EUR	7.12 am	8.02 am
1075877	1,677,850	USD	7.13 am	8.02 am
1075878	659,500	USD	7.16 am	8.01 am
1075879	8,451,500	USD	7.17 am	8.01 am
1075880	140,000	NZD	7.19 am	8.01 am

(7) In the time available, PwC s analysis of telephone conversations was limited to specific times and to specific extensions from 15 September 2003.

The effect of the false transactions was to create a false profit in the general ledger the same day. The following day, when the transactions were surrendered, the false profit was reversed. However, new false transactions were created (and surrendered) on a daily basis to essentially roll forward the false profit or loss and conceal the real position.

We have identified 467 false internal spot transactions in 2003.

Entering false one-sided internal options

The final method, which also initially used the surrendering process, was the creation of false one-sided currency options.

A taped conversation between the Traders indicates that false option transactions were first discussed on 22 October 2003. From that date, regular daily telephone conversations were held between two of the Traders, and occasionally with a third, during which positions would be discussed and false option transactions agreed. These transactions would then be entered into Horizon to obscure the risk positions and record false profits.

Table 2.6 sets out false option transactions that were entered into Horizon and surrendered following the telephone conversation on 22 October 2003.

Table 2.6: Surrendered false one-sided internal options transactions
22 October 2003

Trade no	Buy/ Sell	Call/ Put	Deal Amount	Currency	Time created	7:37am Horizon close off Time surrendered
1078511-2	B	C	300,000,000	AUD	6.20 am	7.39 am
1078511-3	B	P	300,000,000	AUD	6.20 am	7.40 am
1078512-2	B	C	300,000,000	AUD	6.22 am	7.40 am
1078512-3	B	P	300,000,000	AUD	6.22 am	7.39 am

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It is apparent from the taped conversations that the Traders initially assumed that back office were checking internal options transactions, and the false options were therefore surrendered in the one-hour window (as with the false one-sided internal spot foreign exchange transactions, surrendering reverses the accounting entries and suppresses it from certain reports). However, from 24 October 2003 the false options transactions were not immediately surrendered. A discussion between the Traders on 6 November 2003 reveals that by this time they were aware that the back office was not checking internal transactions, and that one-sided transactions would therefore not be identified.

By using options with longer maturities rather than spot foreign exchange, there was no need to surrender and roll forward every day. However, the one-sided transactions had to be surrendered prior to maturity, when a cash settlement would be required and the fact that the transactions were false would be discovered.

The principal objective of the false one-sided option transactions appears to have been to obscure some of the risk measures used to monitor trading. We have identified 78 false one-sided internal options in 2003. Many of these transactions gave rise to small profits on initiation (day-one profits) but a few resulted in day-one profits of significant amounts, and in particular on 15 December one gave rise to a profit of US$40 million. As market prices moved, further profits and losses were generated from the false one-sided option transactions.

Revaluation of the portfolio using incorrect rates

Based on our interviews of the Traders, incorrect revaluation rates could have also been used to value the currency options portfolio for much of the period from July 1998. The revaluation process of currency options was poorly controlled, with only limited independent checks or reviews on the volatility rates supplied by third parties to value the currency options portfolio. At least two of the Traders prepared schedules containing revaluation rates which were emailed to third parties used by the National. These rates were emailed back to the National unamended. We have not established whether there is any effect on the value of the currency options portfolio at year-end as a result of using these rates but have identified some evidence of the reported results being impacted at other times.

End-of-year profit targets

False one-sided internal spot transactions appear to have been used to ensure the currency options team met profit targets for the financial year ended 30 September 2003. Various taped conversations between three of the Traders in September and October 2003 included comments about the need to make budgeted profits for the year to 30 September 2003, and for losses to remain concealed to ensure that their bonuses would not be affected.

On the morning of 1 October 2003 four false internal spot foreign exchange transactions were entered into Horizon shortly before the end-of-day process for 30 September 2003, and surrendered immediately after (see Table 2.7). These transactions affected the trading results for 30 September 2003 by overstating the value of the portfolio by A$42 million, which ensured the desk reported a yearly profit just above the budget for the year(8) of A$37 million.

Table 2.7: Surrendered false one-sided internal spot transactions
30 September 2003(9)

				8:53am Horizon close-off	
Trade no	**Portfolio**	**Amount**	**Currency**	**Time created**	**Time surrendered**
1076450	Trading\JPY-USD	10,500,000	USD	7.59 am	9.02 am
1076451	Trading\EUR-USD	1,376,140	USD	8.00 am	9.02 am
1076452	Proprietary\AUD-USD	16,244,739	USD	8.01 am	9.02 am
1076453	Trading\NZD-USD	398,875	USD	8.12 am	9.02 am

The following table (Table 2.8) shows the performance bonuses paid to the Traders for the year ended 30 September 2003. If the above false transactions had not been processed prior to 30 September 2003 and the accumulated losses not concealed during October 2003, we have been informed that these bonuses would not have been paid.

(8) The National has a 30 September year end for financial reporting purposes.

(9) The transactions are actually recorded on 1 October 2003, but before the 30 September 2003 end-of-day general ledger process.

Table 2.8: Bonuses paid to the Traders

Dealer	2003 A$
Luke Duffy	265,000
Dave Bullen	215,000
Gianni Gray	190,000
Vincent Ficarra	120,000
Total	790,000

The impact on risk

Large losses were incurred in the period from 1 September 2003, and during the final part of 2003 positions were taken that grew increasingly large and risky. Although in some cases the true risk position was obscured by the false transactions which were structured by the Traders to achieve this goal, a large number of limit breaches were approved on a daily basis by Mr Dillon, and at various times reported to the General Manager Markets Division (Ron Erdos). A daily summary of limit breaches was sent for a period to Mr Erdos who then delegated the review to the Head of another desk in the Markets Division.

The VaR position records show that limits were persistently breached throughout 2003. The VaR position then escalated significantly in January 2004. Both these points are clearly illustrated in Figure 2.5 below.

Figure 2.5: Currency options daily desk VaR

Other options risk limit breaches such as vega (commonly referred to as the Greeks (10)) were also routinely reported to and approved by Mr Dillon and reported to others in the Markets Division as noted above.

It appears that CIB management s principal focus in overseeing the currency options desk was on the reported results, with less focus on risks and the nature of transactions being undertaken. Since the results were being smoothed , and losses concealed by means of the false transactions, management derived misplaced comfort that the underlying risks were within acceptable limits.

The following charts show reported spot sensitivity and vega positions, and their respective limits, from October 2003 to January 2004.

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(10) Options are complex instruments. In simple terms, option values are sensitive to five key variables which are routinely measured and compared against limits. These are strike price; time to maturity; market prices; market volatilities and interest rates. By market convention, the corresponding measures have been labelled with letters in the Greek alphabet, eg delta, theta, gamma etc. Hence option value sensitivities are known collectively as the Greeks .

Figure 2.6: Currency options desk spot sensitivity(11) (delta)
October 2003 January 2004

Approved limit range

< reported position

Figure 2.7: Currency options desk volatility sensitivity(12) (vega)
October 2003 January 2004

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(11) Spot rate sensitivity measures the impact on portfolio value to a pre-determined shift in underlying spot rates. In the National s case this is a shift of 1.5%. This limit is equivalent to having a spot position of approximately US$50 million at a 0.7600 exchange rate. In comparison, the National s spot desk position limit was US$110 million. This is similar to, but not the same as the theoretical measure of delta. This measure should have picked up the escalating spot positions in late 2003 but was disguised by both false options transactions and false foreign exchange contracts. Even with these, the measures were still significantly outside limits. This was a soft limit only (see page 43).

(12) Vega is a measure of the impact on portfolio profit and loss from a change in implied market volatilities used to revalue the options. There is evidence that a series of false options transactions was undertaken to specifically mask this risk measure. However, recorded vega for the desk was still often outside limits after September 2003. This was a hard limit.

Approved limit range

< reported position

Lack of confidence in VaR

The situation was exacerbated by questions over the ability of the risk systems to correctly calculate VaR and the quality of the data used in the calculations. This situation had existed for the last three years. CIB Management s confidence in the numbers was undermined to the point where VaR limit breaches were effectively ignored.

The result was a disconnect between the Board s view on the level of risk appetite and how risk was managed and monitored in CIB.

Who discovered the losses

The process of discovery of the losses and false transactions at the currency options desk started at about 7:00am the morning of Friday 9 January 2004. A member of the currency options team revealed concerns about the true position of the desk to another member of the currency options team. The information was passed to another employee supporting the currency options team. At approximately 11:00am on Friday 9 January 2004, this employee approached Mr Dillon and discussed the matter. This employee later investigated Horizon and discovered a loss in the books of approximately US$40 million.

The process of discovery proceeded over the weekend of 10/11 January, with various conversations between the Traders, the employee and Mr Dillon. By the evening of Monday 12 January the losses had been estimated by the employee at US$120 million. Late on 12 January the General Manager Markets, Mr Erdos, was informed of the foreign exchange losses. On Tuesday 13 January 2004 the Traders were suspended by the National.

Forensic analysis of one of the Trader s email files reveals that around 6:30am on Tuesday 13 January 2004, over 14,000 emails were deleted. There appears to be little pattern to the deletion, but these emails have been recovered and reviewed to identify matters relevant to the investigation. We could find no evidence that any similar large-scale deletions were made to the other Traders email files.

3 **What went wrong**

KEY POINTS

The Traders concealed the true position of the currency options portfolio.

Poor supervision of the Traders allowed them to trade not in accordance with the agreed strategy. The principal focus in overseeing the currency options desk appears to have been on the reported results, with less attention devoted to risks and the nature of transactions being undertaken.

The controls and procedures in Operations and Finance were inadequate or non-existent.

Risk limit breaches were routinely reported to and approved by the Joint Head of Global Foreign Exchange and reported to others in the Markets Division. These limit breaches were not investigated properly.

Risk Management did not escalate properly the persistent limit breaches. The need to resolve issues with VaR were not given sufficient attention and urgency.

A number of warning signs (APRA, Internal Audit, Risk Management, and the market place) were not properly and fully responded to.

The culture of the National was one to focus on good news and the Board was not informed of important issues.

The avoidance of excessive risk-taking and of losses from currency options trading requires the consistent operation of a reliable internal risk and control framework to prevent and detect accounting and other errors; an appropriate level of governance to check and oversee how the organisation operates; and people with integrity. Normally, if any one of these aspects breaks down or is weak, the others compensate to prevent serious losses arising. In situations where all three are weak, this then provides the opportunity for losses to arise and not be prevented or detected.

We have referred to a number of authoritative documents and guidance notes to assist in our assessment of what went wrong . These include:

APRA Standards

ASX Council, *Principles of Good Corporate Governance & Best Practice Recommendations*

AFMA SCOR Framework

Committee of Sponsoring Organisations of the Treadway Commission (COSO)

The Basel Committee on Banking Supervision

US OTC Industry Derivatives Policy Group (DPG)

Group of Thirty (G30) Report, *Derivatives: Practices and Principles* and *Enhancing Public Confidence in Financial Reporting*

However, the most relevant and the most widely used benchmark for derivatives such as currency options are the G30 reports. The reports provide best practice principles for the management oversight, valuation and risk management, as well as systems, operations and controls over derivative activities.

In relation to the foreign exchange losses our investigation identified critical weaknesses in all three areas:

- Integrity of people
- Risk and control framework
- Governance and culture.

The integrity of people

For a number of years the Traders misstated the profit and loss of the currency options desk using the practice of smoothing. The smoothing progressed to concealment of significant losses by processing false transactions to conceal the true position of the currency options desk. They did not behave in an honest manner and concealed losses on the assumption that one day, they would earn enough profit to reverse the previously concealed losses.

The risk and control framework

Most leading financial institutions take an enterprise-wide approach to managing risk and ensuring financial control, which also allows for appropriate levels of management discretion within business units. This typically involves a matrix of responsibility between business units, risk management, operations and finance, with each reporting separately to the Chief Executive Officer (CEO).

The allocation of responsibilities between and within these business areas depends on, amongst other things, the business model which the organisation has chosen to adopt, as well as practical considerations such as organisation structure, operating locations and business process design.

Accordingly, there is no one model of risk management and financial control which is best practice. However, there are a number of standards and benchmarks which various bodies have published for regulatory and general guidance purposes.

The National s approach to risk management, in summary, is to place the primary responsibility and accountability for managing risk and ensuring financial control in the hands of business units. This is reinforced at various levels by analysis, monitoring and reporting procedures executed by Group

Risk and Group Finance. This is consistent with the approach taken by many large financial institutions.

We have summarised our findings on the National s risk and control framework into the following themes:

- The currency options trading activity lacked adequate supervision.
- Risk management failed.
- There was an absence of financial controls.
- There were significant gaps in back office procedures.

The currency options trading activity lacked adequate supervision

The CIB strategy was to build the percentage of customer-based income supported by reduced levels of proprietary trading using the bank s balance sheet. This strategy was also to apply to the currency options desk. However, it is clear from transaction records and other evidence that Mr Dillon and the General Manager Markets Division, Mr Erdos, failed to enforce that strategy in respect of the currency options business. In fact it appears that the Traders reversed the strategy by focusing largely on proprietary trading and large, complex position taking. Supervision of the currency options desk was limited to monitoring headline profit and loss reports, and did not involve gaining a full understanding of the transactions being entered into and the related risks.

We have not seen any demonstration that senior and executive management, other than those in Group Risk Management, had an adequate appreciation of the risks involved in trading currency options.

Day-to-day involvement and supervision of the Traders by Mr Dillon was minimal and there appears to have been little supervision by any other management in the Markets Division, other than a review of reported profits. The fact that relatively stable profits were reported was interpreted by CIB management to mean that the strategy was being followed successfully. There is, however, significant evidence that this was not the case. For example:

multiple limit breaches were routinely signed off without rigorous investigation or actions taken to reduce positions transactions were occasionally undertaken before Product Usage Authorities (PUAs)(13) had been fully signed off

warning signs received from the marketplace were ignored or not properly and independently investigated

although staff appraisals of the Traders contained adverse comments about excessive risk-taking, no effective steps were taken to constrain their behaviour.

The VaR and limit monitoring process

Market Risk & Prudential Control (MR&PC) produces a daily risk report which includes details of risk positions (VaR and the Greeks) as well as identifying any limits that have been breached. However, due to the concerns over the reliability of the VaR calculation, the VaR limit breaches in currency options was removed from the front page of the report from April 2002 until just before the discovery of the losses in January 2004. Breaches of other limits were reported every day and with increasing frequency in late 2003. These limit breaches were entered into an excesses database for electronic approval and were approved by Mr Dillon.

(13) PUAs are discussed further in Section 4

For the three years to October 2003 the VaR calculations performed by Market Risk and Prudential Control (MR&PC) were not able to reflect the smile (14) in the valuation of currency options, and as a result the VaR produced by the system was known to be unreliable. MR&PC used an external system (Infinity) and needed to upgrade to a new version which could deal with the various option types used by the currency options desk. The system upgrade went into production in October 2003. MR&PC had not been able to upgrade earlier because it was not the only user of Infinity and the decision to upgrade needed the approval and budget of CIB.

Throughout parallel running and during live running of the upgrade, VaR numbers were consistently higher than the agreed limit for currency options (meaning the National s exposure was greater than approved). The VaR numbers were rejected by the Traders as they claimed the VaR calculation was still unreliable.

No urgency was given to, first, the resolution of the differences between MR&PC and the Traders view of the VaR calculations, and second, the many breaches of other limits by the currency options desk. Indeed, the matter was mentioned under other business in the October 2003 meeting of the CIB Risk Management Executive Committee (RMEC). In the meeting of the same committee on 13 November the matter was brought forward as an action item on the agenda for the meeting on 21 November. At the 21 November meeting limit breaches were not on the agenda or referred to in the minutes. The issue of limit breaches was also on the agenda for the meeting on 16 December but the presentation was deferred due to other agenda items overrunning. However, the matter was discussed briefly at the end of the meeting.

The minutes of the 16 December meeting record that the General Manager MR&PC (Tzu Ming Lao) and the General Manager Markets Division (Mr Erdos) were to work on the excesses with the aim of achieving the 31 January 04 reduction target as the milestone and to report back to the Committee at the next scheduled CIB RMEC meeting .

If VaR could not be calculated with confidence, the trading in new transaction types should not have been approved or should have been limited to a small

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(14) The five key factors which influence option values are the strike price, time to expiry, market prices, market volatilities and interest rates. For a given quoted option, it is possible to work out the market volatility from the option price (implied volatility). The volatility smile describes a market phenomenon whereby options with the same expiry but different strike prices have different implied volatilities. Therefore, in estimating the market value of an option, it is important to use a volatility parameter which corresponds with its strike price.

number, each of which should have been carefully scrutinised. This should have placed increased emphasis on other limits such as the Greeks.

If limit breaches were not being investigated properly and VaR could not be calculated reliably, then effective risk management of currency options was not possible and good business sense would require trading to be carefully managed, curtailed or ceased altogether.

It appears that the main focus in overseeing the currency options desk, especially by the General Manager Markets Division (Mr Erdos), was the reported results and the loss referral limit(15). Since the results of the currency options desk were being smoothed , management derived misplaced comfort that only acceptable risks were being taken. The Greeks and other sensitivity limits are at least as important as a VaR limit in an options portfolio, and should have been properly investigated and reviewed by Mr Dillon, Mr Erdos and MR&PC. If the underlying transaction details in Horizon had been investigated to understand the risks in the currency options portfolio, it is highly likely the false transactions would have been identified.

Large and unusual activity

The Traders also entered into a number of large or unusual transactions, including deep-in-the-money options(16) and other complex structured transactions. Some of the large and unusual transactions were identified by Operations and referred to MR&PC and others were the subject of market speculation.

For example, on the 9th and 10th of October 2003, the currency options desk sold two in-the-money options to another bank for an aggregate premium of US$322 million. One of these was identified by Operations as being unusual and was referred to MR&PC, who duly sought an explanation from the

(15) Loss referral limits are designed to highlight when cumulative trading losses over a specified period of time reach a certain threshold. They are an important complement to VaR and other limits.

(16) Options can be bought and sold at different strike prices and the premium varies accordingly. Depending on the relationship between the strike price and the prevailing market rate (exchange rate in the case of currency options), they are referred to as being at-the-money (the strike price equals market rate), in-the-money (the strike price relative to market rate favours the option buyer and this intrinsic value is reflected in the premium paid), or out-of-the-money (the strike price is unfavourable relative to the market; however, because the buyer has no obligation to exercise the option, the premium is reduced rather than extinguished or negated). It is relatively unusual for corporate clients to purchase deep in-the-money options because of the high premium outlay, and most would favour at-the-money or out-of-the-money structures for hedging purposes. Interbank options trading is normally at-the-money due to the higher liquidity.

Traders. The explanation given was that the deals were done to help fund their cash position and the transaction was cheaper than borrowing the funds internally through the National s funds transfer pricing system. The bank concerned also raised the matter with the National but aside from referring the matter to the EGM Risk Management, the investigation appears to have gone no further. In particular, there was no investigation into why the desk had such a funding need in the first place, or of the commercial validity of the deals.

In March 2002, another Australian bank raised concerns over the size and risk profiles of the transactions being conducted by the currency options desk. In March 2002, Mr Dillon and a member of MR&PC visited the bank that had expressed concern to discuss the unusual nature of some of the transactions executed by the National. Internal National emails as well as correspondence from the other bank indicate that there was an aggressive response, and the concerns were passed off as the other bank not understanding the National s trading strategy and pricing model. Effectively, the message conveyed to the other bank was that if rumours of this nature emanated from them (or the brokers used by the other bank), the National would end its dealing relationships with the bank/broker concerned.

An independent, full and proper investigation into these and similar concerns did not take place. Neither were these concerns reported to the CEO or the Board.

It is clear that MR&PC raised a number of issues with various levels of CIB management, which in many cases were also passed to the Executive General Manager Group Risk Management (Chris Lewis). However, MR&PC did not ensure that such issues were actioned properly or otherwise appropriately resolved.

Risk management failed

It is clear that there were flaws in the design, implementation and execution of risk management. The National s risk management framework places primary responsibility for managing and controlling risk in CIB with CIB management. It appears that the emphasis placed on CIB to take responsibility for managing its risk meant that Risk Management (and in particular MR&PC) could not fulfil an effective policing role. Attempts by MR&PC to enforce limit compliance were effectively ignored and they were not supported by the EGM Group Risk.

The requirement for breaches of desk VaR limits to be reported and approved by no-one higher than the relevant trading and global product head Mr Dillon in both cases, for currency options was a clear design flaw(17).

The situation was exacerbated by a lack of clarity in relation to the division of risk management responsibilities between CIB management and MR&PC. It is clear that the business model was not well understood by CIB management, who viewed the independent risk function as having a stronger compliance brief than the Risk Management function exercised in practice. Accordingly, while risk was an acknowledged business concern, there was a tendency to push the boundary on risk in pursuit of revenue targets. This confusion was not helped by the CIB policy manual, which in section 11.01 (General Policy Responsibility and Segregation of Duties) states that The General Manager MR&PC is the Group s controller of the VaR pool, with specific responsibility for maintaining the integrity of the control framework, daily reporting and monitoring of excesses, and initiating actions to reduce risk positions if the dimension warrants . This is a clear disconnect, in respect of the authority to reduce risk positions, between the CIB policy and the National s risk framework and what happened in practice.

Regardless of how the policy should have been interpreted, the execution of the risk management function and the escalation of emerging issues in relation to the currency options desk failed. The principal failings were:

For a long period of time, the daily risk report produced by MR&PC identified a large number of limit breaches. MR&PC reported these to the business in accordance with agreed procedures, but did not escalate the continuous limit breaches further.

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(17) Only breaches of regional and global VaR were required to be reported to executive management.

Although MR&PC did escalate the breaches of the PUA process, the business still entered into a number of unapproved transactions with relative impunity. In some cases PUAs were used to make good existing limit breaches, or were requested after the event.

MR&PC relied upon a number of disparate systems to calculate VaR and had acknowledged for three years that the VaR for currency options was not reliable. The resolution of this problem was not given sufficient urgency or priority.

MR&PC was responsible for confirming the source of certain parameters used to revalue the currency options portfolio. They did not undertake procedures to review the reasonableness of parameters actually received to ensure that they reflected current market conditions and translated into appropriate values.

There was an absence of financial controls

Our investigation did not find any procedures in CIB Finance to identify, refer and then investigate fully transactions of an unusual or suspicious nature and ensure proper explanations were obtained. In addition, normal month-end processes should have involved proper cut-off procedures (but did not) in particular, a review of any cancelled or amended transactions in the first few days following the month end. Any of the following basic financial control procedures might have identified the concealed losses:

investigation of transactions with high day-one profit or loss, high premium or deferred premium or transactions done at off-market rates

analysis of the profit and loss and deal volumes between customer and proprietary trading

analysis and corroboration of profit and loss drivers, market price movements and the size, nature and risks of the portfolio

analysis of portfolio, customer, deal type concentrations

review of the revaluation rates used at month-end.

It is not clear who had responsibility for the above controls, but it is apparent that controls either did not exist or did not operate effectively. Typically such controls are performed by a function which reports to the CFO.

In the National, finance functions are embedded in the business units like CIB, with dual reporting lines to the business unit EGM and the Chief Financial Officer (CFO).

There were significant gaps and omissions in back office procedures

Operations (or back office) is the CIB division responsible for processing all transactions in the Markets Division, including verification, confirmation, settlement, reconciliations and end-of-day processing. Operations is structured to align with the trading desks, and a dedicated team supports the currency options desk.

In respect of currency options, Operations is responsible for checking transactions as recorded in Horizon, confirming all external transactions, and, until October 2003, checking internal transactions (ie transactions between National entities and between National desks).

In respect of spot foreign exchange transactions, the Operations validation procedures for the currency options desk were not designed properly in that they were based on information that was produced approximately one hour after the daily profit and loss was determined. This window gave the Traders the opportunity to enter false transactions, which were reflected in the reported results, and then amend or surrender them so that they were not included in the information used for Operations validation purposes. This was repeated on a daily basis without detection. Operations did not check that amended or surrendered transactions were valid. Specifically, there was no checking of surrendered internal transactions as the assumption was that they were automatically matched and no checking was necessary.

In early October 2003, losses were experienced in currency options because a genuine internal transaction between the currency options desk and the forward foreign exchange desk had been incorrectly entered into Horizon. At this time discussions took place between traders on various desks and Operations about the process of checking internal transactions. Management in Operations considered that they were merely responsible for ensuring that internal transactions were equal and opposite, not that they were valid. There was an exchange of emails between one of the Traders and Operations management, following which an email was sent by Mr Duffy to a number of front office staff, reminding them that they were responsible for entering internal trades correctly. An extract of the email stated:

The currency options back office does not check internal deals. At least in the short term, this situation will not change. This means input errors will not be picked up by back office.

This email was copied to the junior staff in Operations but not the managers in Operations by way of a group email list.

For reasons that are not clear to us, the junior staff in Operations interpreted Mr Duffy s email to mean that they were no longer required to carry out any checks on internal transactions in Horizon, including checking that internal transactions were equal and opposite. This was not discussed with the managers responsible, who were unaware that their staff had stopped following agreed procedures. As a result of this unauthorised change in procedure, the Traders were able to process false one-sided internal options transactions without them being detected.

Governance and culture

Although our investigation has concentrated on a small part of one business unit within the National, it has given us access to the workings of the Board, its committees and some group-wide functions, such as finance, internal audit and, importantly, risk management. This access has allowed us to form a view of certain aspects of the National s governance and culture, and we summarise our findings below.

Board oversight and governance

The Board is ultimately responsible for any financial loss or other reduction in shareholder value suffered by the organisation. It has a duty to shareholders to ensure that the requisite systems, practices and culture are in place to manage all the risks to which the organisation is exposed. It discharges this responsibility directly and through various committees and by its supervision of management. A number of reports which could have identified matters relevant to the foreign currency losses were submitted to the Board, committees of the Board, and management groups. These are summarised in the following paragraphs.

Board

The most relevant report provided to the Board was a Risk Management Monthly Board Report. This report did not provide information at a level of detail sufficient for the Board to have identified limit breaches or other issues with the currency options desk. However, we would expect to have seen a comment at some point in 2003 that there were difficulties in calculating VaR, and that limit breaches were occurring. In addition, in April 2002, when VaR for currency options was removed from the daily management report due to issues relating to accuracy and reliability, we would have expected this to be noted in the report. Furthermore, one of these reports, dated November 2003, stated that in relation to currency options there was a long Australian dollar position, when in fact the records at the time show a large short position. Correct reporting of the position could have prompted discussion of the situation at the 15 December 2003 Board meeting.

PBAC

The Board delegated the evaluation of the adequacy and effectiveness of risk management and financial control, and other internal control systems, and the evaluation of their operation, to the Principal Board Audit Committee (PBAC) until the establishment in August 2003 of the Principal Board Risk Committee (PBRC).

The PBAC met on a regular basis (eight meetings in 2002, seven meetings in 2003 and four meetings in the three months to December 2003). The PBAC considered a range of matters within their charter including risk management up to and including the 6 November 2003 meeting where a presentation under the heading of Risk included the APRA Tripartite Arrangements.

Information provided to PBAC over the last two to three years contains no reports alerting PBAC to issues relating to the National s currency options business. PBAC received directly a range of reports, in particular the January 2003 APRA letter and the report on the learnings from option losses suffered by AIB. Having read these reports, probing of management may have revealed the seriousness of some of the control breakdowns that existed in relation to the currency options business, such as the inability to reliably calculate VaR and the numerous limit breaches.

PBAC receives details on any high risk issues raised by Internal Audit as well as copies of the reports from the external auditors, KPMG. PBAC also receives reports from Risk Management, Compliance and others on an ad hoc basis.

Reports submitted to PBAC

The APRA letter

PBAC requested and received copies of the APRA letter after it had been received in January 2003 and replied to by EGM Risk in February 2003. From the summary submitted to PBAC, the impression gained would have been that the matters raised were relatively minor and were being addressed. This is consistent with the introduction to APRA s letter which notes that overall they did not identify any issues causing significant concern. In fact, the detail of the letter raised issues which were highly relevant to the foreign exchange losses which were subsequently incurred.

Internal Audit reports

Throughout the last five or so years a number of reports were prepared by Internal Audit on the trading activities and controls over the currency options desk. The most significant was an Internal Audit report issued in December 2001, which identified a number of important control weaknesses in currency options. However, because of the introduction of a new Internal Audit rating system, the Internal Audit report prepared for the quarter ended 31 December 2001 and presented to PBAC did not include the relevant issues identified in the 2001 report.

KPMG reports

KPMG reports received by PBAC identified a number of issues relevant to the foreign exchange losses from the audits conducted in 2001 and 2002. These issues were rated as minor and therefore would not have attracted the attention of PBAC. In relation to 2003, the reporting to PBAC by KPMG before the clearance of the 2003 financial statements in November did not raise any significant issues in relation to limit breaches. By the time the draft management letter was issued to management on 10 December 2003 and the final management letter was issued to PBAC in February 2004, a number of 3-star (major) issues in relation to currency options were highlighted. KPMG did not raise issues related to the absence of financial control over currency options.

Report on learnings from the AIB report

PBAC also received a report in May 2002 on the learnings from foreign currency losses at AIB. The minutes of the meeting identify that, unlike AIB, the National uses VaR and other sensitivity measures to ensure that variations from the normal expected trading ranges are identified. However, there were known inaccuracies in the VaR calculations at that time, and this was not reported to

PBAC.

PBRC

The PBRC was established in August 2003 but met for the first time only in November 2003. At the first meeting a market risk presentation indicated that the Markets Division business was well within VaR limits, and no mention was made of limit breaches. This may have been true of the business as a whole; however, at the time of this meeting there was considerable discussion between the Markets Division and MR&PC about the extent of limit and VaR breaches, particularly for the currency options desk. This was not reported to the PBRC.

CIB management

Three reports from Internal Audit on global foreign exchange (May 1999, December 2001 and January 2003) were issued to CIB management, which contained significant matters in relation to currency options in 1999 and 2001. It is apparent from email correspondence at that time that senior CIB management did not treat these issues as seriously as they deserved and indeed tried to dismiss them in the context of building a currency options business.

Numerous limit breaches and PUA exceptions were reported to CIB management. A summary of the daily limit excesses was sent by MR&PC to the General Manager Markets (Mr Erdos), who delegated the review to the Head of Money Markets. No action was taken to investigate the limit breaches properly.

Risk Management

MR&PC had a significant number of problems with the currency options desk which arose on an almost daily basis. For example:

- numerous and multiple limit breaches
- exceptions to the Product Usage Authority (PUA) process
- warnings from other market participants
- discussions with and letters from APRA.

MR&PC raised these issues with senior management in the Markets Division and the EGM Risk Management, but no concerted effort was made to ensure that items were fully investigated and followed up. It is apparent that MR&PC was often pressured to approve transactions and did not do so. However on at least one occasion, Markets Division management approved the transactions despite MR&PC s objections.

In most trading environments a healthy tension exists between the dealers and those engaged in risk management processes. The Traders were seen by many in the National, including junior traders on the desk, as having an aggressive and arrogant attitude. This attitude was a particular problem for MR&PC and it is clear from our interviews and an examination of certain emails that there was considerable tension between the Traders, Mr Dillon, and MR&PC. Much of this tension was around the PUA process (explained in Section 4) and limit breaches noted previously.

The perception of MR&PC held by the Traders, Mr Dillon and Mr Erdos was that they were slow, incapable of making decisions, and reported irrelevant limit breaches.

The tension continued through most of 2003 and resulted in a key MR&PC member effectively changing role because of an inability to work with the Traders and Markets Division management. This change was known to the Executive General Manager Group Risk Management (Mr Lewis), and the General Manager Markets (Mr Erdos).

Internal Audit

Internal Audit reports into global foreign currency exchange, especially the ones issued in May 1999 and December 2001, identified significant issues relating to currency options. As issues are progressed, Internal Audit s practice was to reduce the ratings and mark those issues as complete once an action plan has been prepared. Internal Audit did not follow up the results of the action plan to ensure an appropriate control had been implemented. For example, the need to revise currency options limits is marked as complete in June 2003 on the basis of the limit structure being finalised and the implementation of a new risk engine. The risk limits were still being breached in October 2003, the month in which the upgraded risk engine was implemented. In our view this item was not complete.

It is also unclear how the issues identified in the 2001 report on global foreign exchange, initially rated as 3-star, were not re-assessed as 3-star plus under the revised rating system. As 3-star items they were not reported to PBAC.

The culture within the National

We believe that the culture (or the tone at the top) is highly relevant to an understanding of what went wrong . We have evidence, from our interviews and meetings, emails and voice recordings from the currency options desk, of the culture that exists within the currency options desk, the Markets Division, CIB, and the National.

We make these comments understanding that we have only been exposed to a small part of the National s overall business focused in currency options and related areas.

Focus on process

First, there is a focus on process, documentation and procedures manuals, rather than on understanding the substance of issues, taking

responsibility and resolving matters. This is apparent in the way Finance, Operations and MR&PC were focused on process and production, with no-one really attempting to understand the nature of the business being conducted. For example, the fact that the currency options desk was reporting large monthly profits in the last quarter of 2003 was not identified as unusual, when there was a significant (and increasing) exposure to the US dollar and the US dollar was weakening.

Abrogation of responsibility

Second, the behaviour of the management in the organisation is that responsibility is passed on rather than assumed. Evidence of this is apparent in Risk Management, which raised issues relating to the currency options desk to CIB management but did not make sure that the CEO or Board were notified when the matters continued over an extended period.

Impact of the culture

The Board and former CEO were attempting to change the culture of the National and promote a more transparent and less arrogant organisation. However, it is clear from a number of matters noted in this report, that significant issues were not escalated to the Board (or its committees) and it seems that there was a focus on suppressing any bad news rather than engaging in a full and frank dialogue. As a consequence, recurring problems such as the limit breaches that the currency options desk incurred were not mentioned to the CEO, the Board or its committees, even when external agencies such as APRA had raised them.

The Board, PBRC and PBAC assumed what was presented to them was a correct and complete analysis of the situation. It was not unreasonable for them to make this assumption but ultimately the Board and CEO are responsible for the culture in the organisation. The Board and CEO must accept responsibility for the tone at the top, and for the environment in which management did not report openly on issues in the business.

Meetings with staff and external third parties more directly connected with the Traders reveal that the culture surrounding currency options provided the opportunity for the Traders to trade, incur losses, conceal those losses, and for them not to be detected despite warning signs. Some of the Traders treated aggressively anyone who questioned their activities, and this included MR&PC, Internal Audit, third parties and other members of the Markets Division.

It appears that CIB and Markets Division management either allowed this culture to exist or took no action to prevent it insofar as it related to the currency options desk. Essentially this allowed the Traders to operate unchecked and flout the rules and standards of the bank.

4 The currency options business

KEY POINTS

The governance of the National is the responsibility of the Board and its committees supported by a large number of management committees including many dealing with risk management

The National s Board approves the strategy and the operational plan and is ultimately responsible for the culture of the organisation.

CIB s strategy for the last 18 months, has been to move away from proprietary trading and focus more on customer business. The development of the currency options desk was part of this strategy.

The National s VaR limit approved by the Board was A$80m, of which A$3.25 million was allocated to the currency options desk.

CIB had its own back office (Operations Division) and was supported by Group Finance and Group Risk Management.

MR&PC (part of Risk Management) was responsible for the overview and monitoring of risk management within CIB. However, there was no formal requirement for limit breaches on the currency options desk to be rectified once approved by the Joint Head of Global Foreign Exchange. MR&PC considered that it was not empowered to enforce limit compliance.

In this section we provide a background and context for the losses by explaining the governance structure of the National, the structure of the business unit within which the currency options trading desk operated, and the risk management and controls structure that existed within the business unit.

Board and committees

The National is governed by the Board of Directors and managed by the CEO, who is also a member of the Board.

Corporate governance is discharged by the Principal Board, supported by a number of relevant Board and senior management committees, as well as through the defined roles and responsibilities of the Executive General Managers.

The Board and Board committee structure is set out in the table below which is extracted and paraphrased from the Corporate Governance section of the National s Annual Financial Report 2003.

Table 4.1: Board and Board committees

Board / Committee	**Key responsibilities**
Board of Directors (Principal Board)	Overall responsibility for corporate governance inclu