Draft

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re NATIONAL AUSTRALIA BANK SECURITIES LITIGATION	: : : :	Master File No. 03 Civ. 6537 (BSJ) (AJP) JURY TRIAL DEMANDED

FIRST AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

Lead Plaintiff [ ], individually and on behalf of all other persons similarly situated, by [ ] undersigned attorneys, for [ ] First Amended Consolidated Class Action Complaint, alleges upon personal knowledge as to [ ]self and [ ] own acts, and upon information and belief as to all other matters, based upon, *inter alia*, the investigation made by and through [ ] attorneys, which investigation included, among other things, a review of the public documents, Securities and Exchange Commission ("SEC") filings, Australian Securities and Investments Commission ("ASIC") filings, analyst reports, news releases and media reports of National Australia Bank, Ltd. ("NAB" or the "Company"), as follows:

NATURE OF THE ACTION

1. This is a securities fraud class action brought on behalf of all purchasers of NAB's American Depository Receipts ("ADRs") between April 1, 1999 and September 3, 2001, inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78j(b) and 78t. This action involves the dissemination of materially false and misleading statements during the Class Period concealing fraud by NAB at its United States subsidiary, HomeSide Lending, Inc. ("HomeSide").

2. HomeSide was a mortgage service provider, servicing some two million customers, with a service portfolio exceeding $180 billion in 2001.

3. As a result of NAB's conduct in connection with HomeSide's financial modeling on its $180 billion mortgage servicing portfolio, NAB's subsidiary HomeSide knowingly used unreasonably optimistic valuation assumptions or methodologies since at least the beginning of the Class Period. These unreasonably optimistic assumptions or methodologies brought HomeSide's and NAB's profitability to a crashing halt on September 3, 2001 when NAB announced that it would write off $1.75 billion due to problems at HomeSide. During the Class Period the Company's ADR price plummeted from an intra-day high of over $92.40 ($174.09 Australian) on August 24, 2001 to an intra-day low of $78.40 ($150.40 Australian) per share on September 4, 2001.[1]

JURISDICTION AND VENUE

4. The claims alleged herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder by the Securities and Exchange Commission ("SEC").

5. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§ 1331 and 1337 and Section 27 of the Exchange Act, 15 U.S.C. § 78aa.

6. Venue is proper in this District, pursuant to Section 27 of the Exchange Act, and 28 U.S.C. § 1391(b). NAB has an office in this District, which is located at 200 Park Avenue,

[1] As of August 27, 2003, one Australian dollar equaled approximately 64 U.S. cents.

34th Floor, New York, New York. In addition, HomeSide did business in this District during the Class Period.

7. In connection with the acts, transactions and conduct alleged herein, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the United States mails, interstate telephone communications and the facilities of a national securities exchange and market.

THE PARTIES

8. Lead Plaintiff [ ] purchased [ ] shares of NAB ADRs on [ ], [year].

9. [TO BE DELETED]

10. [TO BE DELETED]

11. Defendant NAB is a corporate entity organized under the laws of Australia. NAB is headquartered in Melbourne, Australia. NAB is Australia's largest bank. Its ordinary shares trade in efficient markets on the Australian securities exchanges and its ADRs trade on the New York Stock Exchange ("NYSE"). In addition to ownership of HomeSide, NAB has extensive operations in the United States, including, during the Class Period, operations in New York and Michigan, in addition to the HomeSide's operations in Jacksonville, Florida.

12. Defendant HomeSide was at all relevant times a corporation headquartered in Jacksonville, Florida. During the Class Period, HomeSide was a mortgage service provider servicing in excess of two million loans, in return for a fee. After the stunning revelation of the $1.75 billion write-off, NAB sold HomeSide to Washington Mutual, Inc.

13. Defendant Frank Cicutto ("Cicutto") was, at all relevant times, NAB's Managing Director and Chief Executive Officer. Prior to holding those positions, he was NAB's Executive Director, Chief Operating Officer and the Executive General Manager. He has also held various positions at NAB since 1968.

14. Defendant Hugh Harris ("Harris") was, at all relevant times, HomeSide's Chief Executive Officer, until his "resignation" on September 4, 2001. He had served as its Chief Executive Officer since April 1999. He also served as President and Chief Operating Officer of HomeSide from January 1993 to April 1999. From January 1988 to January 1993, he was Vice Chairman of HomeSide in charge of production and secondary marketing. Since March 1996, he was also President, Chief Operating Officer and a Director of HomeSide International, Inc.

15. Defendant Kevin Race ("Race") was, at all relevant times, HomeSide's Chief Operating Officer, until his "resignation" on September 4, 2001. He had been its President and Chief Operating Officer since April 1999. He was also its Executive Vice President and Chief Financial Officer from October 1996 to April 1999 and was the Vice President of HomeSide International, Inc. since October 1996.

16. Defendant W. Blake Wilson ("Wilson") was, at all relevant times, HomeSide's Chief Financial Officer, Executive Vice President and Director of Capital Markets until his "resignation" on September 4, 2001. He had been its Chief Financial Officer since April 1999 and its Executive Vice President and Director of Capital Markets since September 1997. Previously, he was HomeSide's Senior Vice President and Director of Capital Markets since June 1996.

17. Defendants Cicutto, Harris, Race and Wilson are collectively referred to as the "Individual Defendants".

18. Because of the Individual Defendants' position with NAB and/or HomeSide, they had access to the adverse undisclosed information about HomeSide's financial condition, modeling methodologies and computer systems.

19. The Individual Defendants also controlled the content of NAB's and/or HomeSide's press releases, corporate reports, SEC filings, ASIC filings, and communications with analysts. By concealing HomeSide's adverse financial performance, the Individual Defendants were able to meet earning targets and thereby reap significant bonus compensation during the Class Period.

20. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company's public filings, press releases and other publications as alleged herein are the collective actions of the narrowly defined group of defendants identified above.

21. Each of the above officers and directors of NAB and HomeSide, by virtue of their high-level positions, directly participated in the management of HomeSide, was directly involved in the day-to-day operations of HomeSide at the highest levels and was privy to confidential proprietary information concerning NAB's and HomeSide's operations, business, growth, and financial prospects, as alleged herein. Said Individual Defendants were directly involved in or responsible for HomeSide's financial condition, computer modeling and computer systems and the false and misleading public statements and released information related to HomeSide's financial condition as alleged herein. At all times during the Class Period, the Individual

Defendants were aware or recklessly disregarded that the false and misleading statements were being issued regarding the Company, and the Individual Defendants approved or ratified these statements, in violation of the federal securities laws.

22. As an officer and controlling person of a publicly held company whose ordinary shares are traded on the Australian Stock Exchange ("ASX") and London Stock Exchange ("LSE"), among others, and whose ADRs were, and are, registered with the SEC pursuant to the Exchange Act, traded on the NYSE, and governed by the provisions of the federal securities laws, Defendant Cicutto had a duty to disseminate promptly, accurate and truthful information with respect to the Company's business, markets, growth, and present and future business prospects, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price of the Company's ordinary shares and ADRs would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

23. The Individual Defendants participated in the drafting, preparation, and/or approval of the various public, shareholder and investor reports and other communications complained of herein and were aware of, or recklessly disregarded, the misstatements contained therein and omissions therefrom, and were aware of their materially false and misleading nature. Because of their executive and managerial positions with NAB and HomeSide, respectively, each of the Individual Defendants had access to the undisclosed information about HomeSide's true grave financial condition and performance as particularized herein, and knew (or recklessly disregarded) that adverse facts rendered the positive representations made by or about HomeSide and its business issued or adopted by NAB materially false and misleading.

24. The Individual Defendants, because of their positions of control and authority as officers of NAB and HomeSide, respectively, were able to and did control the content of the various SEC filings, press releases and other public statements pertaining to the NAB during the Class Period. The Individual Defendants were provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected. Accordingly, the Individual Defendants are responsible for the accuracy of the public reports and releases detailed herein and are therefore primarily liable for the representations contained therein.

25. Each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of NAB ordinary shares and ADRs by disseminating materially false and misleading statements.

CLASS ACTION ALLEGATIONS

26. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all persons who purchased NAB ADRs on the open market during the Class Period and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

27. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, NAB securities were actively traded. As of October 22, 1999, there were more than 1.48 billion ordinary shares and 3.254 million ADRs (representing 16.273 million ordinary shares) of NAB issued and outstanding. While the precise

number of Class members is unknown to Plaintiff at this time and can only be ascertained through appropriate discovery, there were over 300,000 ordinary shareholders holding of record or beneficially during the Class Period, and, as of October 22, 1999, the ADRs were held by 200 holders with registered addresses in the United States, and likely hundreds more, if not thousands, of beneficial holders of the ADRs in the proposed Class. Record owners and other members of the Class may be identified from records maintained by NAB or its transfer agent and may be notified of the pendency of this action by mail, using a form of notice similar to that customarily used in securities class actions.

28. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the status of HomeSide's financial condition;

(c) the true business, operations and likely foreseeable near-term future growth and prospects for the Company in light of the programs at HomeSide;

(d) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the status of NAB's financial condition; and

(e) to what extent the members of the Class have sustained damages and the proper measure of damages.

29. Plaintiff's claims are typical of the claims of the members of the Class, as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

30. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

31. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

FACTUAL ALLEGATIONS

NAB Needed Foreign Expansion to Grow

32. NAB, Australia's largest bank, with 50,000 employees globally and more than 12 million customers around the world, has aspired to become a global financial institution.

33. In order to achieve its goals, NAB was compelled to look outside of its domestic market as its primary area of growth, as Australia has a population of only around 20 million people.

34. According to its annual report for the year ended September 30, 1999 ("1999 Annual Report"), in 1999 NAB was the largest financial institution in Australia and the third

largest company in Australia by stock market capitalization. In its report, NAB highlighted its global expansion, noting that:

> The geographic diversity of the National's operations does more than reduce the risk of being dependent on one market. Our international operations create economies of scale and a customer base that, in aggregate, are well above the ability of any one bank to achieve in a market the size of Australia.

35. NAB also made the point in the 1999 Annual Report that:

> In 1999, half of the Group's profit came from our international operations. The key international regions, Europe, New Zealand and the United States all increased their profit contribution. The benefits of recent international acquisitions, such as the United States based HomeSide International, Inc., a mortgage origination and service operation, go beyond the addition of revenues and profits in the near term. These businesses fit within the National's overall growth strategy and provide key benefits in sustaining shareholder value.

36. Another "important element of [NAB's] strategy and a key feature of the National's success in recent years has been its ability to reduce its dependency on interest income." This reduction, the 1999 Annual Report stated, was the result of NAB's efforts to increase its involvement in businesses, such as HomeSide, that have substantial fee income potential. Indeed in 1999, "the National earned nearly 43% of its income from non-interest sources such as fees from mortgage servicing in the United States, treasury income and fees from the marketing of a variety of innovative financial services products."

37. As of December 2000, NAB was the largest custodian in Australia with total assets under custody and administration of $180 billion Australian. As was again openly conceded by NAB in December 2000: "The size of our domestic [Australian] market effectively set limits on the ability of companies to grow within Australia."

38. Indeed, by the year 2000, NAB Chairman Rayner boasted that more than 45% of NAB's assets and revenues were outside Australia and, that based on profitability, NAB was one of the 25 largest banks in the world.

39. Rayner reinforced NAB's growth philosophy when he stated on December 14, 2000 at NAB's annual general meeting that: "The bottom line is that only companies of adequate size will attract core capital of the major long term investors. So growth is important."

40. NAB also continued to tout its rapid growth in income from non-interest services such as mortgage servicing. Indeed, Defendant Cicutto boasted that in 2000 more than 50% of NAB's revenues came from non-interest sources, compared to 35% five years earlier, and that 40% of these non-interest income sources did not exist five years ago. This represented a "marked transformation of NAB" according to Cicutto.

41. NAB could hardly hope to realize its ambition to be an international financial services company without an active and expanding presence in the United States.

42. Indeed, HomeSide was critical to NAB's presence in the United States, or at least the perception of that commitment, particularly after NAB announced the sale of its other significant U.S. business, Michigan National Corporation, for approximately $5.3 billion Australian in November 2000.

43. In addition to growing internationally, at its December 14, 2000 annual general meeting, Defendant Cicutto touted another NAB "core strategy": its e-business's strategy.

44. That e-business strategy was designed "to improve the efficiency of [it's] . . . manufacturing, processing and administration."

45. Thus, HomeSide was critical to NAB for four reasons. First, it bolstered NAB's United States presence (particularly after the sale of Michigan National Corporation). Second, it was an important step in NAB's international growth strategy. Third, it would purport to be a showcase for NAB's e-business strategy based upon the processing and administrative efficiency created by online commerce and systems. Fourth, it at least initially appeared to support Cicutto's boast of the growth of non-interest sources of income for NAB.

46. Unfortunately for NAB's security holders, NAB directed and touted HomeSide's operation to fulfill the perception of NAB's growth, even though NAB knew, or was severely reckless in not knowing, that HomeSide's success under NAB was an illusion.

<u>HomeSide's Business</u>

47. NAB acquired HomeSide on February 11, 1998, for $1.22 billion from the Thomas H. Lee Company, Madison Dearborn Partners and strategic partners BankBoston Corporation and Barnett Bank.

48. HomeSide was a mortgage service provider, servicing in 2001 in excess of two million loans, in return for a fee.

49. These fees represented a source of future income for HomeSide (and NAB), the present value of which was calculated using valuation models and then booked by NAB on its balance sheet as an asset known as Mortgage Servicing Rights ("MSR").

50. The value of the MSR was amortized over their expected life.

51. The drivers for increasing profitability in a mortgage servicing business are increasing originations and the number of loans serviced, and doing so with administrative efficiency so that fees increase.

52. NAB, anxious to portray itself as a growing international integrated financial company, drastically increased HomeSide's mortgage servicing portfolio by acquiring portfolios from other mortgage servicing companies.

53. Based on NAB's strategy of growing HomeSide by acquisitions, by March 2000 HomeSide's mortgage servicing portfolio had grown to approximately $188 billion, making HomeSide the sixth largest mortgage servicer in the United States.

54. Early repayments on mortgages affect the value of MSR because they shorten the life over which the mortgage servicer receives fees on loans which it services.

55. Accordingly, HomeSide, like other mortgage servicers, hedged against the risk of early repayment.

56. To analyze the effect of early repayment, its likelihood and the impact upon MSR, HomeSide utilized software systems, including one known as MIAC Analytics that was developed by Mortgage Industry Advisory Company ("MIAC") based in New York City.

57. However, as alleged below, NAB and HomeSide manipulated these financial models in order to falsely portray HomeSide as successful based on artificially inflated MSR values. This artificially inflated asset was then improperly consolidated into the financial statements of NAB.

Defendants' Scheme And Wrongful Course Of Conduct

58. On or about April 1, 1999, Mortgage Banking published an article concerning HomeSide's lending practices in connection with its mortgage business in the United States (the "Mortgage Banking Article"). The Mortgage Banking Article reported the following false and misleading information:

> In the third quarter of 1998, HomeSide Lending, Inc., Jacksonville, Florida, made some changes in the hedges covering its $120 billion servicing portfolio that positioned it well for the liquidity crisis in the third quarter, according to Kevin Race, chief financial officer
>
> HomeSide, like other servicers that hedge, found its hedges outperformed expectations, while asset values for the mortgage servicing rights did not go down as fast because mortgage rates did not fall as far and fast as Treasuries. In fact, Race says, HomeSide's hedge outpaced the decline in servicing rights by 10 percent.
>
> Race has found that the fourth quarter of 1998 and early 1999 have presented HomeSide and other mortgage bankers with "a challenging environment" for hedging. "A lot of people are struggling. As asset values [of mortgage servicing rights] are going up, hedges are going down faster."
>
> HomeSide has also seen "a slight underperformance" of its hedge program, as the mortgage-Treasury spread has tightened, Race says. "We believed that mortgage spreads were wide and would tighten. We didn't anticipate how they would bounce around, particularly [in January]," he says.
>
> Most servicers now are balancing the need to protect the servicing asset with the need to keep down the cost of managing the hedge, Race says. The big question now, he says, is: "How do I create a sufficient level of protection at the lowest implied cost?" (Emphasis added)

59. In fact, HomeSide was poorly positioned due to the manipulation of its mortgage portfolio modeling, as explained herein and at paragraphs 115 through 149. NAB and the Individual Defendants knew of this manipulation or were severely reckless in not knowing of it at the time these statements were made.

60. On April 15, 1999, The Florida Times Union reported on promotions at HomeSide (the "Florida Times Union Article"). The Florida Times Union Article reported that Defendant Harris, a longtime friend of HomeSide's Chairman Joe Pickett, had been promoted to Chief Executive Officer of HomeSide and Defendant Race had moved into Harris' old job of President and Chief Operating Officer. The Florida Times Union Article also reported Defendant Blake would be promoted to Chief Financial Officer. The Florida Times Union Article reported Pickett as saying the "appointments of Hugh, Kevin and Blake position HomeSide to move forward with its strategy for domestic growth and global expansion."

61. On May 20, 1999, American Banker published an article concerning rising interest rates in the United States and the resulting toll on the mortgage business. The article reported a dramatic decline in housing starts in April 1999 and a sharp drop in mortgage applications the previous week. According to the American Banker, economists had stated the market was "bound to cool off at least somewhat from 1998's unusually robust level as [interest] rates rose".

62. However, the American Banker article also quoted Defendant Race as misleadingly saying that HomeSide was "insulated from a downturn because it does not have retail branches and gets most of its mortgages from brokers, correspondents, and banks that agree to sell HomeSide all their loans." Defendant Race was also quoted in the American Banker Article as saying;

> That's the trade-off we made. We did not see some of the boom in terms of origination volumes that some of the retail-oriented players did the last year-and-a-half. By the same token, we are not going to have the issues to deal with in terms of layoffs and fixed-cost structure going into this part of the cycle.
>
> If we had spent a lot of money on bricks and mortar and had radically expanded the staff for the last couple of years, we would probably be pretty

> nervous right now. You will start to see some announced layoffs in the next 60 to 90 days that are substantial in some retail shops.

63. In truth, HomeSide was far from insulated. It's mortgage portfolio was extremely vulnerable due to the artificial manipulation of its portfolio modeling, as explained herein and at paragraphs 115 through 149. NAB and the Individual Defendants knew of this manipulation or were severely reckless in not knowing of it at the time this statement was made.

64. On June 16, 1999, The Wall Street Journal reported that HomeSide had agreed to acquire as much as $7 billion of servicing assets annually during a five-year period from Cendant Corporation's mortgage unit (the "Cendant Purchase"). The Wall Street Journal reported HomeSide had purchased and would service $7 billion of Cendant Mortgage's portfolio, which represented about 60,000 loans.

65. On June 21, 1999, Mortgage Marketplace reported on HomeSide's Cendant Purchase. Defendant Harris, CEO of HomeSide said of the Cendant Purchase, "Our real strategy for the last few years is to continue growing our servicing portfolio. With our preferred partner, we're not only getting a servicing portfolio, but we're getting a flow production for a period of time."

66. On June 29, 1999, NAB issued over $1 billion in National Income Securities ("NIS") securities, which are stapled securities made up of one fully paid note issued by NAB through its New York branch and one unpaid Preference Share also issued by NAB.

67. On July 22, 1999, NAB reported that HomeSide had contributed $37 million to NAB's profit for the period ended June 30, 1999. NAB's July 22, 1999 press release, in commenting on NAB's results, stated:

> Mr. Cicutto said the pleasing features of the latest results included the strong growth in lending and the continued increase in non interest income.
>
> Mr. Cicutto also noted the progress of the Group's global wholesale financial services business and the rapid development of its product specialists such as HomeSide and other financial services.
>
> "Looking ahead, we will continue to focus on diversification of our business and the capturing of the benefits of our global structure."
>
> "The National is well placed to take advantage of the positive economic and financial environment in most of the markets in which we operate," Mr. Cicutto said.

68. In fact, however, the above statements were false and misleading at the time they were made because HomeSide would not have been a contributor to the Group's profits, non interest income or global services had its mortgage portfolio not been knowingly manipulated, as explained herein and at paragraphs 115 through 149, to generate unrealistically high financial results. NAB and the Individual Defendants knew of these problems or were severely reckless in not knowing of these problems at the time these statements were made. Far from rapid development, HomeSide was heading out of control.

69. On or about November 4, 1999, NAB issued a press release announcing "a record Group operating profit of $2,821 million [Australian] for the year to 30 September 1999." This was purportedly an increase of 12.3% on the previous year's results. HomeSide's first year contribution of allegedly $153 million Australian to NAB's profit was cited as a highlight of the results.

70. The press release also reported that Defendant Cicutto was pleased with the past year's results. In touting NAB's success, particularly with regard to HomeSide, Defendant Cicutto stated:

> [w]e made considerable progress with a number of key strategic initiatives such as the implementation of our global business model, the integration of HomeSide and the acceleration of our e-commerce program . . . . [E]ach of these individual successes are indicative of the confidence with which the Group has pursued its Australian and global ambitions.

71. The November 4, 1999 statements were false and misleading at the time they was made. As explained herein and at paragraphs 115 through 149, HomeSide's positive results were due to its mortgage portfolio being artificially overvalued. This was known to defendants or they were severely reckless in not knowing about the manipulation. Also, far from becoming integrated, NAB knew at the time, or was reckless in not knowing, that HomeSide's business was careening off track.

72. Similarly, in its annual report for the fiscal year ended September 30, 1999, NAB misleadingly touted HomeSide's contribution to its global business and shareholder value. NAB stated that a key factor in its 12.3% increase in operating profit after tax (before abnormal items) was an increase in its other operating income resulting, in part, from the addition of HomeSide. NAB stated that in its "debut year" HomeSide contributed $312 million Australian in mortgage servicing fees in 1999 and $153 million Australian to NAB's consolidated profits. These results were erroneously attributed to HomeSide's "first full year with [NAB] and strong volume growth."

73. In the 1999 annual report, NAB also misleadingly stated:

> as interest rates and yield curves change over time the bank may be exposed to a loss in earnings due to the effects of interest rates on the structure of the balance sheet. Sensitivity to interest rates arises from mismatches in the re-pricing dates, cash flows and other characteristics of the assets and their corresponding liability funding. These mismatches are actively managed as part of the overall interest rate risk management process which is conducted in accordance with Group Balance Sheet Management policy and guidelines. In managing the structural interest rate risk, the primary objectives are to limit the extent to which net

> interest income could be impacted from an adverse movement in interest rates and to maximise [sic] shareholder wealth.

74. The statements in NAB's 1999 Annual Report were false and misleading at the time they were made, because NAB failed to disclose that in fact, as explained herein and at paragraphs 115 through 149, HomeSide's positive results were due to its mortgage portfolio being artificially overvalued. This was known to defendants or they were severely reckless in not knowing about the manipulation.

75. On or about May 4, 2000, NAB issued a press release announcing "a record half-yearly result. The Group's operating profit after tax of $1,573 million [Australian] for the six months to 31 March 2000 was 13.2 percent higher than the $1,390 million earned in the March 1999 first half. . . ." Other operating income, which included HomeSide's mortgage servicing fees, was purportedly $2,475 million—an increase of 9.8%. Earnings from NAB's international operations allegedly increased 16.6%, representing almost 50% of NAB's after tax profit. Specifically, the press release stated that profits from the United States had increased to $265 million Australian and that, "[t]he current result includes a solid contribution from Michigan National Corporation, higher profits from HomeSide and interest income attributable to the issue of National Income Securities in June 1999."

76. The press release also reported that Defendant Cicutto "commented that the current result confirms the depth and diversity of the Group's earnings streams and its ability to adapt to sustained competition and varying economic conditions." Specifically he stated:

> During the latest six months we have seen continued strong growth in lending activity, fee based services and tight containment of costs. The latest performance is satisfying, considering the broad range of strategic activities the Group has undertaken during the past six months.

> The National has completed a major review of its corporate strategy, restructured its operations and is close to finalizing the major acquisition of MLC Limited. The ability to both manage this necessary transformation and continue to achieve record profits is a testimony to the overall quality of the Group. Looking ahead, we are confident of our prospects.

77. The above statements regarding NAB's six month results ended March 31, 1000 were false and misleading when made. Defendants were attempting to portray HomeSide (and the diversified opportunities it represented for NAB) as thriving and growing when in fact at the time, as explained herein and at paragraphs 115 through 149, its portfolio was significantly and artificially overvalued and this manipulation was known to defendants or they were severely reckless in not knowing about the manipulation.

78. On May 22, 2000, Australian Financial Review published an article concerning the impact of HomeSide's earnings on NAB (the "May 2000 Australian Financial Review Article"). The May 2000 Australian Financial Review Article reported that although HomeSide continued to fall short of earnings expectations, it remained a potential driver of long-term growth within NAB. The article also reported that in 1998 and 1999, HomeSide contributed $153 million Australian to NAB's $2.82 billion Australian profit.

79. On July 27, 2000, NAB issued a press release concerning its results for its third fiscal quarter ended June 30, 2000 (the "July 27, 2000 Press Release"), reporting a quarterly profit after tax of $829 million Australian--an increase of 18.9% over the June 1999 quarter. In commenting on NAB's performance, Defendant Cicutto stated that the result was solid particularly given that it was achieved against a backdrop of difficult trading conditions for HomeSide in the United States.

80. Defendant Cicutto also stated:

> the Group has once again demonstrated its fundamental strength and its capacity to generate sound performance, whilst moving forward on several strategic fronts. . . . HomeSide has announced a strategic alliance with Fannie Mae that will reshape the market for on-line mortgage origination in the United States . . . .We continued to gain benefits from our geographic diversity . . . .

81. The above statements regarding NAB's third fiscal quarter ended June 30, 2000 were false and misleading when made as a result of the material omission of any mention of the manipulated portfolio modeling, as explained herein and at paragraphs 115 through 149, and the attendant consequences of that overvaluation. This manipulation was known to defendants or they were severely reckless in not knowing about the manipulation.

82. On November 2, 2000, NAB announced its results for the fiscal year ended September 30, 2000. For that period NAB announced a "record" profit of $3,377 million Australian, of which 47.3% was generated outside Australia. In the press release, NAB stated that the highlights of the results included, among other things, that non interest income from mortgage activities and other fee generating business rose 43% from 1999 and that, "HomeSide continued to expand its operations in the United States and announced a strategic alliance with Fannie for the on-line origination of mortgages throughout the United States."

83. Furthermore, in the November 2, 2000 press release, Defendant Cicutto stated, "A priority during the year ahead will be to fully leverage the strengths and potential of our Northern Hemisphere assets." This statement was false and misleading at the time it was made as applied to HomeSide.

84. According to NAB's Form 20-F filed with the SEC, also for the year ended September 30, 2000, HomeSide purportedly contributed a profit after tax (and before abnormal items) of $141 million Australian and $535 million Australian to NAB's operating income,

which allegedly increased 43% in 2000. HomeSide's contribution was said to have been generated by its mortgage servicing fees, which purportedly increased 71.5% because of "an increase in the servicing portfolio due to higher volumes from strategic alliances entered into during 1999."

85. The above statements regarding NAB's fiscal year ended September 2000 were false and misleading when made. Defendants were attempting to portray HomeSide (and the geographic diversity it represented for NAB) as thriving and growing when in fact at the time, as explained herein and at paragraphs 115 through 149, its portfolio was significantly and artificially overvalued and this manipulation was known to defendants or they were severely reckless in not knowing about the manipulation.

86. On or about November 17, 2000, NAB filed its Form 6-K for the month ended November 2000. In that filing NAB stated that "HomeSide's after-tax profit was adversely affected by the impact of lower mortgage production volumes, higher interest rates and pricing competition." The description of HomeSide's activities during this period was false and misleading as a result of the material omission of any mention of its manipulated portfolio modeling and the attendant consequences of that overvaluation.

87. On January 5, 2001, Australasian Business Intelligence reported that NAB was to issue $1.1 billion in mortgage-backed securities. The securities were to be registered in the United States and sold to European and United States investors in a move by NAB to diversify its funding sources. On January 5, 2001, NAB's head of group capital management, Chris Matten, said the move would increase available capital by $70 million Australian.

88. On January 22, 2001, the Australian Financial Review published an article concerning HomeSide's impact on NAB's finances. The Australian Financial Review reported:

> National Australia Bank profits are expected to receive a fillip this year from its struggling US mortgage business HomeSide. A spike in refinancing activity prompted by recent US interest rate cuts is expected to revitalise HomeSide's origination business, which suffered a 55 per cent fall in revenue last year. The division is expected to deliver at least a further [A]$50 million in profits on top of the 5.5 per cent HomeSide contributed to NAB's consolidated profit last year. Credit Suisse First Boston has upgraded its earnings outlook for NAB, arguing that HomeSide is well leveraged to exploit a fresh wave of refinancing in the US mortgage market. The broker now expects NAB to post a net profit of more than [A]$3.8 billion this year, which would represent a 12.8 per cent improvement on the 2000 result of [A]$3.37 billion.

89. On March 16, 2001, the Mortgage Servicing News reported that HomeSide and NAB had completed their first global mortgage securitization. The Mortgage Servicing News article reported the following:

> Jacksonville, FL -- HomeSide International and National Australia Bank have reported that they have priced and completed their first global mortgage-backed securitization, which company officials say was met with "substantial investor interest."
>
> Class "A" notes totaling $1.059 billion were priced at the three-month London interbank offered rate plus 19 basis points and sold to investors in the United States, Europe and Asia through lead managers National Australia Bank (London branch), Deutsche Bank and JP Morgan.
>
> Class "B" notes totaling 20 million Australian dollars (about $10.9 million) were offered to Australian investors and priced at the three month bank bill swap rate plus 52 basis points through National Australia Securities Ltd. as the sole dealer for the issue.

90. On May 10, 2001, NAB announced its results for the sixth months to March 31, 2001. For that period NAB announced a "strong" 28.7% increase in net profit after tax to $4,025 million Australian. In the press release, Defendant Cicutto stated, "This is a strong result that confirms our position as a leading, diversified financial services group. It also demonstrates that

our strategies are working. The national's unique combination of business and geographic diversity is delivering profits and providing significant growth opportunities."

91. With respect to HomeSide, the press release also reported (in pertinent part):

> HomeSide's contribution fell to $71 million after tax from $84 million, however this represents an improvement on the September 2000 half contribution of $48 million. The improvement is due to a 9.7% increase in profit from the US operations, which reflects the recent recovery of production volumes in the US due to falling mortgage interest rates, the development of the Australian business, and the impact of the weaker Australian dollar. . . .
>
> Our internet-based home loan business, HomeSide Solutions, has written US$500 million of new business since last November.

92. The above statements regarding NAB's half year results for 2001 were false and misleading when made as a result of the material omission of any mention of the manipulated portfolio modeling, as explained herein and at paragraphs 115 through 149, and the attendant consequences of that overvaluation. This manipulation was known to defendants or they were severely reckless in not knowing about the manipulation.

93. On June 4, 2001, the Australian Financial Review published an article reporting on NAB's lending business. The June 2001 Australian Financial Review article quoted Andrew Linklater, an NAB executive, as saying: "NAB's HomeSide-branded mortgages, which were sold via mortgage brokers, had delivered 100 per cent growth per annum over the past two years."

94. However, on July 5, 2001, NAB announced that it would book a charge of $450 million ($568 million Australian) with the fiscal year writedown of the balance sheet value of the MSR held by HomeSide (the "July writedown"). In reaction to the revelation of the July

writedown news, NAB's ordinary shares fell $1.80 Australian or more than 5%. The ADRs fell from $86.05 to $81.15, or 5.6%, on the news.

95. The July writedown represented approximately 10% of the then current book value of HomeSide's MSR.

96. In commenting on the July writedown in a NAB press release, dated July 5, 2001, Defendant Cicutto misleadingly stated: "Our underlying business is strong and performing well." Cicutto further stated that the "provision reflects the fact that we are a prudent bank with a disciplined approach for managing risk. That is why we have responded decisively and expeditiously to deal with this."

97. The statements by Defendant Cicutto in the July 5, 2001 press release were false and misleading as they portrayed a false sense of closure and resolution to the HomeSide problem, when in fact, less than two months later, NAB would shock the market with the revelation of a massive $1.75 billion write down.

98. At Credit Suisse First Boston's Sydney Invasion Lunch on August 21, 2001, NAB made a presentation wherein, among other things, it represented that it was a target for earnings per share growth of greater than 10%, notwithstanding the July writedown at HomeSide. This statement was false and misleading at the time it was made. In fact, NAB knew or was severely reckless in not knowing that less than two weeks later it would reveal a massive $1.75 billion writedown at its HomeSide unit, which in fact caused its earnings per share to decline, not grow.

99. At the August 21, 2001 Sydney Invasion Lunch, NAB also represented that in response to HomeSide's July 2001 writedown, it now had taken remedial action to correct the

situation by recording assets "at a sustainable realistic value" and by changes to "systems and procedures." These statements were also false and misleading at the time they were made, because, among other reasons, they falsely portrayed the situation at HomeSide, and its impact on NAB as being resolved, when, in fact, just two weeks later NAB would drop the $1.75 billion HomeSide writedown bombshell on the market.

100. Likewise, NAB's other representations with respect to HomeSide at the August 21, 2001, Sydney Investor Lunch such as "HomeSide's competitive situation remains strong" were false and misleading for the same reasons.

101. On Monday, September 3, 2001, Labor Day in the United States, NAB announced that it would incur a $1.75 billion writedown of the carrying value of HomeSide's operations. NAB determined that the carrying value of HomeSide's mortgage servicing rights far exceeded their fair value and that the asset was impaired.

102. Defendant Cicutto represented that the need for the writedown was recently discovered during NAB's analysis of its strategic options with respect to HomeSide and, specifically, during its review of the market sales value of the company.

103. The $1.75 billion writedown purportedly consisted of the following items:

- $400 million resulted from incorrect interest rate assumptions embedded in HomeSide's MSR valuation model;
- $760 million resulted from changed assumptions in the modeling; and
- $590 million represented a writedown of good will related to HomeSide

NAB further explained that:

> Based on an assessment of the impairment loss arising from the incorrect rate assumption in the internal valuation model, US$389 million of the impairment loss was attributed to the half-year ended March 31, 2001 and the remainder has been attributed to the half year ended September 30, 2001.

104. In reaction to the news, NAB's ordinary shares fell from $4.30 Australian to $28.90 Australian on the Sydney stock exchange on Monday, September 3, 2001. When trading resumed on September 4, 2001 after the Labor Day holiday, NAB's ADRs fell $10.24 to $78.24.

105. The weekend prior to the revelation of the writedown, Rayner formally resigned as Chairman of NAB, having stepped aside the prior month because of an allegedly potential conflict of interest in another matter. Also on the weekend before the writedown, it was reported that Rayner had taken a leave of absence as a non-executive director.

106. In addition, on September 4, 2001 HomeSide's Harris, Race and Wilson "resigned".

107. At NAB, Chris Matton, head of group capital and balance sheet management during the Class Period, left the Company. Matton reported to Bob Prowse, who, in turn reported to Cicutto. When asked to comment on the HomeSide debacle, he declined to do so, reportedly stating that he would take his knowledge "to the grave".

108. On September 4, 2001, in commenting on the $1.75 billion writedown, Charles Allen, who was appointed Chairman at an emergency NAB board meeting on Sunday, September 2, 2001, stated:

> In the end of the day, it is a disaster for the organisation. I think no other National Bank chief executive has stood before you to announce a provision of this size. So it hasn't been a pleasant experience for me. I sincerely regret that taking such

> a decision proved necessary and can assure shareholders the National will carefully review the situation and learn from it.

109. In an effort to blunt criticism of Defendant Cicutto for the HomeSide debacle, Allen also stated on September 3, 2001, "I was appointed chairman yesterday in fairly difficult circumstances. The board, quite unequivocally, has full support for Frank [Cicutto] and for the senior management of the National Australia Bank. There's no intention for Frank [Cicutto] to resign."

NAB Tries To "Spin" The HomeSide Debacle As An Inadvertent Error

110. In its Form 6-K for the full year 2001, filed in November 2001, NAB indicated that the problem, quite benignly, was "discovered" to be an "incorrect interest assumption". Specifically the Form 6-K stated:

> In September, an incorrect interest rate assumption in the MSR valuation model was discovered, which had caused the model to understate HomeSide's sensitivity to interest rate movements, and overstate the value of its servicing rights, leaving the Group underhedged.

THE TRUTH BEHIND THE HOMESIDE DEBACLE

The Australian Financial Review Analysis

111. Far from an innocent error, and contrary to NAB's explanation that the HomeSide debacle was the result of essentially a few errant keystrokes, the Australian Financial Review ("AFR") reported that "some of the blame must lie with Cicutto and his team."

112. According to a September 8, 2001 article by AFR:

> The investigation reveals that HomeSide's hedging difficulties – which are one of the most important parts of the story – were apparent as far back as 1999. The AFR has been told that there had been warnings about failures in the hedging book, yet the problem continued to grow, finally spiralling out of control.

NAB maintains that HomeSide's shock writedown – which totals almost $4 [Australian] billion – came out of the blue. But could the bank have done something about it earlier?

Several former NAB executives interviewed by the AFR believe that the hedging problems should have been avoided. The executives were part of the bank's balance sheet and capital management teams based in Bourke Street.

Since the bank bought HomeSide in 1997, they had watched as traders in New York struggled to hedge the subsidiary's growing mortgage book. As HomeSide continued to expand, efforts to balance out the effects of interest rate movements began to fall miserably.

In 1998, HomeSide recorded net hedging gains of $657 million. But in 1999, hedging losses totalled a staggering $1.4 billion and in 2000 another $480 million was lost.

To put this into perspective, NAB's total profit in 1999 was $2.8 billion, HomeSide's profit that year was $153 million.

* * *

What worried the team in Melbourne was that things appeared to be out of control.

"The hedge numbers – the profit and loss – were all over the place and the volume was very high," one former executive says, speaking anonymously. "A huge amount of money was just swinging backwards and forwards, easily a couple of hundred million at any one time."

"A lot of people were very concerned and it came to me and I asked them to look into it, but it was ignored."

This executive, like many others, left NAB's balance sheet and capital management division during this period.

By early this year, HomeSide's mortgage book had grown to $US187 billion ($358 billion). This made the bank's New York-based dealers among the biggest options traders in the world. On some days, they would have to nearly corner the market in interest rate derivatives just to cover its massive exposures.

Things soon got out of hand. Falling interest rates are bad for mortgage servicers, so they try to hedge against rate movements. HomeSide struggled with this in the late '90s, and the situation deteriorated when the US Federal Reserve began slashing official rates earlier this year. It has now cut interest rates seven times in eight months.

The rate cuts, combined with a US accounting rule change which meant the hedging losses had to be booked, resulted in HomeSide's first writedown, of $870 million, announced in July.

> The new accounting rule, known as FAS 133, changed the mortgage-servicing business overnight. The industry suddenly became a lot less attractive. But the hedging losses were not to be NAB's biggest problem. Deep in the bowels of HomeSide's Jacksonville, Florida headquarters, another time bomb was ticking away.
>
> In the northern autumn of 1999, HomeSide's computers were overhauled. As part of the change, a computer model that worked out the fees the business could expect was replaced. The model was vital to working out how much the HomeSide business was worth. It did this by estimating future interest rates and how quickly clients would pay off their home loans. It used a gross interest rate figure.
>
> The new model used a net interest figure. HomeSide executives made a very simple and stupid mistake: they accidentally plugged the gross interest figure into the new model. The blunder – which was uncovered only during the past week – meant that since 1999, HomeSide's future revenue had been grossly over-estimated.
>
> The mistake with the model cost NAB $US400 million ($766 million). But there was worse to come. Other assumptions in the model had to be changed. This cost $1.4 billion. An $858 million writedown of goodwill made up the remainder of the shock loss, and took the total to almost $4 billion.
>
> The question remains: How did the bank which had first expanded overseas in 1987 suddenly find itself in so much difficulty?
>
> The answer, according to the former NAB executives, is that HomeSide had too much independence. There was not enough hands-on control from Melbourne.
>
> * * *
>
> So where does the blame lie? HomeSide's long-serving boss, Joe Pickett, left in June – one month before the first writedown. Another three of HomeSide's most senior executives resigned this week.
>
> But, so far, no one is accepting any of the blame at the bank's Bourke Street headquarters. (Emphasis added.)

<u>The Wachtell Lipton Investigation</u>

113. The NAB Board of Directors commissioned an independent review into the events leading to the write-downs at HomeSide. That review, prepared by the law firm of Wachtell, Lipton, Rosen & Katz, with the assistance of specialist investment bank Promontory Financial Group (the "Wachtell Report"), was provided to the Board in early 2002. Charles

Allen, the Chairman of NAB, sent a summary of the Wachtell Report to all NAB shareholders in January 2002.

114. Ivor Reis, a stockbroker in Melbourne, Australia and a NAB shareholder who received the summary of the Wachtell Report, published the following report in Bulletin magazine:

> The NAB board decided not to publicly release the Wachtell Lipton report, and I am told this was mostly for legal reasons. But the snippets that NAB chairman Charles Allen did share with the bank's owners shows just how lax the NAB's internal risk controls had become between 1999 and 2001. One paragraph in particular sums up the NAB's risk management shortcomings.
>
> "Group management [NAB head office in Melbourne] had effective internal audit and reporting mechanisms but was not in the executive suite at HomeSide [in Jacksonville, Florida]," Wachtell Lipton reported. "As a result, the group did not have day-to-day involvement in the management of HomeSide, and areas of risk management weakness that the group identified both during due diligence and during subsequent periodic visits were not corrected as immediately or rigorously as the group directed."
>
> In other words, the NAB's senior management had been warned about the financial risks entailed in managing HomeSide's $US 180 bn ($355 bn) mortgage portfolio but a lack of follow-up and implementation left the bank exposed to huge losses in the event of unforeseen and large moves in interest rates. It's probably safe to assume the Wachtell Lipton report did not use the term "asleep at the wheel" but in my opinion that is the report's central conclusion.

The True Reasons For the HomeSide/NAB Debacle

115. However, the debacle at HomeSide did not just result from the "very simple and stupid mistake" reported by AFR, or the "asleep at the wheel" theory advanced in the Wachtell Report. Instead, there was a more invidious basis for the debacle: purposeful manipulation of the valuation methodologies that made HomeSide's financial situation appear significantly better than in fact it was.

116. The reason the value of the portfolio had to be written down was that HomeSide executives, including but not limited to defendants Harris, Race and Wilson, and HomeSide employees Jay B. Busker and Azad Rafat, among others, had deliberately and regularly overvalued its portfolio, and resulting MSR, by hundreds of millions of dollars by modifying assumptions in the computer models used to produce the valuations.

117. During the Class Period, HomeSide arbitrarily changed assumptions in its valuation models, including MIAC Analytics, to increase the valuation of HomeSide's MSR portfolio by hundreds of millions of dollars more than a market-based valuation.

118. The way the process worked was that each month HomeSide downloaded a file from MIAC using its proprietary software called MIAC Analytics, which incorporated relevant market-based assumptions as reported on Bloomberg and plugged them into an internal model. These assumptions included the Bloomberg Median Prepayment Speed figures (prepayment figures are commonly referred to as "PSA" rates), discount rate assumptions and cost assumptions. MIAC itself used market-based assumptions from Bloomberg Media Interactive.

119. HomeSide then ran its models using changed assumptions for each tranche of HomeSide's mortgages that deviated from the MIAC market-based data, with the intention and result that this manipulation made HomeSide's financial situation appear far more positive than it was in fact.

120. A tranche is a group of mortgages with the same maturity, interest rate and risk characteristics. For example, one tranche might be comprised of 15-year Ginnie Mae ("GNMA") mortgages, another of 30-year GNMA mortgages.

121. In short, HomeSide manipulated prepayment and discount rate assumptions to lengthen the average life and duration of its mortgage portfolio, thereby artificially increasing the MSR yield of the portfolio and HomeSide's profitability.

122. Put differently, as interest rates go down, mortgage holders prepay and refinance their mortgages to take advantage of lower rates. The "rate" of these prepayments is reflected in the PSA "speed." The higher the PSA, the faster the level of repayment. As mortgages are prepaid, the MSR "asset" disappears. A prepaid mortgage no longer exists to be "serviced" and, thus, there is no future earnings stream attributable to those servicing rights. Thus, the rate of prepayment, as embodied in the PSA rate, effects the current value of the MSR asset as well as a company's future earnings.

123. This manipulation is illustrated by a review of HomeSide's actual mortgage portfolio of 30-year and 15-year fixed rate conventional mortgages and GNMA-backed mortgages for the months of January and April 2000.

124. During this period, for example, HomeSide used prepayment rates that were sharply below the median prepayment speeds published by Bloomberg to value its portfolio of conventional 30-year and 15-year fixed rate mortgages. In some instances, the Bloomberg median PSA rates were 50% to 300% faster than the PSA rates used by HomeSide.

125. HomeSide also used considerably slower PSA prepayment rates in valuing its 30-year GNMA and especially its 15-year GNMA fixed rate mortgages during January 2000 and April 2000.

126. The median PSA rates published on Bloomberg each month show prepayment projections for unchanged interest rate environments as well as different "up" and "down" 50, 100 and 200 basis point interest rate change scenarios. Not only are the median PSA rates published, but Bloomberg shows each Wall Street firm's view on prepayments for the above scenarios.

127. Applying the Bloomberg PSA rate to valuing a mortgage portfolio is an accepted industry standard.

128. However, the process by which HomeSide and NAB chose prepayment speeds to value HomeSide's mortgage portfolio was not reasonable and not consistent with standard industry practices. By slowing the PSA rates, HomeSide intentionally distorted the rate at which mortgages were being prepaid, artificially lengthened the average life of its portfolio and overvalued its portfolio.

129. The PSA prepayment rates used by HomeSide to value its newly originated, moderately seasoned, and seasoned 30-year fixed rate mortgages were significantly slower than the Median PSA speeds published on Bloomberg for January 2000 and April 2000 in almost all interest rate scenarios.

130. For example, in January 2000, for newly originated 30-year mortgages in an unchanged rate scenario, HomeSide used 137% PSA, a prepayment projection that was almost 36% slower than the Bloomberg median prepayment speeds of 186% PSA. In a down 50 basis point rate scenario, HomeSide used 150% PSA, which was 85% slower than the Bloomberg median speed of 277% PSA.

131. The manipulation with respect to other possible interest rate scenarios was even greater where HomeSide used speeds that were, respectively, 132% and 280% slower than Bloomberg median PSA rates.

132. For its moderately seasoned 30-year mortgages, HomeSide used PSA rates that were 22%, 27%, 52%, and 84% slower than the Bloomberg median PSA rates for unchanged interest rate scenarios, down 50 basis points scenarios, down 100 basis points scenarios, and down 200 basis point rate scenarios, respectively.

133. For its seasoned 30-year mortgages, HomeSide used PSA rates that were 19%, 36%, 63%, and 20% slower than the Bloomberg median PSA rates in unchanged, down 50 basis points, down 100 basis points, and down 200 basis point interest rate scenarios.

134. The manipulations for April 2000 were very similar in the 30-year sector. HomeSide used PSA rates to value its newly originated 30-year mortgages that were 8% to 34% slower in unchanged to down 300 basis point interest rate scenarios.

135. The same was true for its moderately seasoned and seasoned 30-year mortgagees. HomeSide used PSA rates that were 4% to 26% slower for unchanged to down 300 basis point interest rate movements for its moderately seasoned mortgages and PSA rates that were 2% to 22% slower for its seasoned mortgages.

136. With respect to HomeSide's moderately seasoned conventional 15-year mortgages in January 2000, for example, HomeSide used PSA rates that were 5% to 74% slower than the Bloomberg median PSA rates in down 50 basis points to down 300 basis point interest rate scenarios, respectively.

137. In addition, for seasoned conventional 15-year mortgagees in January 2000, HomeSide used PSA rates that were 15% to 67% slower for down 50 to down 300 basis point interest rate scenarios.

138. For April 2000, in the conventional 15-year sector, the PSA rates used by HomeSide were significantly slower on percentage basis. For example, for its 15-year seasoned mortgages, HomeSide used 139% PSA which was 39% slower than the Bloomberg median speed of 193% PSA in the base case scenarios. If rates fell 50, 100, 200 and 300 basis points, HomeSide used PSA rates that were, respectively, 36%, 40%, 30%, and 17% slower than the Bloomberg median PSA rates.

139. With respect to its GNMA mortgages, in January 2000, HomeSide used PSA rates that were 30% slower in base case interest rate scenarios to 379% slower in down 200 basis point scenarios for newly originated mortgages. Moderately seasoned GNMA 30-year mortgages were made up to 112% slower in the down 200 basis point interest rate scenario.

140. In April 2000, HomeSide used PSA rates that were, respectively, 25%, 30%, 24% and 7% slower in unchanged interest rate scenarios, down 50 basis points scenarios, down 100 basis points scenarios, and down 200 basis point interest rate scenarios for its GNMA 30-year mortgages.

141. The manipulations for January and April 2000, for example, were even more pronounced in HomeSide's 15-year GNMA mortgages.

142. In January 2000, for newly originated 15-year GNMAs in an unchanged interest rate scenario, HomeSide used 145% PSA, which was 18% slower than the 171% Bloomberg

median PSA rate. In falling 50 basis point interest rate scenarios, 100 basis point scenarios and 200 basis point scenarios, HomeSide used prepayment speeds that were, respectively, 28%, 62%, and 65% slower.

143. For moderately seasoned 15-year GNMA mortgages, HomeSide used PSA rates that were 26%, 34%, 29%, and 106% slower that the median PSA speeds published on Bloomberg for rates staying unchanged, rates falling 50 basis points, rates falling 100 basis points, and rates falling 200 basis points, respectively. For seasoned 15-year GNMAs, HomeSide used PSA speeds that ranged from 12% to 52% slower.

144. A similar outcome was achieved in April 2000 for 15-year GNMAs. For newly originated 15-year mortgages, HomeSide used PSA speeds that were consistently slower across all interest rate scenarios. For example, in unchanged interest rate scenarios, down 50 basis points scenarios, down 100 basis points scenarios and down 200 basis points scenarios, HomeSide used prepayment rates that were respectively, 56%, 58%, 52%, and 43% slower than the Bloomberg median PSA rates.

145. For moderately seasoned 15-year GNMAs in April 2000, the results were even more dramatic. HomeSide used PSA rates that were respectively, 65%, 68%, 64% and 71% slower for the identical unchanged rate scenarios, down 50 basis points scenarios, down 100 basis points scenarios, and down 200 basis point interest rare scenarios.

146. Another aspect of defendants' inappropriate manipulation concerned the valuation methodology applied to new pools of mortgages HomeSide had acquired. HomeSide would use the MIAC software to value the pools to be acquired, but once acquired, HomeSide would enter the value of the pools on the books at a value higher than the acquisition price.

147. HomeSide also violated impairment rules by moving loans from pool to pool to make “bad” pools “better” so it would not have to declare the pools “impaired” and write them off.

148. In or about July 2000, employees of HomeSide, who were concerned about the inappropriate manipulation of the valuation methodology to artificially inflate the value of HomeSide’s portfolio, delivered a letter by the United States mails and/or facsimile to: (a) Defendant Cicutto; (b) NAB’s risk management department in Melbourne, Australia; and (c) the auditing department of KPMG, then the outside auditor for HomeSide. In this letter, the employees provided a detailed description of the process by which defendants Harris, Race and Wilson manipulated the prepayment and discount rate assumptions to achieve the desired effect and directed the recipients to specific electronic files that would document the fraudulent scheme.

149. For more than 13 months prior to NAB’s disclosure that it would write off $1.75 billion due to problems at HomeSide, defendants NAB and Cicutto had direct knowledge of the specific manipulation of the valuation methodologies that made HomeSide’s financial situation appear significantly better than it was.

150. The statements identified in paragraphs **58, 62, 65, 67, 69, 70, 72, 73, 75, 76, 79, 80, 82, 83, 84, 86, 90, 91, 93, 96, 98, and 99** were materially false and misleading in that, inter alia, at the time they were made, defendants knew that:

(a) HomeSide’s portfolio and its resulting financial performance were based on a manipulated portfolio modeling; and

(b) defendants had deliberately and regularly overvalued HomeSide's portfolio by hundreds of millions of dollars by modifying assumptions in its computer models to produce false and misleading valuations.

151. Defendants failed to disclose the above-referenced material facts at the time they made their statements to the market, as alleged above, concerning the financial performance of HomeSide and NAB.

DEFENDANTS' INSIDER SELLING AND PROFIT FROM THE FRAUD

152. While NAB's and HomeSide's insiders were issuing false and misleading statements about NAB's business and finances, Defendant Cicutto sold shares of NAB he owned for proceeds of $3.1 million Australian dollars to profit from the artificial inflation in NAB's stock price defendants' false statements had created.

153. Notwithstanding his access to non-public information as a result of his position with the Company, Cicutto exercised 200,000 executive options in mid-June 2001. At a conversion price of $16.62 Australian, Cicutto's new shares were valued at $3,566,000 Australian on June 15, 2001, when NAB shares closed at a near high of $34.45 Australian.

154. Cicutto acquired the options in early 1997, and had until February 2002 to exercise the options. Less than three months after exercising the options, the manipulation of the valuation methodologies at HomeSide were publicly revealed.

155. The stock sales by Cicutto were unusual in timing and amount.

156. In addition, defendants received substantial monetary gain from their fraudulent activities. In 2000, NAB announced that it was introducing a performance-linked executive pay

system, known as Economic Value Added or EVA, based on economic value that individuals add to the Company.

157. As a result of this performance-linked executive pay system, Cicutto, for the Company's financial year ending on September 30, 2000, received a salary package of almost $2 million Australian, including performance-based bonuses of $550,000 Australian on top of his $1.3 million Australian base salary.

158. For the Company's financial year ending September 30, 2001, Cicutto received a salary package of $2.92 million Australian, including performance-based bonuses of $1.35 million Australian.

159. These performance-based bonuses paid to Cicutto were derived, in substantial part, from the economic value purportedly added to NAB's economic performance by the manipulated operations at HomeSide. For example, NAB disclosed in its 2001 Annual Financial Report, dated November 8, 2001, that the economic value added to NAB prior to the HomeSide debacle was $1.431 million Australian in 2001, and that the net impact of the HomeSide debacle on EVA in 2001 was $407 million Australian. Accordingly, the inflated HomeSide economic value constituted almost 30% of NAB's entire EVA for 2001, which substantially increased Cicutto's performance-based bonuses.

160. For the Company's financial year ended September 30, 2001, defendant Harris received a salary package of approximately $4.538 million Australian, including long-term incentive payments of $1,918,889 relating to the three year performance from April 1, 1998 to March 31, 2001. These incentive payments were based on performance targets, which targets were achieved through defendants' manipulation of the valuation methodologies at HomeSide.

DEFENDANTS' SCIENTER

161. As alleged herein, defendants acted with scienter in that defendants knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, the Individual Defendants, as described herein, by virtue of their receipt of information reflecting the true facts regarding NAB, their control over, and/or receipt and/or modification of the allegedly materially misleading misstatements and omissions described herein, which made them privy to confidential proprietary information concerning NAB, participated in the fraudulent scheme alleged herein.

162. Scienter is established not only by the actual knowledge or severe recklessness of NAB's conduct, but also by two secondary offerings, collectively raising more than $2 billion, one in June 1999 and the other in January 2001, which were premised upon the promise and performance of HomeSide.

163. Scienter is further established by NAB's January 5, 2001 issuance of $1.1 billion of residential mortgage-backed securities through its HomeSide Mortgage Securities Trust Program. The securities were registered in the United States and sold to investors in the United States and globally. During the Class Period, defendants knew, or recklessly disregarded HomeSide's lack of financial controls and its resulting grave financial condition, contrary to what was being reported to the public.

164. On or about January 29, 2001, NAB issued a press release commenting on the alleged success of HomeSide, and touting the January 5, 2001 offering. Regarding the offering, NAB's Chief Financial Officer, Richard McKinnon, stated, "[w]e also achieved a distribution of investors in the United States, Europe and Asia. The pricing reflects the strength of the National as an issuer, the Group's mortgage securitisation experience through HomeSide and a recognition by investors of the quality of the National's mortgage loans."

165. Additionally, around the time of the January 5, 2001 offering, HomeSide established partnerships with various United States corporations to provide on-line mortgage services; including, on December 11, 2000, with Byowner.com, on December 12, 2000, with The Bekins Company, on December 14, 2000, with Suddath Relocation Services, on January 8, 2001, with NewHomes.com, and on January 3, 2001, with BET.com. The establishment of such partnerships in close proximity to the January 5, 2001, offering served to further bolster the illusion of HomeSide's success, and NAB's "secure" presence in the United States.

UNDISCLOSED MATERIALLY FALSE INFORMATION

166. The market for NAB's securities was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, NAB's securities traded at artificially inflated prices during the Class Period. The artificial inflation continued until the time NAB admitted and/or the market came to realize the nature and extent of the problems of HomeSide and the impact of those problems on NAB.

167. Plaintiff and other members of the Class purchased or otherwise acquired NAB securities relying upon the integrity of the market price of NAB's securities and market information relating to NAB, and have been damaged thereby.

168. During the Class Period, defendants materially misled the investing public, thereby inflating the price of NAB's securities, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein, not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the manipulation in the mortgage portfolio modeling as alleged herein.

169. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by Plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about NAB's business, prospects and operations. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment of NAB and its business, prospects and operations, thus causing the Company's securities to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in Plaintiff and other members of the Class purchasing the Company's securities at artificially inflated prices, thus causing the damages complained of herein.

APPLICABILITY OF PRESUMPTION OF RELIANCE: FRAUD-ON-THE-MARKET DOCTRINE

170. At all relevant times, the market for NAB's securities was an efficient market for the following reasons, among others:

(a) NAB's ADRs met the requirements for listing, and were listed and actively traded on the NYSE, a highly efficient and automated market;

(b) NAB's ordinary shares met the requirements for listing, and were listed and actively traded on the ASX, LSE and other exchanges, all highly efficient markets;

(c) As a regulated issuer, NAB filed periodic public reports with the SEC, the NYSE, and the ASIC;

(d) NAB regularly communicated with public investors via established market communication mechanisms, including through regular dissemination of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(e) NAB was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

171. As a result of the foregoing, the market for NAB's securities promptly digested current information regarding NAB from all publicly available sources and reflected such information in NAB's securities prices. Under these circumstances, all purchasers of NAB's securities during the Class Period suffered similar injury through their purchase of NAB's securities at artificially inflated prices and a presumption of reliance applies.

NO SAFE HARBOR

172. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of NAB who knew that those statements were false when made.

FIRST CLAIM FOR RELIEF

Violation of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants

173. Plaintiff repeats and realleges each and every paragraph contained above as if set forth herein. This Claim is asserted against all defendants.

174. Defendants knew, or were reckless in failing to know, of the material omissions from and misrepresentations contained in the statements as set forth above.

175. Throughout the Class Period, defendants, with knowledge of or reckless disregard for the truth, disseminated or approved releases, statements and reports, referred to above, which

were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

176. During the Class Period, defendants, individually and via a fraudulent scheme, directly and indirectly, participated in a course of business that operated as a fraud or deceit on purchasers of NAB securities and concealed material adverse information regarding the then existing business conditions and financial outlook of the Company as specified herein. Defendants employed devices, schemes and artifices to defraud and engaged in acts, practices and a course of business as herein alleged to commit a fraud on the integrity of the market for the Company's securities and to maintain artificially high market prices for the securities of NAB. This included the formulation, making of and/or participation in the making of, untrue statements of material facts and the omission to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and engaging in acts, practices and a course of business which operated as a fraud and deceit upon Plaintiff and the Class, all in connection with the purchase or acquisition of NAB securities by Plaintiff and members of the Class.

177. By reason of the conduct alleged herein, defendants knowingly or recklessly, directly and indirectly, have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that they: (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices and a course of business that operated as a fraud or

deceit upon Plaintiff and others similarly situated in connection with their purchases of NAB securities.

178. Plaintiff and the Class have suffered substantial damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for NAB securities as a result of defendants' violations of Section 10(b) of the Exchange Act and Rule 10b-5. Plaintiff and the Class would not have purchased NAB securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements and concealment. At the time of purchase by Plaintiff and the Class of NAB securities, the fair and true market value of said securities was substantially less than the prices paid by them.

SECOND CLAIM FOR RELIEF

For Violation Of Section 20(a) Of The Exchange Act Against the Individual Defendants

179. Plaintiff repeats and realleges each and every paragraph contained above as if set forth herein. This Claim is asserted against the Individual Defendants.

180. Each of the Individual Defendants acted as a controlling person of the Company within the meaning of Section 20 of the Exchange Act. NAB controlled each of the Individual Defendants. Each controlling person had the power and authority to cause others to engage in the wrongful conduct complained of herein.

181. By reason of such wrongful conduct, the defendants named in this Claim are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their

wrongful conduct, Plaintiff and the other members of the Class suffered damages in connection with their purchases of the Company's securities.

REQUEST FOR RELIEF

WHEREFORE, Plaintiff respectfully requests relief and judgment, as follows:

(a) Determining that this action is a proper class action pursuant to Rule 23 of the Federal Rules of Civil Procedure;

(b) Awarding compensatory damages in favor of Plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(c) Awarding extraordinary, equitable and/or injunctive relief as permitted by law, equity and the federal statutory provisions sued hereunder;

(d) Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

(e) Such other and further relief as the Court may deem just and proper.

JURY DEMAND

Plaintiff hereby demand a trial by jury.

Dated: New York, New York
December ____, 2006

LABATON SUCHAROW & RUDOFF LLP

By ________________________________
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